

## SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 210, 227, 230, 239, 240, 249, 270, 274, and 275

[Release Nos. 33–10649; 34–86129; IA–5256; IC–33512; File No. S7–08–19]

RIN 3235–AM27

### Concept Release on Harmonization of Securities Offering Exemptions

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Concept release; request for comment.

**SUMMARY:** The Securities and Exchange Commission is publishing this release to solicit comment on several exemptions from registration under the Securities Act of 1933 that facilitate capital raising. Over the years, and particularly since the Jumpstart Our Business Startups Act of 2012, several exemptions from registration have been introduced, expanded, or otherwise revised. As a result, the overall framework for exempt offerings has changed significantly. We believe our capital markets would benefit from a comprehensive review of the design and scope of our framework for offerings that are exempt from registration. More specifically, we also believe that issuers and investors could benefit from a framework that is more consistent and addresses gaps and complexities. Therefore, we seek comment on possible ways to simplify, harmonize, and improve the exempt offering framework to promote capital formation and expand investment opportunities while maintaining appropriate investor protections.

**DATES:** Comments should be received on or before September 24, 2019.

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

#### Electronic Comments

- Use the Commission's internet comment form (<https://www.sec.gov/rules/concept.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7–08–19 on the subject line.

#### Paper Comments

- Send paper comments to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090.

All submissions should refer to File Number S7–08–19. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently,

please use only one method. The Commission will post all comments on the Commission's website (<https://www.sec.gov/rules/concept.shtml>). Comments are also available for website viewing and copying in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.

#### FOR FURTHER INFORMATION CONTACT:

Jennifer Riegel or Amy Reischauer, Office of Small Business Policy, Division of Corporation Finance, at (202) 551–3460; Timothy White or Geeta Dhingra, Division of Trading and Markets, at (202) 551–5550; or Mark T. Uyeda, Division of Investment Management, at (202) 551–6792, U.S. Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–3628.

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#### I. Introduction

The Securities Act of 1933<sup>1</sup> (the “Securities Act”) requires that every offer<sup>2</sup> and sale of securities be registered with the Securities and Exchange Commission (the “Commission”), unless an exemption is available. The purpose of registration is to provide investors with full and fair disclosure of material information so that they are able to make their own informed investment and voting decisions.<sup>3</sup> Congress recognized, however, that in certain situations there is no practical need for registration or the public benefits from registration are too remote.<sup>4</sup> Accordingly, the Securities Act contains a number of exemptions from its registration requirements and authorizes the Commission to adopt

<sup>1</sup> 15 U.S.C. 77a *et seq.*

<sup>2</sup> See 15 U.S.C. 77b(a)(3) (noting that an offer includes every attempt to dispose of a security or interest in a security, for value; or any solicitation of an offer to buy a security or interest in a security).

<sup>3</sup> See, e.g., Commissioner Francis M. Wheat, Disclosure to Investors—A Reappraisal of Federal Administrative Policies under the '33 and '34 Acts (Mar. 1969) (often referred to as the “Wheat Report”).

<sup>4</sup> H.R. Rep. No. 73–85, at 5 (1933).

additional exemptions. As described in more detail below, the scope of exempt offerings has evolved over time through Commission rules and legislative changes. Significantly, the Jumpstart Our Business Startups Act of 2012 (“JOBS Act”) greatly expanded the options to raise capital in exempt offerings.<sup>5</sup> Since then, the Fixing America’s Surface Transportation Act of 2015 (the “FAST Act”)<sup>6</sup> and the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (the “Economic Growth Act”)<sup>7</sup> resulted in further revisions to our exemptions.<sup>8</sup> As a result, the current exempt offering framework is complex and made up of differing requirements and conditions, which may be difficult for issuers, who bear the burden of demonstrating the availability of any exemption,<sup>9</sup> to navigate. Smaller companies with more limited resources, which may be more likely to need to rely on these exemptions given the costs associated with conducting a registered offering and becoming a reporting company, may find it particularly difficult to manage this complexity.

Market participants have conveyed concerns about the complexity of the exempt offering framework and have recommended that the Commission undertake a comprehensive review of the available exemptions.<sup>10</sup> For

example, the 2012 Small Business Forum recommended that the Commission initiate a top-to-bottom review of the exempt offering landscape to ensure a rational regulatory scheme, including providing greater guidance regarding integration of the new, as well as existing, exemptions from registration.<sup>11</sup> In addition, the 2018 Small Business Forum recommended that the Commission rationalize, harmonize, simplify, consolidate, and prioritize the regulatory regime for exempt offerings, including communications restrictions, issuer eligibility, size of the offering, type of investors, disclosure, and other conditions of exemption.<sup>12</sup>

In this concept release, we undertake a broad review of available exemptions to the registration requirements of the federal securities laws that facilitate capital raising and seek input in order to assess whether our exempt offering framework, as a whole, is consistent, accessible, and effective for both issuers and investors or whether we should consider changes to simplify, improve, or harmonize the exempt offering framework. In this regard, we seek to explore whether overlapping exemptions may create confusion for issuers trying to determine and navigate the most efficient path to raise capital. At the same time, we seek to identify gaps in our framework that may make it difficult, especially for smaller issuers, to rely on an exemption from registration to raise capital at key stages of their business cycle. We also consider whether the limitations on who can invest in certain exempt offerings, or the amount they can invest, provide an appropriate level of investor protection

(*i.e.*, whether the current levels of investor protection are insufficient, appropriate, or excessive) or pose an undue obstacle to capital formation or investor access to investment opportunities. For example, we explore whether we should revise our investor eligibility limitations to focus more particularly on the sophistication of the investor, the amount of the investment, or other criteria rather than just the income or wealth of the individual investor. In addition, this release looks at whether we can and should do more to allow issuers to transition from one exempt offering to another and, ultimately, to a registered public offering, if desired, without undue friction or delay. We also examine whether we should take steps to expand issuers’ ability to raise capital through pooled investment funds, and whether retail investors should be allowed greater exposure to growth-stage issuers through pooled investment funds in light of the potential advantages of investing through such funds, including the ability to have an interest in a diversified portfolio. Finally, we look at secondary trading of securities initially issued in exempt offerings and consider whether we should revise our rules governing exemptions for resales of securities to facilitate capital formation and to promote investor protection by improving secondary market liquidity.

Each section of this release can be read, and commented on, independently. We welcome all feedback and encourage interested parties to submit comments on any or all topics of interest and to respond to one, multiple, or all questions asked in this release. In responding to comments, it would be most helpful if commenters provide an explanation why we should or should not take a particular action or approach, as appropriate.

## II. Current Exempt Offering Framework

The Securities Act contains a number of exemptions to its registration requirements and authorizes the Commission to adopt additional exemptions. Section 3 of the Securities Act generally identifies certain classes of securities that are exempt from the registration requirements of the Securities Act.<sup>13</sup> Most of these exemptions are based on characteristics of the securities themselves, though some exempted securities are identified based on the transaction in which they are offered or sold.<sup>14</sup> Section 4 of the

<sup>5</sup> Public Law 112–106, 126 Stat. 306 (2012). The JOBS Act, among other things: Directed the Commission to revise 17 CFR 230.506 (“Rule 506”) to eliminate the prohibition against general solicitation or general advertising for offers and sales of securities to accredited investors (*see* Section II.B.2.b); added Section 4(a)(6) [15 U.S.C. 77d(a)(6)] and Section 4A [15 U.S.C. 77d–1(b)] to the Securities Act and directed the Commission to issue rules to permit certain crowdfunding offerings (*see* Section II.F); and directed the Commission to expand Regulation A [17 CFR 230.250 *et seq.*] (*see* Section II.C).

<sup>6</sup> Public Law 114–94, 129 Stat. 1312 (2015).

<sup>7</sup> Public Law 115–174, 132 Stat. 1296 (2018).

<sup>8</sup> The FAST Act added Section 4(a)(7) to the Securities Act [15 U.S.C. 77d(a)(7)], providing a new exemption for private resales of securities. *See* Section V.A.5. Among other changes, the Economic Growth Act required the Commission to amend Regulation A to permit entities subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act to use the exemption. *See* Section II.C.

<sup>9</sup> *See SEC v. Ralston Purina Co.*, 346 U.S. 119, 126 (1953) (“Keeping in mind the broadly remedial purposes of federal securities legislation, imposition of the burden of proof on an issuer who would plead the exemption seems to us fair and reasonable.”).

<sup>10</sup> Given the impact of the JOBS Act on the exempt offering framework, generally, this release references comments and recommendations provided by various market participants, including any relevant recommendations from the advisory committees to the Commission and the SEC Government-Business Forums on Small Business Capital Formation (each, a “Small Business Forum”), received since the adoption of the JOBS Act in 2012 or, if later, the adoption of the relevant

rule or the most recent amendment or request for comment.

<sup>11</sup> *See* Final Report of the 2012 SEC Government-Business Forum on Small Business Capital Formation (Apr. 2013) available at <https://www.sec.gov/info/smallbus/gbfor31.pdf> (“2012 Forum Report”).

The Small Business Investment Incentive Act of 1980 directed the Commission to conduct an annual government-business forum to undertake an ongoing review of the financing problems of small businesses. 15 U.S.C. 80c–1. The Small Business Forum has met annually since 1982 to provide a platform to highlight perceived unnecessary impediments to small business capital formation and address whether they can be eliminated or reduced. Each forum seeks to develop recommendations for government and private action to improve the environment for small business capital formation, consistent with other public policy goals, including investor protection. Information about the Small Business Forum is available at <https://www.sec.gov/corpfin/infosmallbusforum-2.shtml>.

<sup>12</sup> *See* Final Report of the 2018 SEC Government-Business Forum on Small Business Capital Formation (Jun. 2019) available at <https://www.sec.gov/info/smallbus/gbfor37.pdf> (“2018 Forum Report”).

<sup>13</sup> 15 U.S.C. 77c.

<sup>14</sup> For example, Section 3(b)(1) of the Securities Act authorizes the Commission to exempt certain

Securities Act identifies a number of transactions that are exempt from the registration requirements.<sup>15</sup> In addition, Section 28 of the Securities Act, which was added by the National Securities Markets Improvement Act of 1996 (“NSMIA”),<sup>16</sup> authorizes the Commission to exempt other persons, securities, or transactions to the extent “necessary or appropriate in the public interest [and] consistent with the protection of investors.”<sup>17</sup>

The statutory exemptions and those established by the Commission’s rules and regulations include a variety of requirements, investor protections, and other conditions. For example, some

exemptions limit the amount of securities that may be offered or sold. Some exemptions limit the manner in which the offering can be conducted, such as by prohibiting the use of general solicitation or general advertising to solicit investors. Some offerings are exempt if they restrict sales to certain sophisticated or “accredited” investors that are presumed to possess sufficient financial sophistication and ability to sustain the risk of loss of their investment or to fend for themselves to render the protections of the Securities Act’s registration process unnecessary.<sup>18</sup> In addition, some exemptions specify

disclosures required to be included in prescribed forms to be filed with the Commission or otherwise provided to all or a subset of prospective investors. Many exemptions exclude certain types of issuers, such as non-U.S. issuers, issuers subject to the reporting requirements of the Securities Exchange Act of 1934 (the “Exchange Act”),<sup>19</sup> or investment companies, or specifically disqualify offerings involving certain “bad actors” from relying on the exemption.

Table 1 summarizes some of the characteristics of the most commonly used exemptions<sup>20</sup> from registration.<sup>21</sup>

TABLE 1—OVERVIEW OF CAPITAL-RAISING EXEMPTIONS

Type of offering	Offering limit within 12-month period	General solicitation	Issuer requirements	Investor requirements	SEC filing requirements	Restrictions on resale	Preemption of state registration and qualification
Section 4(a)(2) .....	None .....	No .....	None .....	Transactions by an issuer not involving any public offering. See <i>SEC v. Ralston Purina Co.</i> <sup>22</sup>	None .....	Yes. Restricted securities.	No.
Rule 506(b) of Regulation D <sup>23</sup> .	None .....	No .....	“Bad actor” disqualifications apply.	Unlimited accredited investors. Up to 35 sophisticated but non-accredited investors.	Form D <sup>24</sup> .....	Yes. Restricted securities.	Yes.
Rule 506(c) of Regulation D.	None .....	Yes .....	“Bad actor” disqualifications apply.	Unlimited accredited investors; Issuer must take reasonable steps to verify that all purchasers are accredited investors.	Form D .....	Yes. Restricted securities.	Yes.
Regulation A: Tier 1.	\$20 million .....	Permitted; before qualification, testing the waters permitted before and after the offering statement is filed.	U.S. or Canadian issuers. Excludes blank check companies, <sup>25</sup> registered investment companies, business development companies, issuers of certain securities, and certain issuers subject to a Section 12(j) order. “Bad actor” disqualifications apply. No asset-backed securities.	None .....	Form 1–A, including two years of financial statements. Exit report.	No .....	No.
Regulation A: Tier 2.	\$50 million .....	.....	.....	Non-accredited investors are subject to investment limits based on annual income and net worth, unless securities will be listed on a national securities exchange.	Form 1–A, including two years of audited financial statements. Annual, semi-annual, current, and exit reports.	No .....	Yes.

issues of securities where the aggregate amount offered does not exceed \$5 million to the extent that “the enforcement of this title with respect to such securities is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering.” 15 U.S.C. 77c(b)(1).

<sup>15</sup> 15 U.S.C. 77d.

<sup>16</sup> Public Law 104–290, 110 Stat. 3416 (Oct. 11, 1996).

<sup>17</sup> 15 U.S.C. 77z–3.

<sup>18</sup> See Regulation D Revisions; Exemption for Certain Employee Benefit Plans, Release No. 33–6683 (Jan. 16, 1987) [52 FR 3015] (the “Regulation D Revisions Proposing Release”).

<sup>19</sup> 15 U.S.C. 78a *et seq.*

<sup>20</sup> Commission rules also provide exemptions for certain offerings where the purpose of the offering is other than to raise capital. For example, 17 CFR 230.701 (“Rule 701”) exempts certain sales of securities made to compensate employees, consultants, and advisors. See note 512 for a brief discussion of Rule 701.

<sup>21</sup> Generally, Table 1 is organized by typical offering size from largest to smallest. Certain regulatory exemptions from registration are based on statutory provisions, but provide specific frameworks or safe harbors to comply with the statutory exemptions. For example, as discussed in more detail in Section II.B.2.a, Rule 506(b) provides a safe harbor to comply with the exemption under Section 4(a)(2) [15 U.S.C. 77d(a)(2)], or, as discussed in Section II.E.2, Rule 147 provides a safe harbor under Section 3(a)(11) [15 U.S.C. 77c(a)(11)]. An issuer may choose not to avail itself of one of these specific regulatory exemptions and instead conduct an offering pursuant to the statutory exemption itself, such as Section 4(a)(2), following principles-based requirements that have been developed over time.

<sup>22</sup> 346 U.S. 119, 126 (1953).

<sup>23</sup> Regulation D [17 CFR 230.501 *et seq.*] relates to transactions exempted from the registration requirements of Section 5 of the Securities Act under 17 CFR 230.504 (“Rule 504”), Rule 506(b) and Rule 506(c). Rule 504 provides an exemption

for the public offer and sale of up to \$5 million of securities in a 12-month period. General solicitation and general advertising are permitted if the offering is registered in a state requiring the use of a substantive disclosure document or sold exclusively to accredited investors under a corresponding state exemption. See Section II.D for a discussion of Rule 504.

<sup>24</sup> While it is not a filing requirement, offerings relying on Rule 506(b) require additional information to be provided to non-accredited investors purchasing in the offering.

<sup>25</sup> While the exemptions identified here as excluding blank check companies do not use the term “blank check company,” they exclude development stage issuers that have no specific business plan or purpose or have indicated that their business plan is to engage in a merger or acquisition with an unidentified company or companies, which is substantially similar to the definition of blank check company in Securities Act Rule 419, used elsewhere in Commission rules. See 17 CFR 230.419.

TABLE 1—OVERVIEW OF CAPITAL-RAISING EXEMPTIONS—Continued

Type of offering	Offering limit within 12-month period	General solicitation	Issuer requirements	Investor requirements	SEC filing requirements	Restrictions on resale	Preemption of state registration and qualification
Rule 504 of Regulation D.	\$5 million .....	Permitted in limited circumstances.	Excludes blank check companies, Exchange Act reporting companies, and investment companies. "Bad actor" disqualifications apply.	None .....	Form D .....	Yes. Restricted securities except in limited circumstances.	No.
Intrastate: Section 3(a)(11).	No federal limit (generally, individual state limits between \$1 and \$5 million).	Offerees must be in-state residents.	In-state residents "doing business" and incorporated in-state; excludes registered investment companies.	Offerees and purchasers must be in-state residents.	None .....	Securities must come to rest with in-state residents.	No.
Intrastate: Rule 147.	No federal limit (generally, individual state limits between \$1 and \$5 million).	Offerees must be in-state residents.	In-state residents "doing business" and incorporated in-state; excludes registered investment companies.	Offerees and purchasers must be in-state residents.	None .....	Yes. Resales must be within state for six months.	No.
Intrastate: Rule 147A.	No federal limit (generally, individual state limits between \$1 and \$5 million).	Yes .....	In-state residents and "doing business" in-state; excludes registered investment companies.	Purchasers must be in-state residents.	None .....	Yes. Resales must be within state for six months.	No.
Regulation Crowdfunding; Section 4(a)(6).	\$1.07 million .....	Permitted with limits on advertising after Form C is filed. Offering must be conducted on an internet platform through a registered intermediary.	Excludes non-U.S. issuers, blank check companies, Exchange Act reporting companies, and investment companies. "Bad actor" disqualifications apply.	Investment limits based on annual income and net worth.	Form C, including two years of financial statements that are certified, reviewed or audited, as required. Progress and annual reports.	12-month resale limitations.	Yes.

As Table 1 illustrates, the current exemptions impose a variety of conditions designed to protect investors. Exemptions tend to incorporate more investor protection measures where non-accredited or less sophisticated investors are permitted to participate in the offering. This focus on the characteristics of the investors involved in a particular offering is articulated in the context of the Section 4(a)(2) exemption in the leading case interpreting that provision, *SEC v. Ralston Purina*.<sup>26</sup> In that case, the Supreme Court set forth the position that the availability of the Section 4(a)(2) exemption "should turn on whether the particular class of persons affected needs the protection of the Act. An offering to those who are shown to be able to fend for themselves is a transaction 'not involving any public offering.'" <sup>27</sup> The emphasis on the characteristics of the investors extends throughout the current exempt offering framework, in which the fewest conditions apply to an offering under an exemption where sales are restricted to accredited investors, while offerings that permit less wealthy or sophisticated investors to participate are subject to an assortment of disclosure requirements, offering and investment limits, and other conditions meant to mitigate the risk of not having the traditional

protections of registration under the Securities Act.

As discussed below, we seek comment on how an investor's characteristics should be considered in determining whether an investor is able to participate in a particular type of exempt offering. In addition, we seek comment throughout this concept release on specific conditions of each of the current capital-raising exemptions from registration and whether the investment protections of those exemptions are appropriately structured to encourage capital formation, while mitigating the risk of not having the traditional investor protections of registration.

We also seek input on the framework as a whole, in light of the many changes implemented over the years. The current exemptions were not adopted as part of one cohesive regulatory scheme but rather developed and evolved over time through Commission rules and legislative changes. In addition to the JOBS Act and the adoption over time of each of the exemptions from registration discussed in this concept release, the evolution of the existing framework and exempt offering market has been significantly affected by other legislative developments over the years. For example, as noted above, NSMIA added Section 28 to the Securities Act, providing the Commission with significant flexibility to tailor the exempt offering framework by giving the Commission authority to exempt

persons, securities, and transactions, or classes thereof, from the Securities Act. NSMIA also preempted the state registration and review of transactions involving "covered securities" and amended Section 18 of the Securities Act to establish classes of covered securities, including securities offered or sold to "qualified purchasers."<sup>28</sup> The authority granted to the Commission under Section 18(b)(3) to adopt rules that define a "qualified purchaser" is another significant source of flexibility for the Commission with respect to the exempt offering framework.<sup>29</sup>

Over time, Congress and the Commission have made changes to the federal securities laws and Commission

<sup>26</sup> Public Law 104-290, 110 Stat. 3416 (Oct. 11, 1996).

<sup>27</sup> In 2015, the Commission used this authority to define "qualified purchaser" to include any person to whom securities are offered or sold in a Regulation A Tier 2 offering. See 17 CFR 230.256.

In 2001, the Commission proposed a definition of "qualified purchaser" that mirrored the definition of accredited investor in Regulation D in an effort to identify well-established categories of persons it had previously determined to be financially sophisticated and therefore not in need of the protection of state registration when they were offered or sold securities. The Commission intended the definition to facilitate capital formation, especially for small businesses, to impose uniformity in the regulation of transactions to these financially sophisticated persons, and to reduce burdens on capital formation. See *Defining the Term "Qualified Purchaser" under the Securities Act of 1933*, Release No. 33-8041 (Dec. 19, 2001) [66 FR 66839 (Dec. 27, 2001)]. Although the Commission solicited comment from interested parties, it took no further action on the proposal.

<sup>26</sup> 346 U.S. 119 (1953).

<sup>27</sup> *Id.* at 125.

rules that may enable issuers to remain private longer than in the past. For example, the JOBS Act and the FAST Act revised the thresholds for registration under Section 12(g) of the Exchange Act, with the result that an issuer that is not a bank, bank holding company, or savings and loan holding company is required to register a class of equity securities under the Exchange Act if it has more than \$10 million of total assets and the securities are “held of record” by either 2,000 persons or 500 persons who are not accredited investors.<sup>30</sup>

The Commission also has taken steps to address uncertainties with respect to the integration of one exempt offering with another exempt offering or with a registered offering, as discussed in detail in Section III below, by providing some guidance to issuers as to their ability to transition from one offering to another.

The exempt markets have also been affected by Commission rule changes

<sup>30</sup> 15 U.S.C. 78l(g)(1); 17 CFR 240.12g-1. An issuer that is a bank, bank holding company, or savings and loan holding company is required to register a class of equity securities if it has more than \$10 million of total assets and the securities are “held of record” by 2,000 or more persons. Prior to the JOBS Act, Section 12(g) of the Exchange Act required an issuer to register a class of its equity securities if, at the end of the issuer’s fiscal year, the securities were “held of record” by 500 or more persons and the issuer had total assets exceeding \$1 million.

Securities are deemed to be “held of record” by each person identified as the owner of such securities on the records maintained by or on behalf of the issuer, subject to certain conditions and exceptions. *See* 17 CFR 240.12g5-1.

For securities issued in an offering under Regulation A, Regulation Crowdfunding [17 CFR 230.227 *et seq.*], or Rule 701, there is a conditional exemption from the mandatory registration provisions of Section 12(g) if certain conditions are met. *See* Sections II.C.1.d and II.F.1.g. *See also* 17 CFR 240.12h-1.

and market developments that provide for some measure of liquidity for securities in exempt offerings. Secondary market liquidity is a key concern of investors and may have a significant impact on an issuer’s choices with respect to capital raising. In other words, an investor’s willingness to participate in an exempt offering and the price he or she would be willing to pay may depend on the investor’s assessment of whether, when, and on what terms the security can be resold. With regard to secondary market resales of securities initially sold pursuant to an exemption from registration, the Commission adopted 17 CFR 230.144 (“Rule 144”) in 1972, providing a non-exclusive safe harbor for resales of securities acquired in transactions not involving a public offering.<sup>31</sup> In 1990, the Commission created a safe harbor for resales of securities by persons other than issuers to “qualified institutional buyers” (“QIBs”) in 17 CFR 230.144A (“Rule 144A”).<sup>32</sup> In 2015, the FAST Act added Section 4(a)(7) to the Securities Act, which exempts certain private resales of securities to accredited investors.<sup>33</sup> Further, in recent years, markets have developed that facilitate the resale of securities of non-reporting companies.<sup>34</sup> However, resales of

<sup>31</sup> *See* Release No. 33-5223 (Jan. 11, 1972) [37 FR 591] (“Rule 144 Adopting Release”). For a discussion of Rule 144, *see* Section V.A.1.

<sup>32</sup> *See* Resale of Restricted Securities; Changes to Method of Determining Holding Period of Restricted Securities under Rules 144 and 145, Release No. 33-6862 (Apr. 23, 1990) [55 FR 17933 (Apr. 30, 1990)] (“Rule 144A Adopting Release”). For a discussion of Rule 144A, *see* Section V.A.2.

<sup>33</sup> Public Law 114-94, 129 Stat. 1312 (2015). *See* Section V.A.5.

<sup>34</sup> *See, e.g.,* David F. Larcker, Brian Tayan, and Edward Watts, *Cashing it in: Private-Company Exchanges and Employee Stock Sales Prior to IPO*, Stanford Closer Look Series (Sep. 12, 2018).

securities originally purchased in a transaction exempt from registration raise a variety of issues, including whether the primary and secondary sales should be considered part of the same distribution of securities and whether secondary sales have an impact on the availability of the exemption from registration relied on for the primary offering.<sup>35</sup> While the primary focus in this concept release is on the harmonization of the exemptions from registration for primary offerings, we also seek public input on whether we should consider rule changes that in certain cases would allow for more or less flexibility with regard to resales.<sup>36</sup>

Separate and apart from these regulatory changes, the exempt markets have been influenced by changes over the years in information and communications technologies. Given the rise of social media and other forms of communication, as well as online trading platforms for unregistered securities, information about exempt securities offerings is far more readily available to potential investors and to the general public and at a lower cost than at the time many of the exemptions were promulgated.

<sup>35</sup> Persons reselling securities must consider whether they could be an “underwriter” if they acquired the securities with a view to “distribution” or if they are participating in a “distribution.” *See* Section 2(a)(11) of the Securities Act [15 U.S.C. 77b(a)(11)] (defining the term “underwriter”). The Section 4(a)(1) [15 U.S.C. 77d(a)(1)] exemption, discussed in Section IV, is not available to a seller that is deemed to be an underwriter, and the resale by such an underwriter may be considered part of the primary offering by the issuer of the securities, calling into question the availability of the exemption for the original offering.

<sup>36</sup> *See* Section IV.

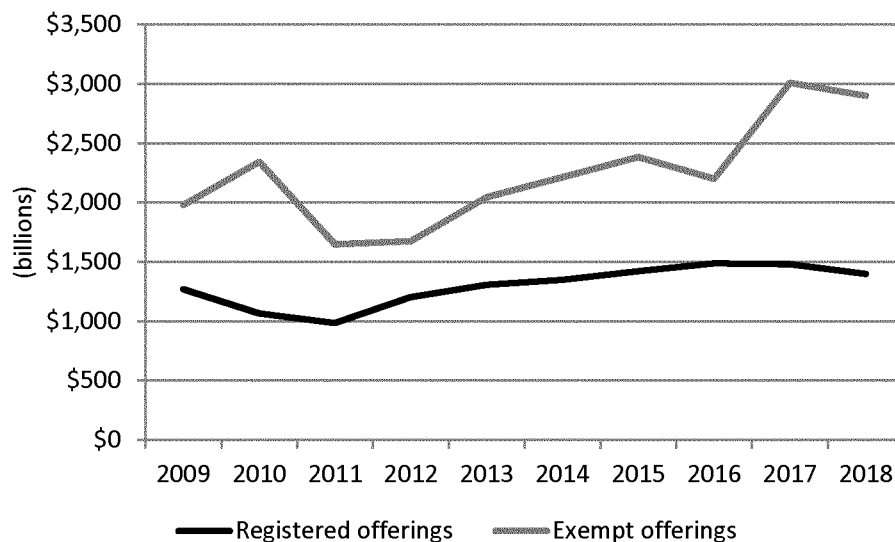
As the regulatory and operational framework for exempt offerings has evolved, the amount raised in exempt markets has increased both absolutely and relative to the public registered markets. In 2018, registered offerings accounted for \$1.4 trillion of new capital compared to approximately \$2.9

trillion that we estimate was raised through exempt offering channels.<sup>37</sup>

Figure 1 shows registered and exempt offerings over the period 2009–2018.<sup>38</sup> The data shows that exempt offerings have accounted for significantly larger amounts of new capital compared to registered offerings during the period under consideration. Both markets exhibit an upward trend, which is

consistent with the favorable macroeconomic environment during this period. Although the magnitudes of exempt capital and registered capital raised vary over time, the amount reported raised in exempt offerings is always larger than the amount raised in registered offerings during this time period.

**Figure 1: Capital raised in exempt and registered capital markets, 2009–2018**



<sup>37</sup> Unless otherwise indicated, information in this release on Regulation D offerings, including offerings under Rule 504 and Rule 506, is based on analysis by staff in the Commission's Division of Economic Risk and Analysis ("DERA") of data collected from Form D [17 CFR 239.500] filings on the Commission's Electronic Data Gathering, Analysis and Retrieval system ("EDGAR") from January 2009 through December 2018. DERA staff determined the amount raised based on the amounts reported as "Total amount sold" in all Form D filings (new filings and amendments) on EDGAR. Subsequent amendments to a new filing were treated as incremental fundraising and recorded in the calendar year in which the amendment was filed. It is likely that the reported data on Regulation D offerings underestimates the actual amount raised through these offerings. First, as discussed in Section II.B.2, 17 CFR 230.503 ("Rule 503") of Regulation D requires issuers to file a Form D no later than 15 days after the first sale of securities, but a failure to file the notice does not invalidate the exemption. Accordingly, it is possible that some issuers do not file Forms D for offerings relying on Regulation D. Second, underreporting could also occur because a Form D may be filed prior to completion of the offering, and our rules do not require issuers to amend a Form D to report the total amount sold on completion of the offering or to reflect additional amounts offered if the aggregate offering amount does not exceed the original offering size by more than 10%.

Data on Regulation A offerings was collected from Form 1-Z [17 CFR 239.94] and 1-K [17 CFR 239.91] filings on EDGAR from May 2015 through December 2018. DERA staff supplemented information from Forms 1-Z and 1-K by manually

reviewing semi-annual reports on Form 1-SA [17 CFR 239.92], available current reports on Form 1-U [17 CFR 239.93], and offering circular supplements filed during the sample period, and for issuers whose securities have become exchange-listed, information from other public sources. However, data on amounts raised may remain incomplete, and discrepancies in classification may arise. Estimates are based on available reports filed during this period and represent a lower bound on the amounts raised given: (1) The time frames for reporting proceeds following completed or terminated offerings; and (2) that offerings qualified during the report period may be ongoing. As discussed in Section II.C.2.b, Regulation A requires issuers in Tier 1 offerings to report sales and to update certain issuer information by filing a Form 1-Z exit report with the Commission not later than 30 calendar days after termination or completion of an offering. Tier 2 issuers are required to report sales in their first annual report on Form 1-K after termination or completion of a qualified offering, or in their exit report on Form 1-Z. Therefore, some issuers that have completed offerings during the sample period might not have reported proceeds during this period. Accordingly, amounts provided for these offerings likely underestimate the actual amount of capital raised during the period.

Data on Regulation Crowdfunding offerings was collected from Form C [17 CFR 239.900] filings on EDGAR from May 2015 through December 2018. For offerings that have been amended, the data reflects information reported in the latest amendment as of the end of the considered period. As discussed in Section II.F, Regulation Crowdfunding requires an issuer to file a progress update on Form C-U within 5 business days after

reaching 100% of its target offering amount. The data on Regulation Crowdfunding excludes 107 withdrawn offerings (involving a Form C-W filing or an intermediary that has withdrawn its registration as of the report date). Some withdrawn offerings may be failed offerings. Amounts raised may be lower than the target or maximum amounts sought.

See note 41 for a discussion of the data on other exempt offerings, which includes Section 4(a)(2), Regulation S [17 CFR 230.901 *et seq.*], and Rule 144A offerings.

See also Scott Bauguess, Rachita Gullapalli and Vladimir Ivanov, *Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009–2017* (Aug. 2018) (the "Unregistered Offerings White Paper"), available at [https://www.sec.gov/files/DERA%20white%20paper\\_Regulation%20D\\_082018.pdf](https://www.sec.gov/files/DERA%20white%20paper_Regulation%20D_082018.pdf). The methodology DERA staff used to analyze data in this release is consistent with the methodology described in more detail in the Unregistered Offerings White Paper.

We do not have data available on, and are unable to estimate, amounts raised under the intrastate exemptions under Securities Act Section 3(a)(11) or Rule 147 or 147A. See Section 70.

<sup>38</sup> The sample period begins in 2009 due to data availability: Form D, from which we obtain data on exempt offerings under Regulation D, was required to be filed electronically starting in 2009. We note that, as a result, the sample period excludes the years of the 2007–2008 financial crisis. The sample period ends in 2018, which is the last full year of data on offerings.

Of the approximately \$2.9 trillion estimated as raised in exempt offerings in 2018, Table 2 shows the amounts that we estimate were raised under each of the identified exemptions in 2018.

**TABLE 2—OVERVIEW OF AMOUNTS RAISED IN THE EXEMPT MARKET IN 2018**

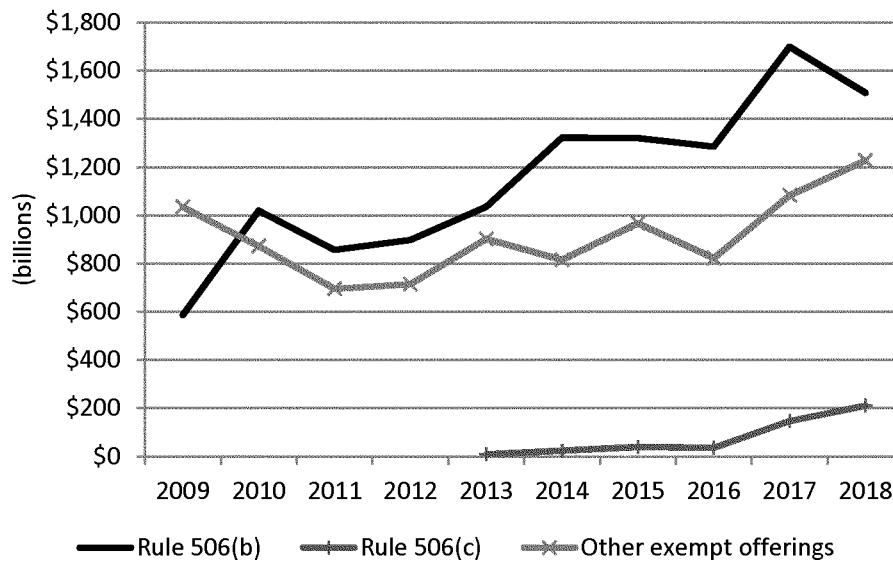
Exemption	Amounts reported or estimated as raised in 2018 (billion)
Rule 506(b) of Regulation D	\$1,500
Rule 506(c) of Regulation D	211
Regulation A: Tier 1	<sup>39</sup> 0.061
Regulation A: Tier 2	<sup>40</sup> 0.675
Rule 504 of Regulation D	2
Regulation Crowdfunding; Section 4(a)(6)	0.055
Other exempt offerings <sup>41</sup>	1,200

The amounts estimated as raised in other exempt offerings include estimated amounts raised in offerings under Rule 144A and Regulation S. Rule 144A is a non-exclusive safe harbor for resales of certain restricted securities. However, Rule 144A is typically used by market participants to facilitate capital raising by issuers by means of a two-step process in which the first step is a primary offering on an exempt basis to one or more financial intermediaries, and the second step is a resale to QIBs in reliance on Rule 144A.<sup>42</sup> Regulation S provides a safe harbor for offers and sales of securities outside the United States so long as the securities are sold in an offshore transaction and there are no “directed selling efforts” in the United States.<sup>43</sup> Although Rule 144A and Regulation S transactions account for a significant proportion of the

transaction activity in the exempt markets, we have opted to focus this concept release on other commonly used safe harbors and exemptions from registration for primary offerings.

Figures 2 and 3 show the trends in capital raising under various offering exemptions during the period 2009–2018. The amounts raised in Rule 506(b), Rule 506(c), other exempt offerings, Regulation A, and Regulation Crowdfunding show an upward trend over the period under consideration, while the amounts raised in Rule 504 offerings have fluctuated significantly; however, as discussed in Section D.3, we believe that the increase in Rule 504 offerings starting in 2016 is largely due to the repeal of 17 CFR 230.505 (“Rule 505”).

**Figure 2: Capital raised in Rule 506(b), Rule 506(c), and other exempt offerings, 2009-2018**



<sup>39</sup> See Table 8.

<sup>40</sup> See *id.*

<sup>41</sup> “Other exempt offerings” includes Section 4(a)(2), Regulation S, and Rule 144A offerings. The data used to estimate the amounts raised in 2018 for other exempt offerings includes: Offerings under Section 4(a)(2) of the Securities Act that were collected from Thomson Financial’s SDC Platinum, which uses information from underwriters, issuer websites, and issuer SEC filings to compile its Private Issues database; offerings under Regulation

S that were collected from Thomson Financial’s SDC Platinum service; and resale offerings under Rule 144A that were collected from Thomson Financial SDC New Issues database, Dealogic, the Mergent database, and the Asset-Backed Alert and Commercial Mortgage Alert publications, to further estimate the exempt offerings under Section 4(a)(2) and Regulation S. We include amounts sold in Rule 144A resale offerings because, as discussed below, those securities are typically issued initially in a transaction under Section 4(a)(2) or Regulation S but generally are not included in the Section 4(a)(2)

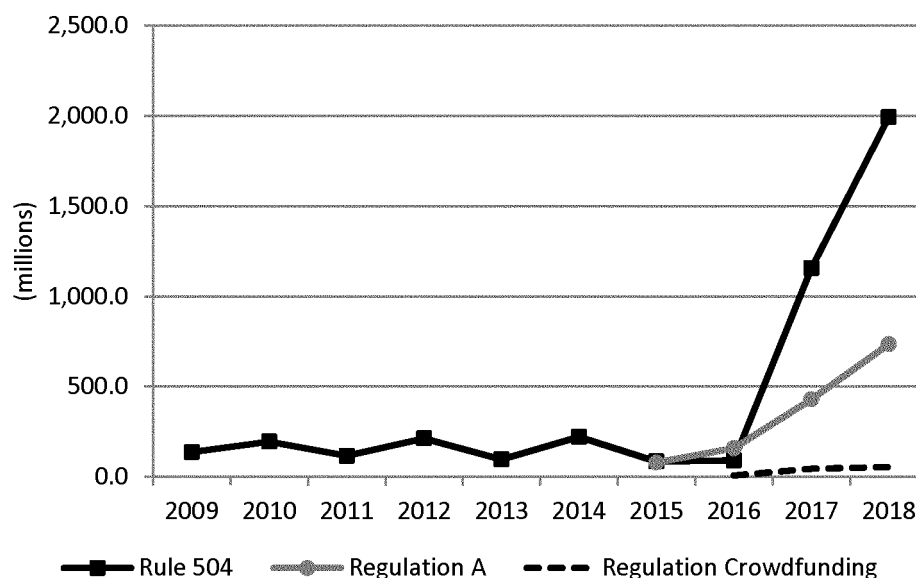
or Regulation S data identified above. See Section V.A.2 for a discussion of the two-step process typically used by market participants in Rule 144A offerings.

These numbers are accurate only to the extent that these databases are able to collect such information and may understate the actual amount of capital raised under these offerings if issuers and underwriters do not make this data available.

<sup>42</sup> See Section V.A.2.

<sup>43</sup> 17 CFR 230.901 *et seq.*

**Figure 3: Capital raised in Rule 504, Regulation A,<sup>44</sup> and Regulation Crowdfunding, 2009-2018**



There are many possible reasons why the amount of capital raised in exempt offerings exceeds the amount raised in registered offerings. However, the focus of this concept release is to seek input on whether, in light of the increased activity in the exempt markets, the current exempt offering framework is working effectively to provide access to capital for a variety of issuers, particularly smaller issuers, and access to investment opportunities for a variety of investors while maintaining investor protections. Historically, a retail investor's primary investment option was registered offerings, and encouraging registered offerings and facilitating investor access to such investment opportunities continues to be a Commission priority, as demonstrated by recent rule changes, proposals, guidance, and other initiatives facilitating capital raising through registered offerings.<sup>45</sup> However,

many issuers, including early-stage and smaller issuers, may find that they need alternative access to capital in order to build their businesses and grow to become public reporting companies. For such issuers, an exempt offering market that allows for efficient access to capital may make it more likely that they achieve this growth.

In addition, it may be argued that the increased amount raised in exempt offerings relative to registered offerings leaves certain types of investors with fewer investment opportunities than might have been available to them if the public markets were used more frequently. The current framework permits non-accredited investors some limited access to unregistered offerings. Based on available data,<sup>46</sup> non-accredited investors participate primarily<sup>47</sup> in offerings under Regulation A,<sup>48</sup> Rule 504, and Regulation Crowdfunding.<sup>49</sup> In 2018, however, aggregate investments in exempt offerings in which non-

accredited investors participated<sup>50</sup> represented less than one percent of investment in all exempt offerings, and approximately two percent of all exempt offerings, excluding other exempt offerings.<sup>51</sup>

A significant number of attractive investment opportunities in the exempt market, including access to many growth-stage issuers, may be available only to investors with certain characteristics, such as accredited investors who, if natural persons, must meet an income or net worth test. For example, the amount of capital raised in Rule 506(b) offerings to accredited investors is greater than amounts raised in registered offerings, and significantly greater than the amounts raised in the types of exempt offerings that are more broadly accessible to non-accredited investors.<sup>52</sup> Accordingly, while a non-accredited investor may be able to invest in multiple offerings across the exempt market, such an investor would likely not have the same level of access to the full range of investment opportunities in the exempt market as an accredited investor would. We seek comment below on whether it would be consistent with capital formation and investor protection for us to consider steps to make a broader range of investment opportunities available to

<sup>44</sup> Due to data limitations, Regulation A totals reflect amounts reported raised annually under Regulation A after the 2015 amendments.

<sup>45</sup> See, e.g., Solicitations of Interest Prior to a Registered Public Offering, Release No. 33-10607 (Feb. 19, 2019) [84 FR 6713 (Feb. 28, 2019)]; Disclosure Update and Simplification, Release No. 33-10532 (Aug. 17, 2018) [83 FR 50148 (Oct. 4, 2018)]; Amendments to Smaller Reporting Company Definition, Release No. 33-10513 (Jun. 28, 2018) [83 FR 31992 (Jul. 10, 2018)]; FAST Act Modernization and Simplification of Regulation S-K, Release No. 33-10618 (Mar. 20, 2019) [84 FR 12674 (Apr. 2, 2019)]. See also Division of Corporation Finance, Draft Registration Statement Processing Procedures Expanded (Jun. 29, 2017; supplemented Aug. 17, 2017), available at <https://www.sec.gov/corpfin/announcement/draft-registration-statement-processing-procedures-expanded>.

<sup>46</sup> We do not have data on, and are unable to estimate, amounts raised under the intrastate exemptions under Securities Act Section 3(a)(11) or Rule 147 or 147A. See Section 70.

<sup>47</sup> While Rule 506(b) offerings can have up to 35 non-accredited but sophisticated investors, issuers reported non-accredited investors as participating in only six percent of Rule 506(b) offerings in each of 2015, 2016, 2017, and 2018, which offerings reported raising between two and three percent of the total capital raised under Rule 506(b) in each of 2015, 2016, 2017, and 2018. See Unregistered Offerings White Paper at Table 12. See also Sections II.B.2 and II.B.2.f for a discussion of the requirements for Rules 506(b) and 506(c).

<sup>48</sup> 17 CFR 230.251 *et seq.*

<sup>49</sup> 17 CFR 227.100 *et seq.*

<sup>50</sup> This data includes offerings under Rule 506(b) but is limited to those offerings where issuers reported one or more participating non-accredited investor.

<sup>51</sup> See note 41 for a discussion of the data on other exempt offerings.

<sup>52</sup> See Section II.B.2.f.



those investors currently considered non-accredited.

All securities offerings are (1) registered with the Commission, (2) exempt from registration, or (3) conducted in violation of the federal securities laws as a result of a failure to register when an exemption is not available. The distinction between fraudulent exempt offerings and illegal offerings as a result of a failure to register is an important one. A failure to comply with the registration provisions of Section 5 of the Securities Act is distinct from a violation of the antifraud provisions of the federal securities laws. Due to data limitations, it is difficult to draw rigorous conclusions about the extent of fraud in exempt securities offerings. Accordingly, we seek data about fraudulent activity in the exempt markets. In particular, we seek quantitative data on fraudulent activity in the context of securities offerings conducted pursuant to a valid exemption from registration, as opposed to illegal securities offerings that fail to comply with the registration provisions of Section 5. Such data may assist us in considering the incidence of fraud in these markets.

Due to data limitations, it is also difficult to draw rigorous conclusions about the average magnitude of investor gains and losses in exempt securities offerings.<sup>53</sup> Accordingly, we also seek data about the performance of investments in exempt markets. We also seek public input on the review of the exempt offering framework as a whole, and whether and how to best achieve our goal of improving and harmonizing the framework. Because the responses to the following requests for comment may overlap with responses to the more specific requests for comment elsewhere in this release, commenters may wish to consider these broader themes in the context of their responses to those more specific requests for comment.

#### *Request for Comment*

1. Does the existing exempt offering framework provide appropriate options for different types of issuers to raise

<sup>53</sup> It is difficult to perform a comprehensive market-wide analysis of investor gains and losses in exempt offerings given the significant limitations on the availability of data about the performance of these investments. Where partial data is available for some types of investments in exempt offerings, it does not lend itself to a comprehensive estimate of investment performance and risks across the entire market of exempt offerings. A typical startup issuer may require a long period of time to experience a liquidity event or close its business, and we lack comprehensive data on such events and associated investor gains and losses. The lack of a secondary trading market for many securities issued in exempt offerings further limits our ability to examine investor gains and losses.

capital at key stages of their business cycle? For example, are there capital-raising needs specific to any of the following that are not being met by the current exemptions: Small issuers; start-up issuers; issuers in a particular industry, such as technology, biotechnology, manufacturing, or consumer products; issuers in different geographic regions, including those in rural areas or those affected by natural disasters; or issuers led by minorities, women, or veterans? What types of changes should we consider to address any such gaps in the exempt offering framework? Would legislative changes be necessary or beneficial to address any such gaps?

2. Do the existing exemptions from registration appropriately address capital formation and investor protection considerations? If so, should we retain our current exempt offering framework as it is? Are there burdens imposed by the rules that can be lifted while still providing adequate investor protection?

3. Is the existing exempt offering framework too complex? Should we reduce or simplify the number of exemptions available? If so, should we focus on having a limited number of exemptions based on the amount of capital sought (for example, a micro exemption, an exemption for offerings up to \$75 million, and an unlimited offering exemption)? Or should we focus our exemptions on the type of investor allowed to participate? Would legislative changes be necessary or beneficial if we were to replace the current exempt offering framework with a simpler offering framework?

4. Are the exemptions themselves too complex? Can issuers understand their options and effectively choose the one best suited to their needs? Do any exemptions present pitfalls for small businesses, especially for issuers that may be unfamiliar with the general concepts underlying the federal securities laws?

5. In light of the fact that some exemptions impose limited or no restrictions at the time of the offer, should we revise our exemptions across the board to focus consistently on investor protections at the time of sale rather than at the time of offer? If our exemptions focused on investor protections at the time of sale rather than at the time of offer, should offers be deregulated altogether? How would that affect capital formation in the exempt market and what investor protections would be necessary or beneficial in such a framework? Would legislative changes be necessary or beneficial if we were to focus on the sale

of a security, rather than the offer and sale?

6. What metrics should we consider in evaluating the impact of our exemptions on efficiency, competition, capital formation, and investor protection? In particular:

- How should we evaluate whether our existing exemptions appropriately promote efficiency, competition, and capital formation? For example, in evaluating our exempt offering market, should we consider whether investors have more opportunities to participate in exempt offerings? To appropriately evaluate the market, should we consider the cost of capital for a variety of issuers? What other indicators should we consider?

- How should we evaluate whether our exemptions provide adequate investor protection? For example, is there quantitative data available that shows an increased incidence of fraud in particular types of exempt offerings or in the exempt market as a whole? If so, what are the causes or explanations and what should we do to address it? What other factors should we consider in assessing investor protection?

7. How has technology affected an issuer's ability to communicate with its potential and current investors? Do our exempt offering rules limit an issuer's ability to provide disclosure promptly to its potential and current investors? Are there technologies or means of communication (e.g., online chat or message boards) that would effectively provide updated disclosure to potential and current investors that are currently not being used due to provisions in our rules or regulations? If so, what rules are limiting this disclosure and what changes should we consider? Given the transformation of information dissemination that has occurred since our rules were adopted and particularly over the last two decades, should we consider any rule changes to enhance an issuer's ability to communicate with investors throughout the exempt offering framework? How would such changes affect capital formation in the exempt market and what investor protections would be necessary or beneficial in such a framework? Would legislative changes be necessary or beneficial to make such changes?

8. Are there rule changes we should consider to ease issuers' transition from one exempt offering to another as their businesses develop and grow?

9. Would rule changes that simplify, harmonize, and improve the exempt offering framework have an effect on the registered public markets? For example, would a more streamlined exempt market encourage more issuers to

remain private longer or forgo registered offerings, and result in less capital being raised in the registered market over time? Are there changes to the current exempt offering framework that we should consider to help issuers transition to a registered public offering without undue friction or delay? Are there changes to the exempt offering framework that we should consider to encourage more issuers to enter the registered public markets? Would these changes increase the costs to issuers? Would these changes benefit investors or particular classes of investors? Would legislative changes be necessary or beneficial to address any such changes?

10. Which conditions or requirements are most or least effective at protecting investors in exempt offerings? Are there changes to these investor protections or additional measures we should implement to provide more effective investor protection in exempt offerings? Are there investor protection conditions that we should eliminate or modify because they are ineffective or unnecessary? Would legislative changes be necessary or beneficial to address any changes to investor protection conditions?

11. In light of the increased amount of capital raised through the exempt offering framework, should we consider rule changes that will help make exempt offerings more accessible to a broader group of retail investors than those who currently qualify as accredited investors? If so, what types of changes should we consider? For example, should we expand the definition of accredited investor to take into account characteristics other than an individual's wealth? Should we allow investors, after receiving disclosure about the risks, to opt into accredited status? Should we amend the existing exemptions or adopt new exemptions to accommodate some form of non-accredited investor participation such that these exemptions may be more attractive to, or more widely used by, issuers?

12. When the current exemptions from registration include offering limits or limits on the amount an individual investor may invest, what should we take into account to determine whether the limits and amounts are appropriate? Should the amounts of all offering limits or investment limits be subject to periodic inflation adjustments? If so, what inflation measure should we use for such adjustments and how often should the adjustments occur? Should we use dollar limits, or some other measure? For example, should individual investment limits be based on a percentage of the investor's income

or investment portfolio? Do these limits impose any particular challenges, for example, by having different effects in different parts of the country due to regional differences?<sup>54</sup> Should any investors be limited in how much they can invest?

13. Many of the existing exemptions from registration require issuers to provide specified disclosure to investors at the time of the offering and, in some cases, on an ongoing basis following the offering. The type of information required to be provided, and the frequency with which the disclosures are required, vary from exemption to exemption. Should we harmonize the disclosure requirements of the various exemptions? If so, how? Should we focus on making the requirements more uniform or more scaled to the characteristics of the issuer or of the offering? Could changes to the various disclosure requirements of the exemptions help to facilitate issuers' transition from one exempt offering to another or to a registered offering? Would legislative changes be necessary or beneficial if we were to replace the current exempt offering framework with such a framework?

14. Should the availability of any exemptions be conditioned on the involvement of a registered intermediary, such as the registered funding portal or broker-dealer in crowdfunding offerings, particularly where the offering is open to retail investors who may not currently qualify as accredited investors?<sup>55</sup>

15. Should the availability of any exemptions be conditioned on particular characteristics of the issuer or lead investor(s)? For example, in an offering to non-accredited investors where there is one or more lead investors, should we require that the lead investor(s) hold a minimum amount of the same security type (or a junior security) sold to the non-accredited investors?

16. Should we consider a more unified approach to the exempt offering framework that focuses on the types of investors permitted to invest in the offering and the size of the offering, tailoring the additional investor protections and conditions to be applied based on those characteristics? For example, should we consider changes to the requirements for any or all of the

existing exemptions from registration so that specific requirements (such as disclosure requirements or individual investment limits) will not apply if participation in the offering is limited to accredited investors? Would legislative changes be necessary or beneficial if we were to replace the current exempt offering framework with a more unified approach?

17. Should we consider rule changes that would allow non-accredited investors to participate in exempt offerings of all types, subject to conditions such as a limit on the size of the offering, a limit on the amount each non-accredited investor could invest in each offering, across all offerings, or across all offerings of a certain type, a decision by the investor—after receiving disclosure about the risks—to opt into the offering, and/or specific disclosure requirements? If so, should we scale the type and amount of information required to be disclosed to non-accredited investors based on the characteristics of the investors or the offering, such as the net worth or sophistication of the non-accredited investors, or whether the offering amount is capped, individual investment limits apply, or an intermediary is involved in the offering? What benefits would be conferred by such an approach? What would be the investor protection concerns? Would legislative changes be necessary or beneficial if we were to replace the current exempt offering framework with such an approach?

18. Should we move one or more current exemptions into a single regulation, such as currently provided by Regulation D with respect to the exemptions under Rules 506(b), 506(c), and 504? What, if any, current exemptions should be included in a single set of regulations? Would a new single set of exemptions be overly complicated and obscure any possible benefits of coordination and harmonization?

19. Are we effectively communicating information about the exempt offering framework, including the requirements of each exemption, to the issuers seeking to raise capital and investors seeking investment opportunities in this market? What types of communications have worked best? How can we improve our communications to issuers and investors about the exempt offering framework? Are there additional technologies or means of communication that we should use to convey information about exempt offerings to issuers and investors?

<sup>54</sup> See, e.g., Table 4.

<sup>55</sup> The status of persons that provide introductions or otherwise solicit potential investors for an issuer (generally, "finders") is not discussed within this release. The Division of Trading and Markets is reviewing the status of finders for purposes of Section 15(a) of the Exchange Act [15 U.S.C. 78o(a)].

The remainder of this concept release discusses the requirements for each of the capital-raising exemptions from registration that make up our current exempt offering framework. As indicated in the requests for comment set forth following the discussion of each exemption, we are seeking feedback from issuers, investors, and other market participants on whether any changes to Commission rules or the underlying statutes are needed or desired to improve the utility of the exemptions or the entire exempt offering framework consistent with investor protection. This release also discusses other broad topics that are relevant to the entire, or a significant portion of, the framework, including the definition of “accredited investor,” the integration analyses applied in the context of exempt offerings, exempt offerings by pooled investment funds,<sup>56</sup> and the current regulatory landscape affecting the secondary trading market for securities originally sold in exempt offerings.

#### A. Accredited Investor Definition<sup>57</sup>

##### 1. Background

The “accredited investor” definition is set forth in 17 CFR 230.501(a) (“Rule 501(a)”) of Regulation D<sup>58</sup> and is “intended to encompass those persons whose financial sophistication and ability to sustain the risk of loss of investment or ability to fend for

<sup>56</sup> We refer in this release to “pooled investment funds” because that term is used in Form D.

<sup>57</sup> Section 413(b)(2)(A) of the Dodd-Frank Wall Street Reform and Consumer Protection Act [Pub. L. 111–203, 124 Stat. 1376 (2010)] (the “Dodd-Frank Act”) directed the Commission to review the accredited investor definition as it relates to natural persons every four years to determine whether the definition should be modified or adjusted for the protection of investors, in the public interest, and in light of the economy. We intend the discussion in this Section II.A to satisfy that requirement. See Report on the Review of the Definition of “Accredited Investor” (Dec. 18, 2015) (“Accredited Investor Staff Report”), available at <https://www.sec.gov/corpfin/reportspubs/special-studies/review-definition-of-accredited-investor-12-18-2015.pdf>. See also Section II.A.3 for a discussion of the Accredited Investor Staff Report, which was prepared in connection with the first review in 2015.

<sup>58</sup> In addition, Securities Act Section 2(a)(15) [15 U.S.C. 77b(a)(15)] and 17 CFR 230.215 (“Rule 215”) under the Securities Act define accredited investor for purposes of Securities Act Section 4(a)(5) [15 U.S.C. 77d(a)(5)]. Section 4(a)(5) exempts non-public offers and sales of up to \$5 million made solely to accredited investors. However, based on DERA staff’s review of Form D filings from January 1, 2009 through December 31, 2018, no issuer has reported relying on the Section 4(a)(5) exemption. The definition of accredited investor in Section 2(a)(15) enumerates certain categories of persons and authorizes the Commission to prescribe additional categories. Pursuant to this authority, the Commission has prescribed additional categories in Rule 215. The definition contained in Rule 215 is substantially similar to Rule 501(a).

themselves render the protections of the Securities Act’s registration process unnecessary.”<sup>59</sup> The definition is a central component of several exemptions from registration, including Rules 506(b) and 506(c) of Regulation D.<sup>60</sup>

Accredited investors may, under Commission rules, participate in investment opportunities that are generally not available to non-accredited investors, such as investments in many private issuers and offerings by hedge funds, private equity funds, and venture capital funds.<sup>61</sup> The Rule 506 market has become a large and vibrant market for raising capital, especially for small business capital formation.<sup>62</sup> Rule 506 offerings to accredited investors occur with greater frequency than any other type of offering surveyed by the staff.<sup>63</sup> Issuers in those offerings are not required to provide any substantive disclosure and are permitted to sell securities to an unlimited number of accredited investors with no limit on the amount of money that can be raised from each investor or in total.<sup>64</sup>

Under the Regulation D accredited investor definition, natural persons are accredited investors if:

- Their income exceeds \$200,000 in each of the two most recent years (or

<sup>59</sup> See, e.g., Regulation D Revisions Proposing Release; see also Amendments for Small and Additional Issues Exemptions under the Securities Act (Regulation A), Release No. 33–9741 (March 25, 2015) [80 FR 21805 (April 20, 2015)] (“2015 Regulation A Release”) at note 146.

<sup>60</sup> See Section II.B for a discussion of Rule 506.

<sup>61</sup> Purchasers in Rule 506(c) offerings are limited to accredited investors. See note 47 for data reflecting non-accredited investors’ participation in Rule 506(b) offerings. See Sections II.B.2 and II.B.2.f for a discussion of the requirements for Rules 506(b) and 506(c). See Section IV.A.2 for a discussion of private funds.

Recent research has examined the importance of the pool of accredited investors for the entry of new businesses and employment. In their working paper, Lindsey and Stein (2019) examine the effects on angel finance stemming from Dodd-Frank Act’s elimination of the value of the primary residence in the determination of net worth for purposes of accredited investor status. See note 66 and accompanying text. Lindsey and Stein find that geographic areas experiencing a larger reduction in the number of potential accredited investors experienced negative effects on new firm entry and employment levels at small entrants. See Laura Lindsey and Luke C.D. Stein (2019) *Angels, Entrepreneurship, and Employment Dynamics: Evidence from Investor Accreditation Rules*, Working paper.

<sup>62</sup> The aggregate amount of capital raised through Rule 506(b) and (c) offerings is large, but the median size of offerings by non-financial issuers is less than \$1 million, indicating a large number of small offerings, consistent with the original regulatory objective to target the capital formation needs of small businesses. See Unregistered Offerings White Paper.

<sup>63</sup> See Unregistered Offerings White Paper.

<sup>64</sup> See 17 CFR 230.506(b) and 17 CFR 230.506(c).

\$300,000 in joint income with a person’s spouse) and they reasonably expect to reach the same income level in the current year;<sup>65</sup> or

- Their net worth exceeds \$1 million (individually or jointly with a spouse), excluding the value of their primary residence.<sup>66</sup>

In addition, directors, executive officers, and general partners of the issuer selling the securities are accredited investors for purposes of that issuer.<sup>67</sup> Certain enumerated entities with over \$5 million in assets qualify as accredited investors,<sup>68</sup> while others, including regulated entities such as banks and registered investment companies, are not subject to the assets test.<sup>69</sup> The definition of an accredited investor includes, among others, the following entities:

- A bank, registered broker-dealer, insurance company, registered investment company, business development company (“BDC”) as defined in the Investment Company Act of 1940 (“Investment Company Act”),<sup>70</sup> or small business investment company (“SBIC”);<sup>71</sup>
- A private business development company as defined in the Investment Advisers Act of 1940 (“Advisers Act”);<sup>72</sup>
- An employee benefit plan (within the meaning of the Employee Retirement Income Security Act

<sup>65</sup> 17 CFR 230.501(a)(6).

<sup>66</sup> 17 CFR 230.501(a)(5). Section 413(a) of the Dodd-Frank Act excluded the value of a person’s primary residence from the net worth calculation and directed the Commission to adjust similarly any accredited investor net worth standard in its Securities Act rules. In 2011, the Commission revised Rules 215 and 501 to exclude any positive equity that individuals have in their primary residences. See Net Worth Standard for Accredited Investors, Release No. 33–9287 (Dec. 21, 2011) [76 FR 81793 (Dec. 29, 2011)] (“Primary Residence Adopting Release”). The revised calculation requires that any excess of indebtedness secured by the primary residence over the estimated fair market value of the residence be considered a liability for purposes of determining accredited investor status on the basis of net worth. The Commission also added a 60-day look-back period to prevent investors from artificially inflating their net worth by incurring incremental indebtedness secured by their primary residence, thereby effectively converting their home equity into cash or other assets that would be included in the net worth calculation.

<sup>67</sup> 17 CFR 230.501(a)(4). In addition, directors, executive officers, and general partners of a general partner of the issuer are accredited investors for purposes of the issuer. 17 CFR 230.501(a)(4).

<sup>68</sup> 17 CFR 230.501(a)(1), (3), and (7).

<sup>69</sup> 17 CFR 230.501(a)(1), (2), and (8).

<sup>70</sup> 15 U.S.C. 80a–2(a)(48). In this release, unless otherwise specified, we use the term “BDC” to refer to a business development company as defined in the Investment Company Act. See note 526 for a description of a BDC.

<sup>71</sup> 17 CFR 230.501(a)(1). See Section IV for a discussion of pooled investment funds.

<sup>72</sup> 15 U.S.C. 80b–2(a)(22).

(“ERISA”) <sup>73</sup> if a bank, insurance company, or registered investment adviser makes the investment decisions, or if the plan has total assets in excess of \$5 million; <sup>74</sup>

- A tax exempt charitable organization, corporation, or partnership with assets in excess of \$5 million; <sup>75</sup>

- An enterprise in which all the equity owners are accredited investors; <sup>76</sup> and
- A trust with assets of at least \$5 million, not formed only to acquire the securities offered, and the purchases of which are directed by a person who meets the legal standard of having sufficient knowledge and experience in financial and business matters to be

capable of evaluating the merits and risks of the prospective investment. <sup>77</sup>

An entity that is not covered specifically by one of the enumerated categories is generally not an accredited investor under the rule.

Below we estimate the number of U.S. households that qualify as accredited investors under the existing criteria. <sup>78</sup>

TABLE 3—HOUSEHOLDS QUALIFYING UNDER EXISTING ACCREDITED INVESTOR CRITERIA

Criterion	Number of qualifying households (Standard errors are in parentheses)	Qualifying households as % of U.S. households (Standard errors are in parentheses)
Individual income <sup>79</sup> threshold (\$200,000) .....	11.2 million (0.3 million) .....	8.9% (0.2%).
Joint income <sup>80</sup> threshold (\$300,000) .....	5.8 million (0.2 million) .....	4.6% (0.2%).
Net worth <sup>81</sup> (\$1,000,000) .....	11.8 million (0.3 million) .....	9.4% (0.2%).
Overall number of qualifying households <sup>82</sup> .....	16.0 million (0.3 million) .....	13.0% (0.2%).

The data above provides an estimate of the overall pool of qualifying households in the United States. It does not, however, represent the actual number of accredited investors that do

or would invest in the Regulation D market or in other exempt offerings. <sup>83</sup> Below we also present information on median and mean income and net worth of U.S. households in major U.S. geographic regions. The data shows that

household income and net worth tend to be much higher in the Northeast and West regions. This indicates that households that would qualify as accredited investors are more likely to be located in these two regions.

TABLE 4—U.S. HOUSEHOLD INCOME AND NET WORTH, BY REGION <sup>84</sup>

(\$ thousands)	Northeast	Midwest	South	West
Mean household income (before-tax) .....	136.5	102.0	100.0	108.5
Median household income (before-tax) .....	64.4	54.7	51.5	57.5
Mean household net worth .....	851.3	658.8	636.9	873.7
Median household net worth .....	154.5	103.2	87.0	114.3

<sup>73</sup> Public Law 93–406, 88 Stat. 829 (1974).

<sup>74</sup> 17 CFR 230.501(a)(1).

<sup>75</sup> 17 CFR 230.501(a)(3).

<sup>76</sup> 17 CFR 230.501(a)(8).

<sup>77</sup> 17 CFR 230.501(a)(7).

<sup>78</sup> For this analysis, we use the same methodology and variable definitions as the 2015 Accredited Investor Staff Report. The underlying household data for this analysis was obtained from the Federal Reserve Board’s Survey of Consumer Finances (the “SCF”) for 2016, available at <https://www.federalreserve.gov/econresdata/scf/scfindex.htm>. The SCF is a triennial survey that provides insights into household income and net worth, where the household is considered to be the primary economic unit within a family. As of the date of this release, the most recent SCF data is from the 2016 survey. The SCF employs weights to make the data representative of the U.S. population.

The 2015 Accredited Investor Staff Report used the definitions from Jesse Bricker, Lisa J. Dettling, Alice Henriques, Joanne W. Hsu, Kevin B. Moore, John Sabelhaus, Jeffrey Thompson, and Richard A. Windle, Changes in U.S. Family Finances from 2010 to 2013: Evidence from the Survey of Consumer Finances, Federal Reserve Bulletin, Vol. 100, No. 4 (2014).

We estimate households and not individuals due to data limitations because the database underlying our analysis measures wealth and income at the household level. It should be noted that in the SCF database, income is reported at the household level. Similar to the 2015 Accredited Investor Staff Report, we do not attempt to differentiate income

based on marital status of the household because data on individual income from all sources is not publicly available in the database. As a result, accredited investor (household) estimates based on individual income thresholds are likely to be overestimated and would represent upper bounds. A household can have multiple family members with independent sources of income that qualify them as accredited investors based on income. We count them as one accredited investor for each household, which implies we are also likely underestimating the actual pool of accredited investors when we provide household estimates. Consequently, the household estimates we derive using the joint income threshold would represent a lower bound for individuals qualifying on the basis of income. The actual number of individuals that qualify as accredited investors on an income basis (individual or joint) would, in all likelihood, lie between the estimates that we derive for the individual income threshold and the joint income threshold.

<sup>79</sup> For purposes of this analysis, income is defined to include wage income, business income, rent income, interest and dividend income, pension income, social security income, income from retirement accounts, transfers, and other income. According to the SCF documentation, income data is collected for the year prior to the year of the SCF while family balance sheet data covers the status of the family at the time of the interview. Thus, we use income data inflation-adjusted to 2016. Further, for comparability, income data is adjusted for inflation by a factor of 1.05914411 from 2016 dollars to March 2019 dollars using Consumer Price

Index (“CPI”) data from the U.S Department of Labor Bureau of Labor Statistics (“BLS”).

<sup>80</sup> See note 79.

<sup>81</sup> For purposes of this analysis, net worth is defined as the difference between household assets and household debt. Assets include all financial assets (stocks, bonds, mutual funds, cash and cash management accounts, retirement assets, life insurance, managed assets like trusts and annuities, and other financial assets like deferred compensation, royalties, futures, etc.) and non-financial assets. Debt includes mortgage and home equity loans, lines of credit, credit card debt, installment loans including vehicle loans, margin loans, pension loans, and other debt (e.g., loans against insurance). We exclude the value of the household’s principal residence and any outstanding mortgages associated with the principal residence. Further, for comparability, net worth data is adjusted for inflation by a factor of 1.05914411 from 2016 dollars to March 2019 dollars using BLS CPI data.

<sup>82</sup> The number of households qualifying under either the income or net worth criterion is smaller than the sum of the number of households qualifying under the income and the number of households qualifying under the net worth criterion because some households may qualify under both criteria.

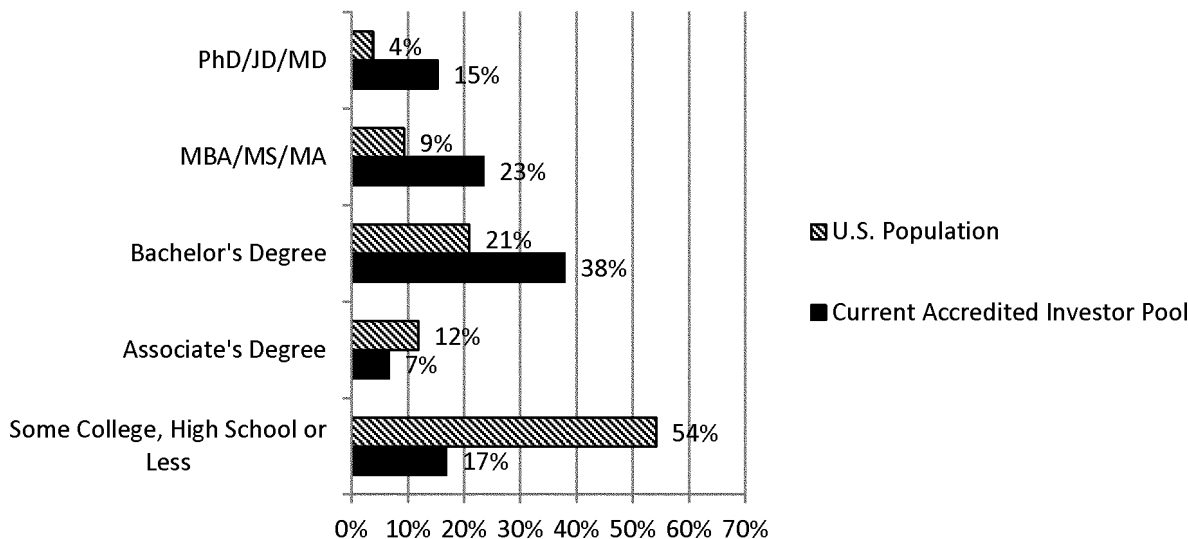
<sup>83</sup> Form D data and other data available to us on private placements do not allow us to estimate the number of unique accredited investors participating in the exempt offerings.

Below we also provide an overview of the educational attainment level of the estimated accredited investor pool,

based on the existing criteria. As can be seen below, accredited investors tend to

be more highly educated relative to the general population.

**Figure 4: Education profile of the accredited investor pool<sup>85</sup>**



We lack data to generate a comprehensive estimate of the overall number of institutional accredited investors because disclosure of accredited investor status across all institutional investors is not required and because, while we have information to estimate the number of some categories of institutional accredited investors, we lack comprehensive data that will allow us to estimate the unique number of investors across all categories of institutional accredited investors under Rule 501.<sup>86</sup>

## 2. Implications Outside of the Regulation D Context

The Regulation D accredited investor definition plays an important role in other federal securities law contexts. For example:

- Regulation A limits the amount of securities non-accredited investors can purchase in certain of those offerings to no more than 10% of the greater of their annual income or their net worth.<sup>87</sup> Accredited investors are not subject to investment limits under Regulation A.
- Under Section 12(g) of the Exchange Act,<sup>88</sup> an issuer that is not a

bank, bank holding company or savings and loan holding company is required to register a class of equity securities under the Exchange Act if it has more than \$10 million of total assets and the securities are “held of record” by either 2,000 persons, or 500 persons who are not accredited investors.<sup>89</sup> As a result, issuers seeking to rely on these thresholds must differentiate between record holders who are accredited investors and non-accredited investors.

- Under Section 5(d) of the Securities Act, an emerging growth company<sup>90</sup> is permitted to “test the waters”<sup>91</sup> with potential investors that are QIBs<sup>92</sup> or

<sup>84</sup> The Federal Reserve Board’s 2016 SCF Chartbook, available at <https://www.federalreserve.gov/econres/files/BulletinCharts.pdf>, at 28, 29, 64, 65. The public version of the SCF database does not provide information regarding geographical location of households. As a result, we are unable to identify in which states households that qualify as accredited investors are likely to be concentrated. Unlike Table 3, in which we exclude the value of the primary residence from net worth, Table 4 does not exclude the value of the primary residence from the net worth of households. The figures were adjusted for inflation to March 2019 dollars using BLS CPI data.

<sup>85</sup> The data underlying these charts was obtained from the 2016 SCF, adjusted for inflation to March 2019 dollars.

<sup>86</sup> For example, Form ADV filers report information about the number of clients of different types, such as pooled investment vehicles, banking institutions, corporations, charities, pension plans, etc., some of which are potential institutional accredited investors. However, the data available to us does not allow identification of unique clients (to account for cases where a client has multiple

advisers) or institutional accredited investors that do not retain services of a Form ADV filer. Further, Form D filings do not provide a breakdown of investors by type—institutions or natural persons—that invested in an offering.

<sup>87</sup> 17 CFR 230.251(d)(2)(i)(C). See Section I.I.C.1.c.

<sup>88</sup> 15 U.S.C. 78l(g).

<sup>89</sup> See *id.*; see also 17 CFR 240.12g-1 (“Rule 12g-1”) (clarifying that accredited investor status for this purpose is determined as of the last day of its most recent fiscal year rather than at the time of the sale of the securities); Changes to Exchange Act Registration Requirements to Implement Title V and Title VI of the JOBS Act, Release No. 33-10075 (May 3, 2016) [84 FR 6713 (Feb. 28, 2019)] (“Changes to Exchange Act Registration Requirements Release”) at Section I.I.B. (“Under amended Rule 12g-1, an issuer will need to determine, based on facts and circumstances, whether prior information provides a basis for a reasonable belief that the security holder continues to be an accredited investor as of the last day of the fiscal year.”).

<sup>90</sup> An emerging growth company refers to an issuer that had total annual gross revenues of less

than \$1.07 billion during its most recently completed fiscal year and, as of December 8, 2011, had not sold common equity securities under a registration statement. That issuer continues to be an emerging growth company for the first five fiscal years after the date of the first sale of its common equity securities pursuant to an effective registration statement, unless one of the following occurs: Its total annual gross revenues are \$1.07 billion or more; it has issued more than \$1 billion in non-convertible debt in the past three years; or it becomes a “large accelerated filer,” as defined in 17 CFR 240.12b-2 (“Rule 12b-2”) under the Exchange Act. See 17 CFR 230.405 (“Rule 405”) and Rule 12b-2 (defining “emerging growth company”).

<sup>91</sup> Communications between an issuer and potential investors for the purpose of assessing investor interest before having to commit the time and expense necessary to carry out a contemplated securities offering are often referred to as “testing the waters.”

<sup>92</sup> See Section V.A.2 for a discussion of the definition of a QIB.

institutional accredited investors<sup>93</sup> before or after filing a registration statement to gauge such investors' interest in a contemplated securities offering. In February 2019, the Commission proposed expanding this testing the waters accommodation to all issuers, including registered investment companies and BDCs.<sup>94</sup>

In addition, some states use the accredited investor definition to determine whether investment advisers to certain private funds are required to be registered.<sup>95</sup> States also incorporate the definition in a variety of other contexts. For example, the definition is used in government finance,<sup>96</sup> finance lending,<sup>97</sup> mortgage lending,<sup>98</sup> insurance,<sup>99</sup> and financial institution regulation.<sup>100</sup> The accredited investor definition also served as a model for an exemption under the Uniform Securities Act of 2002.<sup>101</sup>

FINRA Rule 5123 uses the accredited investor definition to provide an exemption from the general requirement that each member firm that sells an issuer's securities in a private placement file with FINRA a copy of any private placement memorandum, term sheet, or other offering document the firm used within 15 calendar days of the date of the sale, or indicate that it did not use any such offering documents.<sup>102</sup> The exemption applies to offerings sold to, among other persons, accredited investors described in Rule 501(a)(1), (2), (3), or (7). The rule does not

incorporate the entire accredited investor definition and in particular excludes the net worth and income criteria set forth in Rule 501(a)(5) and (6) respectively.<sup>103</sup>

### 3. Accredited Investor Staff Report

In December 2015, the Commission issued a staff report on the accredited investor definition.<sup>104</sup> The report examined the history of the accredited investor definition<sup>105</sup> and considered comments on the definition received from a variety of sources, including public commenters, the Commission's Investor Advisory Committee,<sup>106</sup> the Commission's Advisory Committee on Small and Emerging Companies,<sup>107</sup> and the 2014 Small Business Forum.<sup>108</sup> The report considered alternative approaches to defining "accredited investor," provided staff recommendations for potential updates and modifications to the existing definition, and analyzed the impact potential approaches may have on the pool of accredited investors. The report noted that any change to the accredited investor definition would have to consider both the impact the change could have on investors and the supply

of capital to the Regulation D market. The report acknowledged the tradeoff between using a principles-based accredited investor definition and the need for bright-line standards that investors, issuers, and their advisors can understand and apply easily. In the report, the staff recommended that the Commission consider any one or more of the methods of revising the accredited investor definition described in Table 5 below.

In addition to the staff recommendations described in Table 5 below, the report also discussed whether individuals with certain professional degrees or licenses or financial experience, or who are advised by professionals, should be considered accredited investors. The report, however, did not include any staff recommendations about whether individuals with certain professional degrees or licenses or financial experience, or who are advised by professionals, should be considered accredited investors.

### 4. Comments on the Accredited Investor Staff Report

Following the release of the Accredited Investor Staff Report, the Commission has continued to receive recommendations about revisions to the accredited investor definition from the Advisory Committee on Small and Emerging Companies and the annual Small Business Forum.

In July 2016, the Advisory Committee on Small and Emerging Companies recommended, among other things, that the Commission:

- Not change the current financial thresholds in the accredited investor definition except to adjust on a going-forward basis to reflect inflation;
- Expand the pool of accredited investors to include individuals who have passed examinations that test their knowledge and understanding in the areas of securities and investing, including the Series 7, Series 65, Series 82, and CFA Examinations and equivalent examinations; and
- Explore ways to allow participation by potential investors with specific industry or issuer knowledge or expertise who would not otherwise be considered accredited investors.<sup>109</sup>

The recommendation also noted that the Committee would support expanding the definition to take into account measures of non-financial

<sup>93</sup> An institutional accredited investor refers to any institutional investor who is also an accredited investor.

<sup>94</sup> See Solicitations of Interest Prior to a Registered Public Offering, Release No. 33-10607 (Feb. 19, 2019) [84 FR 6713 (Feb. 28, 2019)].

<sup>95</sup> See, e.g., Final Order Granting Exemption From the Registration Requirements for Investment Advisers to Private Funds and Their Investment Adviser Representatives, Wisconsin Department of Financial Institutions, Division of Securities (Feb. 17, 2012); Certificate Exemption for Investment Advisers to Private Funds, Cal. Code Regs. Title 10 § 260.204.9; Sixth Transition Order administering the Michigan Uniform Securities Act, State of Michigan Department of Energy, Labor & Economic Growth, Office of Financial and Insurance Regulation (Mar. 11, 2011).

<sup>96</sup> See, e.g., Cal. Gov't Code § 64111.

<sup>97</sup> See, e.g., Cal. Fin. Code § 22064.

<sup>98</sup> See, e.g., Fla. Stat. §§ 494.001 and 494.00115.

<sup>99</sup> See, e.g., Tex. Ins. Code § 1111A.002.

<sup>100</sup> See, e.g., Conn. Gen. Stat. § 36a-2 (2014).

<sup>101</sup> Uniform Securities Act of 2002 §§ 102(11)(F) through 102(11)(K), 102(11)(O) and 202(13), National Conference of Commissioners on Uniform State Laws (also known as the Uniform Law Commission). The Uniform Law Commission provides states with model legislation in areas of state statutory law when uniformity is desired and practicable. The Uniform Securities Act of 2002 is a model state securities law available at <https://www.uniformlaws.org/committees/community-home?communitykey=8c3c2581-0fea-4e91-8a50-27ee58da1cf&tab=groupdetails>.

<sup>102</sup> FINRA Rule 5123(b)(1)(J).

<sup>103</sup> The Commission release approving FINRA's adoption of this rule noted the following rationale:

"Several commenters requested additional exemptions from coverage under Rule 5123. [One commenter], for example, requested an exemption for all accredited investors. FINRA stated that it does not believe that the exemption should extend to offers to accredited investors under Rule 501(a)(4), (5), or (6) of Regulation D. In particular, FINRA stated that it believes that the criteria used to measure whether a person meets the accredited investor standard do not necessarily reflect a sufficiently high level of sophistication to justify exemption from the proposed rule."

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendments No. 2 and No. 3 and Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Amendments No. 1, No. 2, and No. 3 to Adopt FINRA Rule 5123 (Private Placements of Securities) in the Consolidated FINRA Rulebook, Release No. 34-67157 (June 7, 2012) [77 FR 35457 (June 13, 2012)].

<sup>104</sup> See Accredited Investor Staff Report. The report focused on the accredited investor definition as used in Regulation D, with the understanding that any revisions to the definition should be made to the Rule 215 definition as well.

<sup>105</sup> See *id* at Section II.

<sup>106</sup> See Recommendation of the Investor Advisory Committee: Accredited Investor Definition (Oct. 9, 2014) available at <http://www.sec.gov/spotlight/investor-advisory-committee-2012/accredited-investor-definition-recommendation.pdf>.

<sup>107</sup> See Advisory Committee on Small and Emerging Companies: Recommendations Regarding the Accredited Investor Definition (Feb. 17, 2015) available at <http://www.sec.gov/info/smallbus/acsec/acsec-accredited-investor-definition-recommendation-030415.pdf>.

<sup>108</sup> See Final Report of the 2014 SEC Government-Business Forum on Small Business Capital Formation (May 2015) available at <http://www.sec.gov/info/smallbus/gbfor33.pdf> ("2014 Forum Report").

<sup>109</sup> See Advisory Committee on Small and Emerging Companies: Recommendations Regarding the Accredited Investor Definition (July 20, 2016) available at <https://www.sec.gov/info/smallbus/acsec/acsec-recommendations-accredited-investor.pdf>.

sophistication, regardless of income or net worth, thereby expanding rather than contracting the pool of accredited investors; however, the recommendations cautioned that any non-financial criteria should be able to be ascertained with certainty as “simplicity and certainty are vital to the utility of any expanded definition of accredited investor.”<sup>110</sup> The Committee also recommended that the Commission continue to gather data for ongoing analysis of what “attributes best encompass those persons whose financial sophistication and ability to sustain the risk of loss of investment or ability to fend for themselves render the protections of the Securities Act’s registration process unnecessary.”<sup>111</sup>

The 2016, 2017, and 2018 Forum Reports all included a recommendation that, consistent with the recommendations of the Advisory Committee on Small and Emerging Companies, the Commission should: (a) Maintain the monetary thresholds for accredited investors; and (b) expand the categories of qualification for accredited investor status based on various types of sophistication, such as education, experience, and training, including without limitation persons holding FINRA licenses or CPA or CFA designations, passing a test that demonstrates sophistication, or status as managerial or key employees affiliated with the issuer.<sup>112</sup>

In October 2017, the U.S. Department of the Treasury prepared a report that included recommendations to, among other things, revise the accredited investor definition.<sup>113</sup> The 2017 Treasury Report recommended that the Commission undertake amendments to the accredited investor definition with the objective of expanding the eligible pool of sophisticated investors. The 2017 Treasury Report stated that the definition could be broadened to include: (a) Any investor who is advised on the merits of making a Regulation D investment by a fiduciary, such as an SEC- or state-registered investment adviser; and (b) financial professionals, such as registered representatives and investment adviser representatives, who are considered qualified to recommend Regulation D investments to others.<sup>114</sup>

In addition, the Commission received over 50 comment letters on the Accredited Investor Staff Report.<sup>115</sup> While a few commenters opposed changes to the definition,<sup>116</sup> most commenters generally supported at least

one of the staff’s recommended changes to the definition.<sup>117</sup> In addition, some commenters advocated for lower thresholds or an elimination of the need for the accredited investor definition altogether.<sup>118</sup>

<sup>117</sup> See Table 3 for a summary of the responses from commenters on each staff recommendation.

<sup>118</sup> See, e.g., Letter from Ryan Carpel dated May 12, 2016 available at <https://www.sec.gov/comments/4-692/4692-30.htm>; Letter from Nader Rahelan dated Apr. 23, 2016 available at <https://www.sec.gov/comments/4-692/4692-25.htm>; Letter from Darrell J. Leamon dated Apr. 29, 2016 available at <https://www.sec.gov/comments/4-692/4692-27.htm>; Letter from Andrew Thompson, J.D. dated Feb. 9, 2016 available at <https://www.sec.gov/comments/4-692/4692-12.htm> (“Thompson Letter”); Letter from Caroline B. Austin dated Jan. 30, 2016 available at <https://www.sec.gov/comments/4-692/4692-11.htm>; Letter from Public Startup Company, Inc. dated Feb. 16, 2016 available at <https://www.sec.gov/comments/4-692/4692-13.pdf> (“PSC Letter”); Letter from Roger Q. Doctor dated Jun. 14, 2016 available at <https://www.sec.gov/comments/4-692/4692-36.htm>; Letter from Karl T. Muth, Lecturer, Northwestern University dated May 17, 2016 available at <https://www.sec.gov/comments/265-27/26527-58.htm> (“Muth Letter”); Anonymous Letter dated Jul. 5, 2016 available at <https://www.sec.gov/comments/4-692/4692-39.pdf> (“Anon 2 Letter”); Letter from Martha J. Escudero Acosta dated Oct 15, 2016 available at <https://www.sec.gov/comments/4-692/4692-45.htm> (“Escudero Letter”); Letter from The TAN2000 International Regulatory Corporation dated Dec. 10, 2016 available at <https://www.sec.gov/comments/4-692/4692-46.pdf> (“TAN2000 Letter”); Letter from Cole Hyland dated Jan. 27, 2017 available at <https://www.sec.gov/comments/4-692/4692-1536599-131180.htm>; Letter from Charles A. Gokas dated Jul. 7, 2017 available at <https://www.sec.gov/comments/4-692/4692-1840627-154975.htm>; Letter from David Kinsfather dated Aug. 5, 2017 available at <https://www.sec.gov/comments/4-692/4692-2185513-159906.htm>; Michael K. Smith dated Jan. 23, 2018 available at <https://www.sec.gov/comments/4-692/4692-2945318-161851.htm>; and Letter from Anonymous Lawyer dated Aug. 2, 2016 available at <https://www.sec.gov/comments/4-692/4692-41.htm> (“Anon 3 Letter”) (recommending that there should be different and lower thresholds for service providers of the issuer to be deemed an accredited investor).

<sup>113</sup> See A Financial System That Creates Economic Opportunities Capital Markets, U.S. Dept. of the Treasury (Oct. 2017 (“2017 Treasury Report”), available at <https://www.treasury.gov/press-center/press-releases/documents/a-financial-system-capital-markets-final-final.pdf>, at p. 44.

<sup>114</sup> See 2017 Treasury Report, at p. 44.

<sup>115</sup> The comment letters received in response to the Accredited Investor Staff Report are available at <https://www.sec.gov/comments/4-692/4-692.shtml>.

<sup>116</sup> See, e.g., Letter from Jillian Sidoti dated Jan. 25, 2016 available at <https://www.sec.gov/comments/4-692/4692-10.htm> (raising concerns about increasing the financial thresholds to “higher, and perhaps unbearable, thresholds”) (“Sidoti Letter”); Letter from Michael John Sewell dated Dec. 23, 2015 available at <https://www.sec.gov/comments/4-692/4692-2.htm> (“Sewell Letter”) (raising concerns about increasing the complexity of defining an accredited investor); and Letter from Robert Kent dated May 4, 2016 available at <https://www.sec.gov/comments/4-692/4692-1736913-151030.htm>.

<sup>110</sup> *Id.*

<sup>111</sup> *Id.*

<sup>112</sup> See Final Report of the 2016 SEC Government-Business Forum on Small Business Capital Formation (Mar. 2017) available at <https://www.sec.gov/info/smallbus/gbfor35.pdf> (“2016 Forum Report”); Final Report of the 2017 SEC Government-Business Forum on Small Business Capital Formation (Mar. 2018) available at <https://www.sec.gov/files/gbfor36.pdf> (“2017 Forum Report”); and 2018 Forum Report.

Of the staff's recommended changes, commenters were overwhelmingly supportive of the creation of additional methods of accreditation other than financial criteria.<sup>119</sup> Many commenters expressed that financial thresholds are

not effective in defining a population of sophisticated investors and that one or more of the alternative methods of accreditation may be more indicative of sophistication than income and net worth alone.<sup>120</sup> A few commenters

recommended investment limits<sup>121</sup> or an additional financial net worth qualification for these investors.<sup>122</sup>

Table 5 provides an overview of the feedback provided by commenters about each of the specific recommendations.

TABLE 5—RESPONSES TO STAFF RECOMMENDATIONS ON THE ACCREDITED INVESTOR DEFINITION

Staff recommendation	Responses from commenters
Leave the current income and net worth thresholds in place, subject to investment limits.	—A few commenters generally supported the recommendation; <sup>123</sup> —Several commenters supported leaving the current income and net worth thresholds in place; <sup>124</sup> —Several commenters were either opposed to, or raised concerns about, adding investment limits to investors that met these thresholds; <sup>125</sup> and —One commenter was opposed both to leaving the current income and net worth threshold in place and to adding investment limits on those investors. <sup>126</sup> A few commenters stated that the structure would add costs and complexity to the capital-raising process. <sup>127</sup>
Add new inflation-adjusted income and net worth thresholds that are not subject to investment limits.	Some commenters supported the recommendation, <sup>128</sup> and some opposed raising the income and net worth thresholds. <sup>129</sup> While one commenter stated that there should be some sophistication qualification, in addition to the net worth or income thresholds, <sup>130</sup> another commenter stated that this qualification should remain independent from any investment limits or qualitative restrictions. <sup>131</sup>
Permit individuals with a minimum amount of investments to qualify as accredited investors.	A few commenters supported this recommendation, <sup>132</sup> and no commenters specifically opposed this recommendation.
Permit individuals with certain professional credentials to qualify as accredited investors.	All of the commenters who expressed a view about this recommendation generally supported this recommendation. <sup>133</sup> Some of these commenters, however, supported the recommendation with the following limitations and conditions: —Some commenters believed that a minimum amount of professional experience should also be a part of this qualification. <sup>134</sup> —One commenter believed that the professional experience should be with early stage financing. <sup>135</sup> —One commenter supported investment limits for these investors. <sup>136</sup>
Permit individuals with experience investing in exempt offerings to qualify as accredited investors.	Several commenters stated that qualifying credentials should include one or more of the following: Passing the Series 7, Series 65, Series 66, or Series 82 examinations, being a certified public accountant (CPA), certified financial analyst (CFA), certified management accountant (CMA), registered investment advisor (RIA) or registered representative (RR), having an MBA from an accredited educational institution or having a certified investment management analyst (CIMA) certification, or having been in the securities industry as a broker, lawyer, or accountant. <sup>137</sup> Other commenters had more general views on the sophistication necessary to qualify an investor as accredited. <sup>138</sup>
Permit knowledgeable employees <sup>141</sup> of private funds to qualify as accredited investors for investments in their employer's funds.	Most of the commenters who expressed a view about this recommendation supported the recommendation, <sup>139</sup> while one commenter opposed it. <sup>140</sup> Several commenters supported the recommendation, <sup>142</sup> while one commenter opposed it. <sup>143</sup>
Index all financial thresholds in the definition for inflation on a going-forward basis.	A few commenters stated that the recommendation is unlikely to have any significant impact. <sup>144</sup>
Permit spousal equivalents to pool their finances for the purpose of qualifying as accredited investors.	Most of the commenters who expressed a view about this recommendation supported the recommendation, <sup>145</sup> while a few commenters opposed it. <sup>146</sup>
Permit all entities with investments in excess of \$5 million to qualify as accredited investors.	Responses were mixed, with a few commenters that generally supported the recommendation <sup>147</sup> and one commenter that opposed it. <sup>148</sup> Responses were mixed, with a few commenters that supported the recommendation <sup>149</sup> and a few commenters that opposed it. <sup>150</sup>

<sup>119</sup> See, e.g., Letter from Consumer Federation of America and Americans for Financial Reform dated Apr. 27, 2016 available at <https://www.sec.gov/comments/4-692/4692-26.pdf> ("CFA/AFR Letter"); Letter from Crowdfund Intermediary Regulatory Advocates dated Jan. 14, 2016 available at <https://www.sec.gov/comments/4-692/4692-6.pdf> ("CFIRA Letter"); Letter from Biotechnology Innovation Organization dated Apr. 8, 2016 available at <https://www.sec.gov/comments/4-692/4692-21.pdf> ("BIO Letter"); Letter from National Small Business Association dated Mar. 29, 2016 available at <https://www.sec.gov/comments/4-692/4692-18.pdf> ("NSBA Letter"); Letter from North American Securities Administrators Association, Inc. ("NASAA") dated May 25, 2016 available at <https://www.sec.gov/comments/4-692/4692-34.pdf> ("NASAA Letter"); Letter from Engine dated Mar. 14, 2016 available at <https://www.sec.gov/comments/4-692/4692-17.pdf> ("ENGINE Letter"); Letter from Investment Management Consultants Association dated Mar. 29, 2016 available at <https://www.sec.gov/comments/4-692/4692-19.pdf> ("IMCA Letter"); Letter from Dar'shun Kendrick, Kendrick Law Practice dated May 1, 2016 available at [https://www.sec.gov/comments/4-692/4692-](https://www.sec.gov/comments/4-692/4692-29.htm)

[29.htm](https://www.sec.gov/comments/4-692/4692-22.htm) ("Kendrick Letter"); Letter from Anonymous Investment Banker dated Apr. 13, 2016 available at <https://www.sec.gov/comments/4-692/4692-22.htm> ("Banker Letter"); Letter from Keith J. Johnson, JD dated Mar. 6, 2016 available at <https://www.sec.gov/comments/4-692/4692-16.pdf> ("Johnson Letter"); Letter from Cornell Securities Law Clinic dated Apr. 30, 2016 available at <https://www.sec.gov/comments/4-692/4692-28.pdf> ("Cornell Law Clinic Letter"); Letter from the Small Business Investor Alliance dated Mar. 7, 2016 available at <https://www.sec.gov/comments/4-692/4692-15.pdf> ("SBA Letter"); PSC Letter; Letter from Leonard A. Grover, Founder/CEO, FinToolbox/ Screener.co dated Jun. 13, 2016 available at <https://www.sec.gov/comments/4-692/4692-35.pdf> ("Grover Letter"); Letter from Investment Adviser Association dated Jun. 29, 2016 available at <https://www.sec.gov/comments/4-692/4692-38.pdf> ("IAA Letter"); Anon 2 Letter; Letter from Tom C.W. Lin, Associate Professor of Law, Temple University Beasley School of Law dated Jul. 14, 2016 available at <https://www.sec.gov/comments/4-692/4692-40.pdf> ("Lin Letter"); Escudero Letter; Letter from Jeff Carlsen, CPA dated Jan. 17, 2017 available at [\[1497754-130754.htm\]\(https://www.sec.gov/comments/4-692/4692-1497754.htm\) \("Carlsen Letter"\); Letter from Kyle Beagle dated Jan. 13, 2016 available at <https://www.sec.gov/comments/4-692/4692-4.htm> \("Beagle Letter"\); Letter from Ava Badiee dated May 10, 2016 available at <https://www.sec.gov/comments/4-692/4692-31.pdf> \("Badiee Letter"\); Letter from Chase R. Morello, Esq. dated Jan. 13, 2016 available at <https://www.sec.gov/comments/4-692/4692-5.pdf> \("Morello Letter"\); Mark R. Maisonneuve, CFA dated Apr. 26, 2017 available at <https://www.sec.gov/comments/4-692/4692-1722772-150627.htm> \("Maisonneuve Letter"\); TAN2000 Letter; Letter from Managed Funds Association dated Jun. 16, 2016 available at <https://www.sec.gov/comments/4-692/4692-37.pdf> \("MFA-1 Letter"\); and Letter from Managed Funds Association dated May 18, 2017 available at <https://www.sec.gov/comments/s7-07-16/s70716-1761663-152156.pdf> \("MFA-2 Letter"\).](https://www.sec.gov/comments/4-692/4692-</a></p>
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<sup>120</sup> See, e.g., CFA/AFR Letter; CFIRA Letter; Banker Letter; Cornell Law Clinic Letter; Grover Letter; Anon 2 Letter; Carlsen Letter; and Maisonneuve Letter.

<sup>121</sup> See, e.g., Badiee Letter.

<sup>122</sup> See, e.g., NASAA Letter.



TABLE 5—RESPONSES TO STAFF RECOMMENDATIONS ON THE ACCREDITED INVESTOR DEFINITION—Continued

Staff recommendation	Responses from commenters
Permit an issuer's investors that meet and continue to meet the current accredited investor definition to be grandfathered with respect to future offerings of the issuer's securities.	Most of the commenters who expressed a view about this recommendation supported the recommendation, <sup>151</sup> while one commenter opposed it. <sup>152</sup>
Permit individuals who pass an accredited investor examination to qualify as accredited investors.	Most of the commenters who expressed a view about this recommendation supported the recommendation. <sup>153</sup> A few of these commenters, however, noted workability concerns, administration costs and the inability of a test to properly measure financial sophistication and account for industry and investment experience. <sup>154</sup> One commenter stated that a more thorough analysis of the level of financial sophistication required was needed. <sup>155</sup>

### In addition, multiple commenters recommended changes to the accredited

<sup>123</sup> See, e.g., CFA/AFR Letter; NASAA Letter; and Johnson Letter.

<sup>124</sup> See, e.g., SBIA Letter; CFIRA Letter; ENGINE Letter (“Any increase in the financial thresholds should be justified based on the goals of the definition, and there is no evidence that the current definition is failing to adequately protect investors.”); and BIO Letter (“Completely removing a substantial portion of current investors from the accredited pool could have an immediate, drastic, and potentially devastating impact on capital availability for emerging companies.”).

<sup>125</sup> See, e.g., NSBA Letter (“Creating a middle-ground or a lower tier will only increase the regulatory burdens and make it more difficult for small businesses to comply with the regulations”); SBIA Letter (stating that the recommendations relating to restricting the pool of accredited investors would “significantly harm the pool of available capital for small business investment”); CFIRA Letter (raising concerns that the recommendation would shrink the pool of available capital for small business investments); ENGINE Letter (stating that adding investment limitations on the pool of existing accredited investors would “effectively create a second tier of accredited investor, diminishing the total pool of capital available to startups”); and BIO Letter (raising concerns about investment limitations, including that such limitations would “entirely foreclose participation by conditional accredited investors in certain offerings”).

<sup>126</sup> See, e.g., Cornell Law Clinic Letter (stating that the Commission should focus on “overhauling the current threshold, rather than simply mitigating it with investment limitations”).

<sup>127</sup> See, e.g., NSBA Letter (stating that obtaining information about prior investments to assess the investment limit would be “difficult information for small business or even the broker to obtain, and needlessly complicates the process”); Cornell Law Clinic Letter (“Adding investment limitations may not only fail to address issues of capital formation and identifying sophisticated investors, but also add administrative costs and complexity that may then restrict otherwise qualified investors.”); and BIO Letter.

<sup>128</sup> See, e.g., Letter from Public Investors Arbitration Bar Association dated May 17, 2016 available at <https://www.sec.gov/comments/4-692/4692-33.pdf> (“PIABA Letter”) (“the current accredited investor standard, in creating a comparatively large pool of investors qualified to be offered Reg. D securities, makes it a particularly attractive tool to promote fraudulent schemes”); NASAA Letter; Badiie Letter; Johnson Letter; Cornell Law Clinic Letter (“[T]he Clinic supports inflation adjustments because it would more accurately qualify financially sophisticated investors than the current income and net asset thresholds.”); MFA–1 Letter; and MFA–2 Letter (stating that the adjustments would “help to ensure that the thresholds have not been diluted over time”).

<sup>129</sup> See, e.g., NSBA Letter; ENGINE Letter (stating that there is no evidence that the current definition

has harmed individuals who would be excluded under an inflation adjusted threshold); SBIA Letter (stating that the recommendations relating to restricting the pool of accredited investors would “significantly harm the pool of available capital for small business investment”); TAN2000 Letter; Sidoti Letter (requesting that the Commission “consider smaller companies and investors prior to updating the parameters to higher, and perhaps unbearable, thresholds”); and BIO Letter.

<sup>130</sup> See, e.g., PIABA Letter (“Because of the speculative nature of private placements, it is important that investors have the financial means necessary to withstand the risks inherent in these securities.”).

<sup>131</sup> See, e.g., MFA–1 Letter and MFA–2 Letter (noting the importance of retaining the certainty that this bright line rule provides for issuers).

<sup>132</sup> See, e.g., CFA/AFR Letter (“We agree with the staff study that, ‘Investments may in some cases be a more meaningful measure of individuals’ experience with and exposure to the financial and investing markets than income or net worth.’”); and Cornell Law Clinic Letter (“Allowing individuals to qualify as accredited investors through a minimum amount of investments aligns with the Commission’s goal to determine which individuals are exempt from public securities law requirements due to financial sophistication.”).

<sup>133</sup> See, e.g., CFA/AFR Letter; Kendrick Letter; NSBA Letter; NASAA Letter; Beagle Letter; Badiie Letter; Morello Letter; Johnson Letter; Cornell Law Clinic Letter; IMCA Letter; Banker Letter; Grover Letter; TAN2000 Letter; Carlsen Letter; MFA–1 Letter; MFA–2 Letter; Maisonnette Letter; and CFIRA Letter.

<sup>134</sup> See, e.g., Kendrick Letter; Cornell Law Clinic Letter; NASAA Letter; and TAN2000 Letter.

<sup>135</sup> See, e.g., TAN2000 Letter.

<sup>136</sup> See, e.g., Beagle Letter.

<sup>137</sup> See, e.g., CFA/AFR Letter (“... the Series 7, Series 65, and Series 82 examinations likely ‘provide demonstrable evidence of relevant investor sophistication because of the subject matter their examinations cover.’”); NASAA Letter (recommending qualifying credentials to include passing the Series 7, Series 65, or Series 66, provided that there is also a requisite minimum amount of professional experience); MFA–1 Letter and MFA–2 Letter (recommending qualifying credentials would include being a CPA or CFA or having a MBA from an accredited educational institution); Maisonnette Letter (recommending qualifying credentials would include being a CFA); IMCA Letter (recommending qualifying credentials would include having a CIMA certification); CFIRA Letter (recommending qualifying credentials would include being a CPA, CFA, CMA, RIA, RR or securities attorney); and Kendrick Letter (recommending qualifying credentials would include having been in the securities industry as a broker, lawyer or accountant).

<sup>138</sup> See, e.g., NSBA Letter (“... if someone is sophisticated enough to advise others on investing in these types of offerings, for example, they should themselves be qualified to invest in them”); Cornell Law Clinic Letter (credentials required should be substantially high to cause financial sophistication

to make up for the loss in ability to sustain financial losses); Grover Letter (experts in industries historically passed over by angel investors should be allowed to qualify as accredited investors); and Carlsen Letter (individuals with business related college degrees).

<sup>139</sup> See, e.g., CFA/AFR Letter (“a better measurement of relevant expertise than mere investment experience”); NSBA Letter (“[this recommendation addresses] those who previously qualified as an accredited investor . . . however subsequently failed to qualify as an accredited investor”); Beagle Letter (stating that the recommendation should limit the amount individuals who qualify under it can invest); Johnson Letter (“the exact individuals that should be accredited investors”); and Cornell Law Clinic Letter (“[the] quintessential sign of sophistication is experience in the field”).

<sup>140</sup> See, e.g., NASAA Letter (noting that such investors were already likely to qualify as accredited and it would be “difficult to objectively assess that an individual’s experience investing in an exempt offering has given rise to financial sophistication”).

<sup>141</sup> The staff recommendation stated that the Commission could use the definition of the term knowledgeable employee in 17 CFR 270.3c–5 (“Rule 3c–5”) under the Investment Company Act (“knowledgeable employee”).

<sup>142</sup> See, e.g., CFA/AFR Letter (“... such individuals ‘likely have significant investing experience and sufficient access to the information necessary to make informed decisions about investments in their employer’s funds’”); NSBA Letter; Cornell Law Clinic Letter (“Knowledgeable employees of private funds are likely some of the highest levels of financial sophistication among potential investors.”); MFA–1 Letter; and MFA–2 Letter (“... such knowledgeable employees have meaningful investing experience and sufficient access to information necessary to make informed investment decisions about the private fund’s offerings. In addition, investments by knowledgeable employees are beneficial for private fund investors in that they further align investor interests of adviser employees and fund investors.”).

<sup>143</sup> See, e.g., NASAA Letter (“Such an approach could raise suitability issues, may be difficult to verify, and ultimately has a negligible impact in improving capital formation efforts.”).

<sup>144</sup> See, e.g., CFA/AFR Letter; and NASAA Letter.

<sup>145</sup> See, e.g., PIABA Letter; CFA/AFR Letter (stating that periodic adjustments would help avoid the type of shock to the system that the current recommendations are likely to have); NASAA Letter; Johnson Letter; Cornell Law Clinic Letter (stating that indexing financial thresholds for inflation would “keep these financial thresholds current with the market and thus more accurately qualify financially sophisticated investors”); MFA–1 Letter; and MFA–2 Letter.

<sup>146</sup> See, e.g., ENGINE Letter (stating that there is not enough evidence that such adjustments are necessary to protect investors); and SBIA Letter (stating that the recommendations relating to restricting the pool of accredited investors would

“significantly harm the pool of available capital for small business investment”); *see also* NSBA Letter (“Indexing the thresholds levels for the accredited investor definition may complicate compliance as the thresholds will change”).

<sup>147</sup> *See, e.g.*, CFA/AFR Letter (stating that this recommended change “helps to bring the securities laws up to date with modern values and expectations”); NSBA Letter (noting that this recommended change would “expand opportunities to invest in small businesses to more households”); and SBIA Letter.

<sup>148</sup> *See, e.g.*, Cornell Law Clinic Letter (“... the Commission does not provide a clear rationale behind why civil unions and domestic partnerships should be given equal regulatory treatments as marriages other than that such treatment would provide consistency across Commission rules such as the family office rule, accountant independence standards, and crowdfunding rules”).

<sup>149</sup> *See, e.g.*, SBIA Letter; NSBA Letter (stating that this recommendation recognizes that “those with such significant assets invested are both very likely to be sophisticated enough to protect themselves from the risks of the investment and also secure enough to withstand the potential loss of a particular investment”); and NASAA Letter (“An investments test is a better gauge of financial sophistication than simply analyzing net worth or income.”). *See also* SBIA Letter (“However a \$5 million threshold is very high and will severely limit investment by 529 Plans and other similar plans.”).

<sup>150</sup> *See, e.g.*, Beagle Letter (stating that an asset-based test as well as the knowledge of the representatives making the investment should be used in determining an entity’s accredited investor status); Cornell Law Clinic Letter (stating that the amount of an entity’s investments is not a reliable indicator of financial sophistication) and Reardon Letter (stating that a change from “assets” to “investments” would be “ill-advised, and would exclude many prospective investors, particularly outside of large urban areas where the financial support of local companies is crucial to the local economy”).

<sup>151</sup> *See, e.g.*, BIO Letter; NSBA Letter (stating that this recommendation is “incredibly important to the small business community”); Johnson Letter; SBIA Letter; MFA-1 Letter and MFA-2 Letter (stating that to provide investors with the ability to prevent investment dilution, current investors who are no longer accredited investors should be able to purchase securities by the issuer or any wholly-owned subsidiaries of the issuer).

<sup>152</sup> *See, e.g.*, Cornell Law Clinic Letter (“The future offerings of the issuer’s securities may not necessarily have the same level of financial risk as the issuer’s former offerings. The investor may be exposed to greater financial risk and, therefore, should also meet the new accredited investor definition for future offerings, regardless of the issuer or existing investments.”).

<sup>153</sup> *See, e.g.*, SBIA Letter; CFIRA Letter (stating that investors who pass a standardized test covering the specificities of private placements should also be considered able to “fend for themselves,” having demonstrated their understanding of the risks involved in investment in these securities by passing the requisite examination); NSBA Letter (suggesting that the private sector be involved in the development and administration of the test); Beagle Letter (supporting the recommendation only if it was accompanied by limits on the amount an investor could invest in private offerings); Cornell Law Clinic Letter (“... having an accredited investor examination would increase the number of informed investors in the market because passing a rigorous test is a bright-line rule that shows an advanced level of financial sophistication and indicates that the investor is able to fend for themselves.”); IMCA Letter (stating that there should be continuing education requirements to

investor definition that were not contemplated in the staff recommendations. These recommendations were:

- Allow individuals to self-certify their status as accredited investors;<sup>154</sup>
- Allow otherwise non-accredited investors to retain professionals to advise them in order to qualify as accredited investors without limitation;<sup>157</sup>

- Allow any individual to invest in early growth issuers if such individual invests less than 10% of his or her income or is advised by sophisticated professionals;<sup>158</sup>

- Conduct a study of the United Kingdom’s approach to qualifying investors as sophisticated enough to take part in certain investments;<sup>159</sup>

- Harmonize the definitions of “qualified purchasers” in Section 2(a)(51) of the Investment Company Act<sup>160</sup> and “qualified client” under the Investment Advisors Act<sup>161</sup> to include accredited investors.<sup>162</sup> Another commenter suggested harmonizing the definition of “family” across the Securities Act, Investment Company Act, and the Investment Advisors Act to allow a family office and its family clients to be accredited investors for purposes of Regulation D and Sections 3(c)(1) and 3(c)(7) of the Investment Company Act;<sup>163</sup>

- Clarify that having a broker’s client meet the “accredited investor”

meet this criterion and suggesting that the private sector be involved in the development and administration of the test); NASAA Letter (suggesting that there also be a five year experience requirement); PSC Letter (suggesting an internet-based test); Grover Letter; Badiie Letter; and TAN2000 Letter (suggesting the test be reflective of knowledge of early stage financing).

<sup>154</sup> *See, e.g.*, NASAA Letter; and Badiie Letter.

<sup>155</sup> *See, e.g.*, CFA/AFR Letter.

<sup>156</sup> *See, e.g.*, NSBA Letter; Thompson Letter; and PSC Letter.

<sup>157</sup> *See, e.g.*, NSBA Letter; IMCA Letter; IAA Letter; and CFA/AFR Letter (conditioned on individuals acting as a professional having no personal financial stake in the issuer). *But see* Muth Letter (expressing concern whether investors would be sufficiently protected by relying on the guidance of outside advisors with respect to unusual or complex investments).

<sup>158</sup> *See, e.g.*, Morello Letter.

<sup>159</sup> *See, e.g.*, ENGINE Letter. *See also* Badiie Letter (describing the UK’s approach).

<sup>160</sup> *See* Section IV.A.2.b for a discussion of qualified purchasers.

<sup>161</sup> *See* Section IV.A.2.c for a discussion of qualified clients.

<sup>162</sup> *See, e.g.*, MFA-1 Letter and MFA-2 Letter (“These changes would simplify the existing mismatch in standards for private fund investors without raising investor protection concerns. In particular, these changes would maintain existing financial thresholds and continue to ensure that only sophisticated investors are able to invest in private funds.”). *See* Section IV.

<sup>163</sup> *See, e.g.*, Letter from Martin E. Lybecker, Perkins Coie LLP dated Aug. 8, 2016 available at <https://www.sec.gov/comments/4-692/4692-42.pdf>.

definition does not relieve a broker from its obligation to make only suitable recommendations;<sup>164</sup>

- Create an accredited investor designation for algorithmic investors;<sup>165</sup>
- Add a limit on the spousal pooling allowance;<sup>166</sup>

- Expand the accredited investor standard in Rule 501(a)(8) to include existing or newly formed entities in which: (a) The investment decisions are made exclusively by accredited investors; and (b) accredited investors have provided a supermajority of the capital to be invested (*e.g.*, 75–80%);<sup>167</sup> and

- Consider additional changes to address the geographic disparity in the number of accredited investors among the different regions of the country.<sup>168</sup>

One commenter also made a recommendation that the Commission develop an approach to third-party verification of accredited investor status that actively encourages the availability of such services while ensuring the independence and reliability of such providers.<sup>169</sup>

## 5. Request for Comment

For additional requests for comment related to the accredited investor definition as it applies to pooled investment funds, *see* Section IV.D.

20. Should we change the definition of accredited investor or retain the current definition? If we make changes to the definition, should the changes be consistent with any of the recommendations contained in the Accredited Investor Staff Report?<sup>170</sup> Have there been any relevant developments since the 2015 issuance of the Accredited Investor Staff Report, such as changes to the size or attributes of the pool of persons that may qualify as accredited investors; developments in the market or industry that may assist in potentially identifying new categories of individuals that may qualify as accredited investors;<sup>171</sup> or changes in the risk profile, incidence of fraud, or other investor protection concerns in offerings involving accredited investors that we should consider? How do those

<sup>164</sup> *See, e.g.*, PIABA Letter.

<sup>165</sup> *See, e.g.*, Lin Letter.

<sup>166</sup> *See, e.g.*, Cornell Law Clinic Letter.

<sup>167</sup> *See, e.g.*, Reardon Letter.

<sup>168</sup> *See, e.g.*, NSBA Letter.

<sup>169</sup> *See, e.g.*, CFA/AFR Letter.

<sup>170</sup> *See* discussion of the Accredited Investor Staff Report at Section II.A.3.

<sup>171</sup> *See, e.g.*, the revised qualifying exams administered by FINRA to become registered securities professionals, including a new introductory-level exam that precedes a qualification exam: <https://www.finra.org/industry/qualification-exams>.

changes affect investors, issuers, and other market participants?

21. Should we revise the financial thresholds requirements for natural persons to qualify as accredited investors and the list-based approach for entities to qualify as accredited investors? If so, should we consider any of the following approaches to address concerns about how the current definition identifies accredited investor natural persons and entities:

- Leave the current income and net worth thresholds in place, subject to investment limits;
- Create new, additional inflation-adjusted income and net worth thresholds that are not subject to investment limits;
- As recommended by the Advisory Committee on Small and Emerging Companies in 2016, index all financial thresholds for inflation on a going-forward basis;
- Permit spousal equivalents to pool their finances for purposes of qualifying as accredited investors;
- Revise the definition as it applies to entities with total assets in excess of \$5 million by replacing the \$5 million assets test with a \$5 million investments test and including all entities rather than specifically enumerated types of entities; and
- Grandfather issuers' existing investors that are accredited investors under the current definition with respect to future offerings of their securities.

22. As recommended by the Advisory Committee on Small and Emerging Companies in 2016, the 2016, 2017, and 2018 Small Business Forums, and the 2017 Treasury Report, should we revise the accredited investor definition to allow individuals to qualify as accredited investors based on other measures of sophistication? If so, should we consider any of the following approaches to identify individuals who could qualify as accredited investors based on criteria other than income and net worth:

- Permit individuals with a minimum amount of investments to qualify as accredited investors;
- Permit individuals with certain professional credentials to qualify as accredited investors;
- Permit individuals with experience investing in exempt offerings to qualify as accredited investors;
- Permit knowledgeable employees of private funds to qualify as accredited investors for investments in their employer's funds;
- Permit individuals who pass an accredited investor examination to qualify as accredited investors; and

• Permit individuals, after receiving disclosure about the risks, to opt into being accredited investors.

23. Under the current definition, a natural person just above the income or net worth thresholds would be able to invest without any limits, but a person just below the thresholds cannot invest at all as an accredited investor. Should we revise this aspect of the definition? If so, how?

24. What are the advantages and disadvantages to issuers and investors of changing—by either narrowing or expanding—the accredited investor definition?

25. Are there other changes to the definition that we should consider when harmonizing our exempt offering rules? For example, should we amend Rule 501(a)(3) to expand the types of entities that may qualify as accredited investors? If so, what types of entities should be included? Should we consider amendments to apply an investments-owned standard, or other alternative standard, for entities to qualify as accredited investors?

26. Many foreign jurisdictions provide exemptions from registration or disclosure requirements for offers and sales of securities to sophisticated or accredited investors.<sup>172</sup> These jurisdictions use a variety of methods to identify sophisticated or accredited investors. In addition to criteria based on income, net worth, total assets, or investment amounts, certain regulatory regimes rely on certification or verification by financial professionals. Are there experiences in other jurisdictions that should inform our approach?

27. Should we, as recommended by the 2017 Treasury Report, revise the accredited investor definition to expand the eligible pool of sophisticated investors? If so, should we permit an investor, whether a natural person or an entity, that is advised by a registered financial professional to be considered an accredited investor? Being advised by a financial professional has not historically been a complete substitute for the protections of the Securities Act registration requirements and, if applicable, the Investment Company Act. If we were to permit an investor advised by a registered financial professional to be considered an accredited investor, should we consider any other investor protections in these circumstances? For example, should we require educational or other qualifications for a financial professional advising such an investor

<sup>172</sup> See Section III.I. of the Accredited Investor Staff Report.

and, if so, what type of qualifications? What additional disclosure, if any, should the financial professional be required to provide to the investor in connection with an investment available only to accredited investors? Should the financial professional be required to assess the appropriateness of the investment in an exempt offering on a transaction-by-transaction basis, or would it be appropriate to make the assessment looking at the investor's investment portfolio as a whole?

28. If we were to permit an investor advised by a registered financial professional to be considered an accredited investor, should we specify or limit the types or amounts of investments that such an investor can make in exempt offerings? For example, should we allow investors that are not accredited investors under the current definition to invest in pooled investment funds, such as private funds under Section 3(c)(1) under the Investment Company Act,<sup>173</sup> if these investors are: (1) Subject to limits on the amounts of investments in such pooled investment funds, such as a dollar amount or percentage of investments; and/or (2) limited to making the investment out of retirement or other similarly federally-regulated accounts (*i.e.*, accounts that are more likely to be invested for the long term)? Would such a change substantially eliminate current distinctions between registered funds and private funds? Are there provisions of the Investment Company Act that should apply to such funds, such as diversification requirements, redemption requirements, and/or restrictions on leverage and affiliated transactions? Are there different disclosures that such funds should have to provide investors? Should the type of private fund be limited to a qualifying venture capital fund or otherwise have a limit on the fund's size?<sup>174</sup> Should there be restrictions or requirements on the class or classes of interests in such funds available to investors advised by a registered financial professional? Should there be any restrictions or requirements regarding fees and expenses for such investors relative to the fees and expenses for other investors in the fund? What other conditions or limitations are appropriate, if any?

29. If an investment limit is implemented for investors considered to be accredited investors because they are advised by registered financial professionals, what should we take into

<sup>173</sup> 15 U.S.C. 80a-3(c)(1). See Section IV.A.2 for a discussion of Section 3(c)(1) funds.

<sup>174</sup> See Section IV.A.2.a for a discussion of qualifying venture capital funds.

consideration in setting the amount of the limit? Should the limit vary depending on the particular exemption relied on for the offering or be consistent for all exempt offerings? Should the limit vary depending on the type of issuer conducting the exempt offering (e.g., whether the issuer is an operating company or a pooled investment fund, whether the issuer has a class of securities registered under the Exchange Act, or whether the issuer is subject to any on-going disclosure requirements)? Would varying limits increase complexity for issuers and investors? Should the limit be applied on a per-offering basis or some other basis? Should the limit be determined on an aggregate basis for all securities purchased in exempt offerings over the course of a year or some other time period?

30. If we were to expand the definition of an accredited investor and/or limit the types or amounts of investments by accredited investors in exempt offerings, what challenges would exist in the application and enforcement of the revised criteria?

31. Are there other regulatory regimes, such as ERISA, that may affect the ability of certain classes of investors to invest in exempt offerings?

32. Under Rule 12g-1, to calculate the number of holders of record that were not accredited investors as of the last day of its most recent fiscal year, an issuer needs to determine, based on facts and circumstances, whether prior information provides a basis for a reasonable belief that the security holder continues to be an accredited investor as of the last day of the fiscal year. If such prior information does not provide a reasonable basis, is it difficult for an issuer to calculate the number of holders of record that were not accredited investors as of the last day of its most recent fiscal year pursuant to Rule 12g-1? If so, should we consider changes to Rule 12g-1? For example, should we revise Rule 12g-1 to permit issuers to determine accredited investor status at the time of the last sale of securities to the respective purchaser, rather than the last day of its most recent fiscal year? Would such a change raise concerns about the use of outdated information that may no longer be reliable?<sup>175</sup>

<sup>175</sup> See Changes to Exchange Act Registration Requirements Release at Section II.B.

### B. Private Placement Exemption and Rule 506 of Regulation D

#### 1. Section 4(a)(2) of the Securities Act

Section 4(a)(2)<sup>176</sup> of the Securities Act exempts from registration requirements “transactions by an issuer not involving any public offering.” The Securities Act does not define the phrase “transactions by an issuer not involving any public offering.” Accordingly, it has been left to court decisions and Commission interpretations to define the scope of the exemption.

##### a. Scope of Exemption

In *SEC v. Ralston Purina Co.*,<sup>177</sup> the Supreme Court established the basic criteria for determining the availability of Section 4(a)(2).<sup>178</sup> To qualify for this exemption, which is sometimes referred to as the “private placement” exemption, the persons in the offering must:

- Be shown to be able to fend for themselves and, accordingly, do not need the protection afforded by the Securities Act;<sup>179</sup> and
- Have access to the type of information normally provided in a prospectus for a registered securities offering.<sup>180</sup>

The precise limits of the statutory private placement exemption are not defined by rule. Whether a transaction is one not involving any public offering is essentially a question of fact and necessitates a consideration of all surrounding circumstances, including such factors as the relationship between the offerees and the issuer, and the nature, scope, size, type, and manner of the offering.<sup>181</sup> If an issuer offers

<sup>176</sup> 15 U.S.C. 77d(a)(2).

<sup>177</sup> 346 U.S. 119 (1953).

<sup>178</sup> See Section IV.A.2 for a discussion of restrictions under Sections 3(c)(1) and 3(c)(7) of the Investment Company Act on certain funds’ ability to make a public offering of its securities.

<sup>179</sup> See *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953) (“The focus of inquiry should be on the need of the offerees for the protections afforded by registration. The employees here were not shown to have access to the kind of information which registration would disclose. The obvious opportunities for pressure and imposition make it advisable that they be entitled to compliance with § 5.”).

<sup>180</sup> See *id.*

<sup>181</sup> See Non-Public Offering Exemption, Release No. 33-4552 (Nov. 6, 1962) [27 FR 11316 (Nov. 16, 1962)] (“Non-Public Offering Exemption Release”). Section 4(a)(2) was traditionally viewed as a way to provide “an exemption from registration for bank loans, private placements of securities with institutions, and the promotion of a business venture by a few closely related persons.” In 1962, prompted by increased use of the exemption for speculative offerings to unrelated and uninformed persons, the Commission clarified limitations on the exemption’s availability. See Non-Public Offering Exemption Release.

securities to even one person who does not meet the necessary conditions, the exemption may be in violation of the Securities Act. An issuer relying on Section 4(a)(2) is restricted in its ability to make public communications to attract investors to its offering because public advertising is incompatible with a claim of exemption under Section 4(a)(2).<sup>182</sup> Section 4(a)(2) does not specify limits on the amount that an issuer can raise or the amount an investor can invest in an offering.

##### b. Issuance of Restricted Securities

Purchasers in a Section 4(a)(2) offering receive “restricted securities.”<sup>183</sup> “Restricted securities” are securities that were issued in certain exempt transactions. Rule 144(a)(3) identifies the types of offerings that result in the acquisition of restricted securities. Security holders can only resell restricted securities into the market by registering the resale transaction or relying on a valid exemption from registration for the resale, such as Section 4(a)(1), available to “transactions by any person other than an issuer, underwriter, or dealer.” For the resale of restricted securities, most holders rely on Rule 144, which provides a safe harbor from being considered an “underwriter” under, and therefore ineligible to rely on the exemption from registration in, Section 4(a)(1).<sup>184</sup>

##### c. Filing Requirements and Relationship With State Securities Laws

An issuer conducting an offering pursuant to Section 4(a)(2) is not required to file any information with, or pay any fees to, the Commission. Such issuer, however, must comply with state securities laws and regulations in each state in which securities are offered or sold, also known as “blue sky” laws.

<sup>182</sup> See Non-Public Offering Exemption Release.

<sup>183</sup> See 17 CFR 230.144(a)(3)(i). See also Rule 144 Adopting Release (“Rule 144, together with the other related rules and amendments, is designed to provide full and fair disclosure of the character of securities sold in trading transactions and to create greater certainty and predictability in the application of the registration provisions of the [Securities] Act by replacing subjective standards with more objective ones.”).

<sup>184</sup> For a discussion of Rule 144 and other resale exemptions, see Section V.A. See also Rule 144 Adopting Release (“persons who offer or sell restricted securities without complying with Rule 144 are hereby put on notice by the Commission that in view of the broad remedial purposes of the [Securities] Act and of public policy which strongly supports registration, they will have a substantial burden of proof in establishing that an exemption from registration is available for such offers or sales and that such persons and the brokers and other persons who participate in the transactions do so at their risk”).

Each state's securities laws or regulations have their own registration or qualification requirements and exemptions from such requirements.

## 2. Rule 506 of Regulation D

Regulation D originated as an effort to facilitate capital formation, consistent with the protection of investors.<sup>185</sup> It simplified and clarified existing rules and regulations, eliminated unnecessary restrictions those rules and regulations placed on issuers, particularly small businesses, and harmonized federal and state exemptions.<sup>186</sup>

The Commission adopted Rule 506 of Regulation D as a non-exclusive "safe harbor" under Section 4(a)(2), providing objective standards on which an issuer could rely to meet the requirements of the Section 4(a)(2) exemption.<sup>187</sup> In 2012, Section 201(a) of the JOBS Act required the Commission to eliminate the prohibition on using general solicitation under Rule 506 where all purchasers of the securities are accredited investors and the issuer takes reasonable steps to verify that the purchasers are accredited investors.<sup>188</sup> To implement Section 201(a), the Commission adopted paragraph (c) of Rule 506, and retained the prior Rule 506 safe harbor as Rule 506(b).<sup>189</sup> Offerings under both Rule 506(b) and Rule 506(c) must satisfy the conditions of:

- 17 CFR 230.501 ("Rule 501") (definitions for the terms used in Regulation D);
- 17 CFR 230.502(a) ("Rule 502(a)") (integration);<sup>190</sup>
- 17 CFR 230.502(d) ("Rule 502(d)") (limitations on resale); and

<sup>185</sup> See Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales, Release No. 33-6389 (Mar. 8, 1982) [47 FR 11251 (Mar. 16, 1982)] (the "Regulation D Adopting Release").

<sup>186</sup> See *id.*

<sup>187</sup> See Regulation D Adopting Release. Rule 506 of Regulation D replaced former 17 CFR 230.146. Attempted compliance with any rule in Regulation D does not preclude an issuer from claiming the availability of another applicable exemption. For example, an issuer's failure to satisfy all the terms and conditions of Rule 506(b) does not raise a presumption that the exemption provided by Section 4(a)(2) is not available. See 17 CFR 230.500(c) ("Rule 500(c)").

<sup>188</sup> Public Law 112-106, sec. 201(a), 126 Stat. 306, 313 (Apr. 5, 2012).

<sup>189</sup> See Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Release No. 33-9415 (Jul. 10, 2013) [78 FR 44771 (Jul. 24, 2013)] ("Rule 506(c) Adopting Release"). Note that as a result of Congress' directive in Section 201(a) of the JOBS Act, Rule 506 continues to be treated as a regulation issued under Section 4(a)(2) of the Securities Act, notwithstanding the ability of an issuer to make public communications to solicit investors for its offering under Rule 506(c).

<sup>190</sup> See Section III.

- Rule 506(d) ("bad actor" disqualification).

Offerings under Rule 506(b) must also satisfy the conditions of:

- 17 CFR 230.502(b) ("Rule 502(b)") (type of information to be furnished);<sup>191</sup> and
- 17 CFR 230.502(c) ("Rule 502(c)") (limitations on the manner of offering).<sup>192</sup>

In addition, Rule 503, which requires the filing of a notice of sales on Form D, applies to all Rule 506 offerings. We summarize below first the terms and conditions specific to each of Rule 506(b) and Rule 506(c) offerings, and then the rule requirements that apply to all Rule 506 offerings.

### a. Rule 506(b) Safe Harbor

Issuers conducting an offering under Rule 506(b) can sell securities to an unlimited number of accredited investors with no limit on the amount of money that can be raised from each investor or in total. An offering under Rule 506(b), however, is subject to the following requirements:

- No general solicitation or advertising to market the securities<sup>193</sup> is permitted; and
- Securities may not be sold to more than 35 non-accredited investors that, either alone or with a purchaser representative, must have sufficient knowledge and experience in financial and business matters to be capable of evaluating the merits and risks of the prospective investment.<sup>194</sup>

### (1) Prohibition on General Solicitation and General Advertising

As discussed above, public or general advertising of the offering and general solicitation of investors are incompatible with the private placement exemption. Although the terms "general solicitation" and "general advertising" are not defined in Regulation D, Rule 502(c) does provide examples of general solicitation and general advertising, including advertisements published in newspapers and magazines, communications broadcast over television and radio, and seminars where attendees have been invited by general solicitation or general advertising.<sup>195</sup> The Commission has stated that other uses of publicly available media, such as unrestricted websites, also constitute general

solicitation and general advertising.<sup>196</sup> In determining whether an advertisement or other communication would constitute a general solicitation of securities, the Commission has historically interpreted the term "offer" broadly, and has explained that "the publication of information and publicity efforts, made in advance of a proposed financing which have the effect of conditioning the public mind or arousing public interest in the issuer or in its securities constitutes an offer."<sup>197</sup> In this release, we refer to both general solicitation and general advertising as they relate to an "offer" of securities as "general solicitation."

### (2) Disclosure Requirements for Non-Accredited Investors

If non-accredited investors are participating in an offering under Rule 506(b), the issuer conducting the offering must furnish to non-accredited investors the information required by Rule 502(b)<sup>198</sup> a reasonable time prior to the sale of securities and provide non-accredited investors with the opportunity to ask questions and receive answers about the offering.<sup>199</sup> Further, if the issuer provides additional information to accredited investors, it must make this information available to the non-accredited investors as well.<sup>200</sup> If an issuer limits purchasers in its Rule 506(b) offering to accredited investors, Rule 506(b) does not require the issuer to provide substantive disclosure to those accredited investors. Nevertheless, issuers and funds conducting private accredited investor-only offerings often provide prospective purchasers with information about the issuer. An issuer that provides information to non-accredited investors may choose to provide the information to accredited investors as well, in view of the antifraud provisions of the federal securities laws.<sup>201</sup>

<sup>196</sup> See Use of Electronic Media for Delivery Purposes, Release No. 33-7233 (Oct. 6, 1995) [60 FR 53458, 53463-64 (Oct. 13, 1995)]; Use of Electronic Media, Release No. 33-7856 (Apr. 28, 2000) [65 FR 25843, 25851-52 (May 4, 2000)].

<sup>197</sup> Securities Offering Reform, Release No. 33-8591 (July 19, 2005) [70 FR 44722 (Aug. 3, 2005)] ("Securities Offering Reform Release") at note 88 ("The term 'offer' has been interpreted broadly and goes beyond the common law concept of an offer.") (citing *Diskin v. Lomasney & Co.*, 452 F.2d 871 (2d. Cir. 1971); *SEC v. Cavanaugh*, 1 F. Supp. 2d 337 (S.D.N.Y. 1998)). See also Securities Act Section 2(a)(3) (noting that an offer includes every attempt to dispose of a security or interest in a security, for value; or any solicitation of an offer to buy a security or interest in a security).

<sup>198</sup> See 17 CFR 230.502(b)(2)(i) through (vii).

<sup>199</sup> See 17 CFR 230.502(b)(2)(v).

<sup>200</sup> See 17 CFR 230.502(b)(2)(iv).

<sup>201</sup> See Note to 17 CFR 230.502(b).

<sup>191</sup> See Section II.B.2.a(2).

<sup>192</sup> See Section II.B.2.a(1).

<sup>193</sup> See 17 CFR 230.502(c).

<sup>194</sup> See 17 CFR 230.506(b). See also Section II.A.

<sup>195</sup> See 17 CFR 230.502(c).

The type of information to be furnished to non-accredited investors varies depending on the size of the offering and the nature of the issuer; however, the disclosure generally contains the same type of information as provided in a Regulation A offering or in a registered offering, including financial statement information, certain portions of which are required to be audited or certified.<sup>202</sup>

Specifically, if the issuer is not subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act, the issuer must furnish certain non-financial statement information and financial statement information. The issuer is required to provide this information only to the extent it is material to an understanding of the issuer, its business, and the securities being offered.<sup>203</sup> Regarding non-financial statement information, the issuer must provide the information required by Part II of Form 1-A<sup>204</sup> (if the issuer is eligible to use Regulation A<sup>205</sup>) or Part I of a Securities Act registration statement on a form that the issuer would be entitled to use (if the issuer is not eligible to use Regulation A).<sup>206</sup> The required financial statement information for issuers not subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act varies depending on the size of the offering.<sup>207</sup> The issuer must furnish the following information to the extent material to an understanding of the issuer, its business, and the securities being offered:

- For offerings up to \$2 million, the information required in Article 8 of Regulation S-X,<sup>208</sup> except that only the issuer's balance sheet, which shall be dated within 120 days of the start of the offering, must be audited;<sup>209</sup>
- For offerings up to \$7.5 million, the financial statement information required in Form S-1<sup>210</sup> for smaller reporting companies. If an issuer, other than a limited partnership,<sup>211</sup> cannot obtain audited financial statements without

unreasonable effort or expense, then only the issuer's balance sheet, which shall be dated within 120 days of the start of the offering, must be audited;<sup>212</sup> or

- For offerings over \$7.5 million, the financial statement information as would be required in a registration statement filed under the Securities Act on the form that the issuer would be entitled to use. If an issuer, other than a limited partnership,<sup>213</sup> cannot obtain audited financial statements without unreasonable effort or expense, then only the issuer's balance sheet, which shall be dated within 120 days of the start of the offering, must be audited.<sup>214</sup>

If the issuer is not subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act and is a foreign private issuer<sup>215</sup> eligible to use Form 20-F,<sup>216</sup> it must disclose the same kind of information required to be included in an Exchange Act registration statement on a form that the issuer would be entitled to use.<sup>217</sup> The financial statements need to be certified only to the extent that such information would be required to be audited under Rule 502(b) for issuers not subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act.<sup>218</sup>

On the other hand, if the issuer is subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act, at a reasonable time prior to the sale of securities the issuer must furnish to investors either:

- Its annual report to shareholders for the most recent fiscal year<sup>219</sup> and the definitive proxy statement filed in connection with that annual report;<sup>220</sup> or

<sup>212</sup> 17 CFR 230.502(b)(2)(i)(B)(2).

<sup>213</sup> See note 211.

<sup>214</sup> 17 CFR 230.502(b)(2)(i)(B)(3).

<sup>215</sup> A foreign issuer, other than a foreign government, will qualify as a "foreign private issuer" if 50% or less of its outstanding voting securities are held by U.S. residents; or if more than 50% of its outstanding voting securities are held by U.S. residents and none of the following three circumstances applies: The majority of its executive officers or directors are U.S. citizens or residents; more than 50% of the issuer's assets are located in the United States; or the issuer's business is administered principally in the United States. See 17 CFR 240.12b-2; 17 CFR 230.405.

<sup>216</sup> 17 CFR 249.220f.

<sup>217</sup> 17 CFR 230.502(b)(2)(i)(C).

<sup>218</sup> See 17 CFR 230.502(b)(2)(i)(C). The audited financial statement requirements for issuers not subject to the reporting requirements of section 13 or 15(d) of the Exchange Act are contained in 17 CFR 230.502(b)(2)(i)(B) and discussed in the immediately preceding paragraph.

<sup>219</sup> The annual report must meet the requirements of Rules 14a-3 or 14c-3 under the Exchange Act (17 CFR 240.14a-3 or 17 CFR 240.14c-3).

<sup>220</sup> See 17 CFR 230.502(b)(2)(ii)(A). If requested by the purchaser in writing, the issuer must also provide a copy of the issuer's most recent Form 10-K (17 CFR 249.310) under the Exchange Act.

• The most recently filed of the following:

- Annual report on Form 10-K;<sup>221</sup>
- Registration statement on Form S-1;<sup>222</sup>
- Registration statement on Form S-11;<sup>223</sup> or
- Registration statement on Form 10.<sup>224</sup>

In addition, the issuer must provide any reports or documents required to be filed by the issuer under Sections 13(a), 14(a), 14(c), and 15(d) of the Exchange Act since the distribution or filing of the report or registration statement furnished above and a brief description of the securities being offered, the use of the proceeds from the offering, and any material changes in the issuer's affairs that are not disclosed in the documents furnished.<sup>225</sup>

If the issuer is subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act and is a foreign private issuer, the issuer may instead provide the information contained in its most recent Form 20-F<sup>226</sup> or Form F-1<sup>227</sup> filing.<sup>228</sup>

For business combinations or exchange offers, in addition to information required by Form S-4,<sup>229</sup> the issuer must provide to each purchaser at the time the plan is submitted to security holders, or, with an exchange, during the course of the transaction and prior to sale, written information about any terms or arrangements of the proposed transactions that are materially different from those for all other security holders.<sup>230</sup>

<sup>221</sup> 17 CFR 249.310.

<sup>222</sup> 17 CFR 239.11.

<sup>223</sup> 17 CFR 239.18.

<sup>224</sup> 17 CFR 249.10; see 17 CFR 230.502(b)(2)(ii)(B).

Exhibits required to be filed with the Commission as part of a registration statement or report, other than an annual report to shareholders or parts of that report incorporated by reference in a Form 10-K report, need not be furnished if the contents of material exhibits are identified and such exhibits are made available to a purchaser, upon his or her written request, a reasonable time before his or her purchase. See 17 CFR 230.502(b)(2)(iii).

<sup>225</sup> See 17 CFR 230.502(b)(2)(ii)(C).

<sup>226</sup> 17 CFR 249.220f.

<sup>227</sup> 17 CFR 239.31.

<sup>228</sup> See 17 CFR 230.502(b)(2)(ii)(D).

<sup>229</sup> 17 CFR 239.25.

<sup>230</sup> See 17 CFR 230.502(b)(2)(vi). If an issuer is not subject to the reporting requirements of section 13 or 15(d) of the Exchange Act, it may satisfy the requirements of Part I.B. or C. of Form S-4 by providing the same kind of information as would be required in Part II of Form 1-A (if the issuer is eligible to use Regulation A) or Part I of a registration statement filed under the Securities Act on the form that the issuer would be entitled to use (if the issuer is not eligible to use Regulation A).

<sup>202</sup> See 17 CFR 230.502(b)(2)(i) through (vii).

<sup>203</sup> See 17 CFR 230.502(b)(2).

<sup>204</sup> 17 CFR 239.90.

<sup>205</sup> See Section I.I.C.1.a for a discussion of the Regulation A eligibility requirements.

<sup>206</sup> See 17 CFR 230.502(b)(2)(i)(A).

<sup>207</sup> See 17 CFR 230.502(b)(2)(i)(B).

<sup>208</sup> 17 CFR 210.8.

<sup>209</sup> 17 CFR 230.502(b)(2)(i)(B)(1).

<sup>210</sup> 17 CFR 239.10.

<sup>211</sup> If the issuer is a limited partnership and cannot obtain the required financial statements without unreasonable effort or expense, it may furnish financial statements that have been prepared on the basis of federal income tax requirements and examined and reported on in accordance with generally accepted auditing standards by an independent public or certified accountant.

## b. Rule 506(c)

Rule 506(c) permits issuers to broadly solicit and generally advertise an offering, provided that:

- All purchasers in the offering are accredited investors,
- The issuer takes reasonable steps to verify purchasers' accredited investor status, and
- Certain other conditions in Regulation D are satisfied.<sup>231</sup>

Issuers conducting an offering under Rule 506(c) can sell securities to an unlimited number of accredited investors with no limit on the amount of money that can be raised from each investor or in total. If an issuer seeks to conduct an offering using general solicitation under Rule 506(c), but does not comply with the conditions of the exemption, the issuer would need to find another available exemption for the offering.<sup>232</sup>

Rule 506(c) provides a principles-based method for verification of accredited investor status as well as a non-exclusive list of verification methods. The principles-based method of verification requires an objective determination by the issuer (or those acting on its behalf)<sup>233</sup> as to whether the steps taken are "reasonable" in the context of the particular facts and circumstances of each purchaser and transaction. Among the factors that an issuer should consider under this principles-based method are:

- The nature of the purchaser and the type of accredited investor that the purchaser claims to be;
- The amount and type of information that the issuer has about the purchaser; and
- The nature of the offering, such as the manner in which the purchaser was

solicited to participate in the offering, and the terms of the offering, such as a minimum investment amount.<sup>234</sup>

The principles-based method is intended to provide issuers with significant flexibility in deciding the steps needed to verify a person's accredited investor status and to avoid requiring them to follow uniform verification methods that may be ill-suited or unnecessary to a particular offering or purchaser in light of the facts and circumstances.<sup>235</sup> In the Rule 506(c) Adopting Release, the Commission discussed a number of factors an issuer could consider in determining the potential documentation that an issuer may need to verify a person's accredited investor status.<sup>236</sup>

In adopting the principles-based method of verification, the Commission also envisioned a role for third parties that may wish to enter into the business of verifying the accredited investor status of investors on behalf of issuers, by indicating that an issuer should also be entitled to rely on a third party that has verified a person's status as an accredited investor, provided that the issuer has a reasonable basis to rely on such third-party verification.<sup>237</sup> However, an issuer will not be considered to have taken reasonable steps to verify accredited investor status if it, or those acting on its behalf, required only that a person check a box in a questionnaire or sign a form, absent

<sup>234</sup> See *id.* at Section II.B.3.a.

<sup>235</sup> See *id.*

<sup>236</sup> See *id.* In that release, the Commission stated that "[a]fter consideration of the facts and circumstances of the purchaser and of the transaction, the more likely it appears that a purchaser qualifies as an accredited investor, the fewer steps the issuer would have to take to verify accredited investor status, and vice versa. For example, if the terms of the offering require a high minimum investment amount and a purchaser is able to meet those terms, then the likelihood of that purchaser satisfying the definition of accredited investor may be sufficiently high such that, absent any facts that indicate that the purchaser is not an accredited investor, it may be reasonable for the issuer to take fewer steps to verify or, in certain cases, no additional steps to verify accredited investor status other than to confirm that the purchaser's cash investment is not being financed by a third party." In addition, the Commission stated that the means through which the issuer publicly solicits purchasers may be relevant in determining the reasonableness of the steps taken to verify accredited investor status. For example, "[a]n issuer that solicits new investors through a website accessible to the general public, through a widely disseminated email or social media solicitation, or through print media, such as a newspaper, will likely be obligated to take greater measures to verify accredited investor status than an issuer that solicits new investors from a database of pre-screened accredited investors created and maintained by a reasonably reliable third party."

<sup>237</sup> See Rule 506(c) Adopting Release at text accompanying note 113.

other information about the purchaser indicating accredited investor status.<sup>238</sup>

In addition to this flexible, principles-based method, Rule 506(c) includes a non-exclusive list of verification methods that issuers may use, but are not required to use, when seeking to satisfy the verification requirement with respect to natural person purchasers.<sup>239</sup> This non-exclusive list of verification methods consists of:

- Verification based on income, by reviewing copies of any Internal Revenue Service form that reports income, such as Form W-2, Form 1099, Schedule K-1 of Form 1065, or a filed Form 1040;
- Verification of net worth, by reviewing specific types of documentation dated within the prior three months, such as bank statements, brokerage statements, certificates of deposit, tax assessments, or a credit report from at least one of the nationwide consumer reporting agencies, and obtaining a written representation from the investor;
- A written confirmation from a registered broker-dealer, a registered investment adviser, a licensed attorney, or a certified public accountant stating that such person or entity has taken reasonable steps to verify that the purchaser is an accredited investor within the last three months and has determined that such purchaser is an accredited investor; and
- For a person who had invested in the issuer's Rule 506(b) offering as an accredited investor before September 23, 2013, and remains an investor of the issuer, a certification by such person at the time of sale that he or she qualifies as an accredited investor.<sup>240</sup>

The Commission included this non-exclusive list of verification methods for natural persons in Rule 506(c) in response to commenters requesting more certainty, but expressly stated that issuers are not required to use any of the specified methods and may rely on the principles-based approach to comply with the verification requirement.<sup>241</sup> However, despite the ability to use the

principles-based approach to comply with the verification requirement.<sup>241</sup> However, despite the ability to use the

principles-based approach to comply with the verification requirement.<sup>241</sup> However, despite the ability to use the

principles-based approach to comply with the verification requirement.<sup>241</sup> However, despite the ability to use the

<sup>238</sup> See Rule 506(c) Adopting Release at Section II.B.3.a.

<sup>239</sup> See 15 CFR 230.506(c)(2)(ii). The rule does not set forth a non-exclusive list of methods for the verification of investors that are not natural persons. The Commission indicated in the adopting release its view that the potential for uncertainty and the risk of participation by non-accredited investors is highest in offerings involving natural persons as investors. See Rule 506(c) Adopting Release at Section II.B.3.

<sup>240</sup> See 17 CFR 230.506(c)(ii)(A) through (D); see also Rule 506(c) Adopting Release at Section II.B.3.b.

<sup>241</sup> See Rule 506(c) Adopting Release at Section II.B.3.

<sup>231</sup> See 17 CFR 230.501 (Definitions and terms used in Regulation D) and 17 CFR 230.502(a) (Integration) and (d) (Limitations on Resales).

<sup>232</sup> The issuer may be able to claim the availability of another exemption. See 17 CFR 230.500(c). In general, however, an issuer may be precluded from relying on Section 4(a)(2) if it used public communications to solicit investors for its offering. See Rule 506(c) Adopting Release at text accompanying note 42 ("[A]n issuer relying on Section 4(a)(2) outside of the Rule 506(c) exemption will be restricted in its ability to make public communications to solicit investors for its offering because public advertising will continue to be incompatible with a claim of exemption under Section 4(a)(2).").

<sup>233</sup> See Rule 506(c) Adopting Release at note 113 ("[I]n the future, services may develop that verify a person's accredited investor status for purposes of new Rule 506(c) and permit issuers to check the accredited investor status of possible investors, particularly for web-based Rule 506 offering portals that include offerings for multiple issuers. This third-party service, as opposed to the issuer itself, could obtain appropriate documentation or otherwise take reasonable steps to verify accredited investor status.").

principles-based approach, market participants have communicated to the staff that many issuers rely primarily on the listed verification methods.<sup>242</sup>

#### c. Limitations on Resale

Purchasers in either a Rule 506(b) or a Rule 506(c) offering receive restricted securities and therefore are subject to limitations on the resale of the securities acquired in the transaction.<sup>243</sup> The issuer relying on Rule 506(b) or 506(c) must exercise reasonable care to ensure that the purchasers of the securities are not underwriters within the meaning of Securities Act Section 2(a)(11).<sup>244</sup> Reasonable care may be demonstrated by the following: (1) Reasonable inquiry to determine if the purchaser is acquiring the securities for such purchaser's own use or for other persons; (2) written disclosure to each purchaser prior to the sale that the securities have not been registered and, therefore, cannot be resold unless they are registered under the Securities Act or an exemption from registration is available; and (3) placement of a legend on the certificate or other document that evidences the securities stating that the securities have not been registered under the Securities Act and setting forth or referring to the restrictions on transferability and sale of the securities.<sup>245</sup> In addition, the issuer in a Rule 506(b) offering is required to disclose the resale limitations to any non-accredited investors.<sup>246</sup>

As discussed above, the holders of the restricted securities can only resell the securities by registering the resale transaction or relying on a valid exemption, such as Section 4(a)(1) or the non-exclusive safe harbor in Rule 144.<sup>247</sup>

#### d. Filing Requirements and Relationship With State Securities Laws

An issuer conducting an offering under either Rule 506(b) or Rule 506(c) is required to file a notice with the Commission on Form D within 15 days after the first sale of securities in the

<sup>242</sup> See also N. Peter Rasmussen, *Rule 506(c)'s General Solicitation Remains Generally Disappointing* (May 26, 2017), available at <https://www.bna.com/rule-506cs-general-b73014451604/>.

<sup>243</sup> See 17 CFR 230.502(d). The definition of "restricted securities" in Rule 144(a)(3) specifically includes securities acquired from the issuer that are subject to the resale limitations of Rule 502(d). See 17 CFR 230.144(a)(3)(ii).

<sup>244</sup> See 17 CFR 230.502(d).

<sup>245</sup> See 17 CFR 230.502(d). While taking these actions will establish the requisite reasonable care, they are not the exclusive method to demonstrate such care. Other actions by the issuer may satisfy this provision.

<sup>246</sup> See 17 CFR 230.502(b)(2)(vii).

<sup>247</sup> See Section II.B.1.b. For a discussion of Rule 144 and other resale exemptions, see Section IV.

offering.<sup>248</sup> An issuer must file an amendment to a previously filed notice for an offering: To correct a material mistake of fact or error in the previously filed notice; to reflect a change in the information provided in the previously filed notice, except as provided in the General Instructions to Form D;<sup>249</sup> and annually, on or before the first anniversary of the most recent previously filed notice, if the offering is continuing at that time.<sup>250</sup> The Commission does not charge any fee to file or amend a Form D.

If an issuer's offering meets the conditions of either Rule 506(b) or Rule 506(c), the issuer is not required to register or qualify the offering with state securities regulators.<sup>251</sup> Section 18 of the Securities Act generally provides for preemption of state law registration and qualification requirements for certain categories of securities, defined as "covered securities."<sup>252</sup> Section 18(b)(4)(F) of the Securities Act provides covered security status to all securities sold in transactions exempt from registration under Commission rules promulgated under Section 4(a)(2), which includes Rules 506(b) and 506(c) of Regulation D.<sup>253</sup> An offering by such an issuer, however, remains subject to state law enforcement and antifraud authority. Additionally, issuers may be subject to filing fees in the states in which they intend to offer or sell securities and be required to comply

<sup>248</sup> See 17 CFR 230.503. Filing a Form D notice is required, but a failure to file the notice does not invalidate the exemption.

<sup>249</sup> The General Instructions to Form D provide that an issuer is not required to file an amendment to a previously filed notice to reflect a change that occurs after the offering terminates or a change that occurs solely in the following information: The address or relationship to the issuer of a related person identified in response to Item 3; an issuer's revenues or aggregate net asset value; the minimum investment amount, if the change is an increase, or if the change, together with all other changes in that amount since the previously filed notice, does not result in a decrease of more than 10%; any address or state(s) of solicitation shown in response to Item 12; the total offering amount, if the change is a decrease, or if the change, together with all other changes in that amount since the previously filed notice, does not result in an increase of more than 10%; the amount of securities sold in the offering or the amount remaining to be sold; the number of non-accredited investors who have invested in the offering, as long as the change does not increase the number to more than 35; the total number of investors who have invested in the offering; and the amount of sales commissions, finders' fees or use of proceeds for payments to executive officers, directors or promoters, if the change is a decrease, or if the change, together with all other changes in that amount since the previously filed notice, does not result in an increase of more than 10%. 17 CFR 239.500.

<sup>250</sup> See General Instructions to Form D. 17 CFR 239.500.

<sup>251</sup> See 17 U.S.C. 77r(b)(4)(F).

<sup>252</sup> See 15 U.S.C. 77r(c).

<sup>253</sup> See 17 CFR 230.506(a). See also note 189.

with state notice filing requirements. The failure to file, or pay filing fees related to, any such materials may cause state securities regulators to suspend the offer or sale of securities within their jurisdiction.

#### e. Bad Actor Disqualification

Offerings under Rule 506 are subject to the disqualification provisions found in Rule 506(d) of Regulation D. The "bad actor" disqualification provisions disqualify offerings from relying on Rule 506(b) or 506(c) if the issuer or other "covered persons"<sup>254</sup> have experienced a disqualifying event, such as being convicted of, or sanctioned for, securities fraud or other violations of specified laws.<sup>255</sup>

Many of these events are disqualifying only if they occurred during a specified look-back period (for example, a court injunction that was issued within the last five years or a regulatory order that was issued within the last ten years). The look-back period is measured by counting back from the date of sale of securities in the relevant offering to the date of the potentially disqualifying event—for example, the issuance of the injunction or regulatory order and not the date of the underlying conduct that led to the disqualifying event.

The disqualification provisions do not apply to events occurring before the effective date of the provisions.<sup>256</sup> Instead, Rule 506(d) requires the issuer to disclose to each purchaser those events that would have been disqualifying but for the fact that they occurred prior to the effective date.<sup>257</sup>

The rule provides an exception from disqualification when the issuer is able to demonstrate that it did not know and, in the exercise of reasonable care, could not have known that a covered person with a disqualifying event participated in the offering.<sup>258</sup>

<sup>254</sup> "Covered persons" include: The issuer, including its predecessors and affiliated issuers; directors, officers, general partners, or managing members of the issuer; beneficial owners of 20% or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power; promoters connected with the issuer in any capacity at the time of sale; and persons compensated for soliciting investors, including the general partners, directors, officers, or managing members of any such solicitor. See 17 CFR 230.506(d)(1).

<sup>255</sup> See 17 CFR 230.506(d)(1)(i) through (viii) for the list of disqualifying events.

<sup>256</sup> 17 CFR 230.506(d)(2)(i).

<sup>257</sup> 17 CFR 230.506(e).

<sup>258</sup> 17 CFR 230.506(d)(2)(iv). The specific steps an issuer should take to exercise reasonable care will vary according to particular facts and circumstances. The instruction to Rule 506(d)(2)(iv) states that an issuer will not be able to establish that it has exercised reasonable care unless it has made, in light of the circumstances, a factual inquiry into whether any disqualifications exist.



In addition, disqualification under Rule 506(d) will not arise if, before any sales are made in the offering, the court or regulatory authority that entered the relevant order, judgment or decree advises in writing—whether in the relevant judgment, order or decree or separately to the Commission or its staff—that disqualification under the rule should not arise as a consequence

of such order, judgment, or decree.<sup>259</sup> The rule also provides for the ability to seek waivers from disqualification from the Commission based on a showing of good cause that it is not necessary under the circumstances that the exemption be denied.<sup>260</sup>

f. Analysis of Rule 506 in the Exempt Market

As reflected in Table 6 below, Rule 506(b) continues to dominate the market for exempt securities offerings and even exceed amounts raised in the registered market. In 2018, the amount raised by Rule 506(b) offerings, \$1.5 trillion, was larger than the \$1.4 trillion raised in registered offerings.<sup>261</sup>

TABLE 6—OFFERINGS UNDER RULE 506, SEPTEMBER 23, 2013–DECEMBER 31, 2018

	Rule 506(b)	Rule 506(c)
Number of Issuers .....	97,164 .....	8,025.
Number of Offerings .....	112,193 .....	9,358.
Percentage of Offerings under Regulation D .....	89% .....	11%.
Amount Reported Raised .....	\$7,300 billion <sup>262</sup> .....	\$466.4 billion <sup>263</sup> .
Percentage of Amount Raised under Regulation D .....	94% .....	6%.

As discussed above in Section II.A, while offerings under Rule 506(b) can have up to 35 non-accredited but sophisticated investors, non-accredited investors were reported as participating in only approximately 6% of Rule 506(b) offerings in each of 2015, 2016, 2017, and 2018, which offerings reported raising between two and three percent of the total capital raised under Rule 506(b) in each of 2015, 2016, 2017, and 2018.<sup>264</sup> The information requirement is the principal difference between a Rule 506(b) offering that includes non-accredited investors and one that is limited to accredited investors. Accordingly, it appears that the vast majority of issuers either are able to meet their capital needs through offerings to accredited investors only or, alternatively, may be limiting their Rule

506(b) offerings to accredited investors to avoid these disclosure requirements, which are generally similar to the non-financial disclosure requirements of a Regulation A offering and the financial statement requirements of a Form S–1 registration statement with reduced audit requirements.<sup>265</sup> If issuers are limiting their offerings to accredited investors to avoid the disclosure requirements, it is not possible to conclude if those issuers are successfully able to meet their capital needs through Rule 506(b) offerings.

The vast majority of Regulation D issuers continue to raise capital through Rule 506(b) offerings. Rule 506(b) offerings account for a larger amount of capital raised than Rule 506(c) offerings both in the aggregate across all offerings and for the average offering. One reason

why Rule 506(b) continues to dominate the Regulation D market may be that issuers with pre-existing sources of financing and/or intermediation channels are accustomed to relying on Rule 506(b) and do not need the flexibility provided by Rule 506(c). Other issuers may become more comfortable with Rule 506(c) market practices as they develop over time.<sup>266</sup> Some issuers may be reluctant to use general solicitation because they do not wish to share information publicly (through advertising materials) for competitive and general business reasons.<sup>267</sup> There may also be concerns about the added burden or appropriate levels of verification of the accredited investor status of all purchasers and

<sup>259</sup> 17 CFR 230.506(d)(2)(iii).

<sup>260</sup> 17 CFR 230.506(d)(2)(ii).

<sup>261</sup> See note 37 and accompanying text.

<sup>262</sup> This amount includes an incremental amount of approximately \$3,200 billion reported raised in amendments to initial filings.

<sup>263</sup> This amount includes an incremental amount of approximately \$81 billion reported raised in amendments to initial filings, some of which were initiated as Rule 506(b) offerings.

<sup>264</sup> As a comparison point, during the same four-year period, non-accredited investors were reported as participating in over 60% of the Rule 504 offerings. Rule 504 permits issuers to raise up to \$5 million in a 12-month period from an unlimited number of investors (without regard to whether or not those investors are accredited). Issuers conducting a Rule 504 offering are not subject to the information requirements in Rule 502(c), but must register the offering or have a state exemption from registration in every state in which the issuer is offering and selling securities. See Section II.D for a discussion of Rule 504.

<sup>265</sup> See 17 CFR 230.502(b)(2). See also William K. Jr. Sjostrom, PIPEs, 2 Entrepreneurial Bus. L.J. 381 (2007), at n.72 and accompanying text. (stating, in the context of private investments in public equity, that “[t]ypically, PIPE deals are marketed only to accredited investors so that the issuer does not have

to contend with meeting these disclosure and sophistication requirements”).

<sup>266</sup> See, generally, comments of Jean Peters, Board member, Angel Capital Association, at the 33rd Securities and Exchange Commission Government-Business Forum on Small Business Capital Formation, November 20, 2014, transcript available at <https://www.sec.gov/info/smallbus/sbforum112014-final-transcript.pdf> (“Peters Comments”).

<sup>267</sup> See, e.g., N. Peter Rasmussen, Rule 506(c)’s General Solicitation Remains Generally Disappointing (May 26, 2017), available at <https://www.bna.com/rule-506cs-general-b73014451604/>. See also, Peters Comments.

See also Manning G. Warren (2017) The Regulatory Vortex for Private Placements, *Securities Regulation Law Journal*, Vol. 45, Issue 9 (“Warren 2017 Study”) (summarizing discussions with securities counsel and the results of a survey of counsel specializing in private placements of securities regarding the reasons for reluctance to rely on Rule 506(c), including the “highly practicable and reliable” Rule 506(b) model; preference to recruit investors “with whom [issuers] have preexisting personal and business relationships” in lieu of “accredited strangers”; issuer preference to “preserve the confidentiality of their private securities offerings and related business plans” from “potential competitors but also from state and federal regulators”; as well as

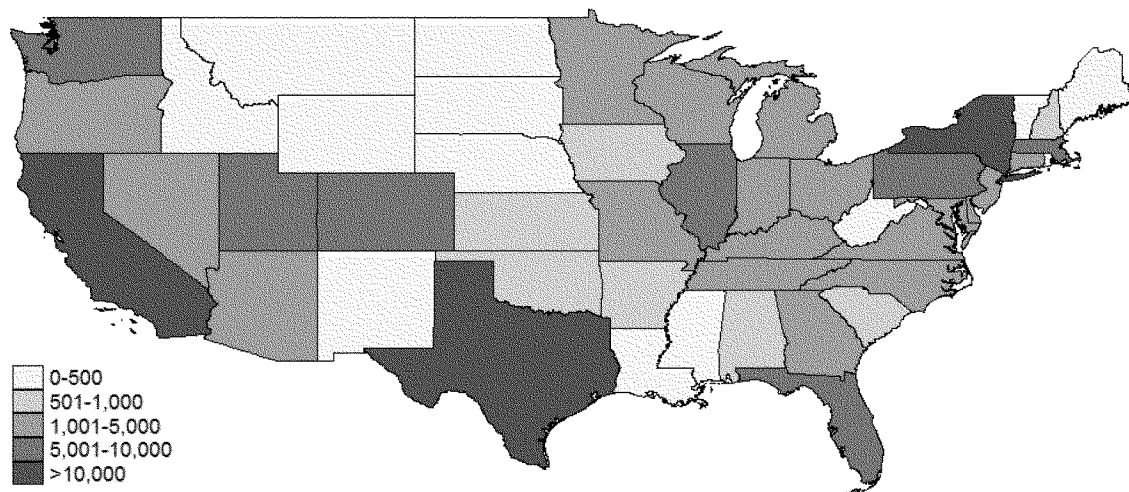
a reluctance to “engage in an independent verification process in order to objectively determine the accredited investor status of each accredited investor in Rule 506(c) offerings.” With respect to the last concern, this study states that “[m]ost securities lawyers have not yet developed a comfort level with the necessary ‘reasonable steps to verify.’ . . . Moreover, this compliance requirement could chill the interests of many significant investors who have understandable reluctance to share their tax returns, brokerage statements and other confidential financial information with issuers’ management and attorneys . . . [S]ome two-thirds of the respondents expressed concerns over compliance with the verification requirement . . . The possibilities that accredited investors will walk away from Rule 506(c) offerings based on privacy concerns clearly [contribute] to issuer reluctance to use Rule 506(c) and to a corollary preference to use Rule 506(b) as the exemption from registration.”). See also Larissa Lee (2014) The Ban Has Lifted: Now Is the Time to Change the Accredited-Investor Standard, *Utah Law Review*, Vol. 2014, Issue 2; Elan W. Silver (2015) Reaching the Right Investors: Comparing Investor Solicitation in the Private-Placement Regimes of the United States and the European Union, *Tulane Law Review*, Vol. 89; Dale A. Oesterle (2015) Intermediaries in internet Offerings: The Future Is Here, *Wake Forest Law Review*, Vol. 50.

possible investor privacy concerns.<sup>268</sup> Regulatory uncertainty has also been previously identified as a possible explanation for the relatively low level of the Rule 506(c) offerings.<sup>269</sup> While Rule 500(c) of Regulation D makes clear that an issuer's failure to satisfy all the terms and conditions of Rule 506(b) does not preclude the issuer's ability to rely on the exemption provided by

Section 4(a)(2), an issuer relying on Section 4(a)(2) outside of the Rule 506(c) exemption, including because of an inadvertent failure to comply with the requirements of Rule 506(c), could be precluded from relying on Section 4(a)(2) if, as discussed above, it used public communications to solicit investors for its offering because public

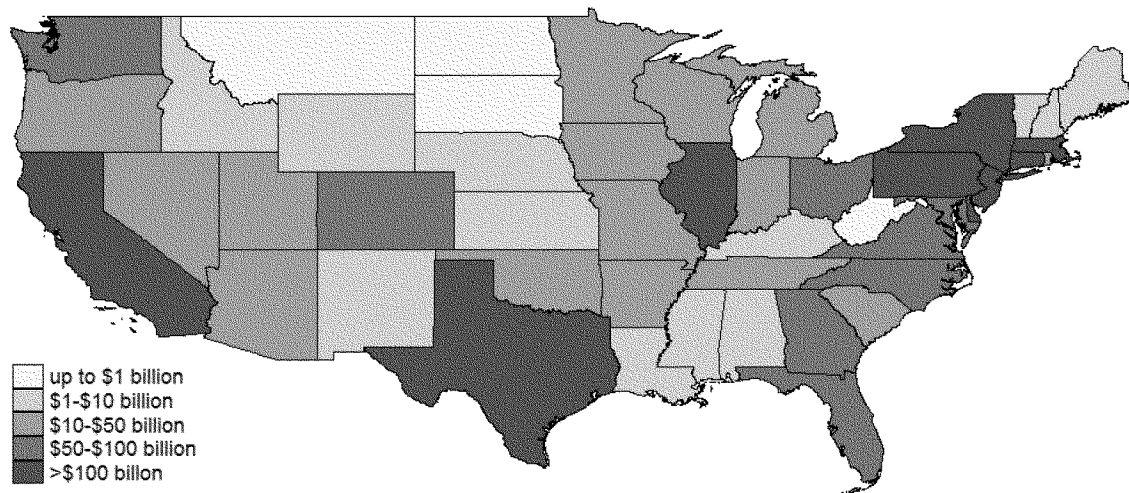
advertising is incompatible with a claim of exemption under Section 4(a)(2).<sup>270</sup> Geographically, offerings under Rule 506 were relatively concentrated, both in terms of number and proceeds. Maps of offering activity under Rule 506 during 2009–2018 by issuer location (covering 48 U.S. states) are shown below:

**Figure 5: Number of Rule 506 offerings by issuer location, 2009-2018**



\*U.S. 48 states

**Figure 6: Aggregate amount raised in Rule 506 offerings by issuer location, 2009-2018**



\*U.S. 48 states

3. Request for Comment

For additional requests for comment related to exempt transactions under Section 4(a)(2) or Rule 506 involving

pooled investment funds, see Section IV.D.

33. Should we consider any changes to Rule 506(b) or 506(c)? Do the

requirements of Rules 506(b) and 506(c) appropriately address capital formation and investor protection considerations?

<sup>268</sup> See note 267.

<sup>269</sup> See, e.g., Online Deal Marketing Outlook for Q1 2014: Regulators Rain on Parade as Rule 506(c)

Enthusiasts Ready for Storm of Advertising (April 2014), Dealflow.com, available at [https://web.archive.org/web/20150430200100/https://dealflow.com/whitepapers/Dealflow\\_White\\_Paper\\_](https://web.archive.org/web/20150430200100/https://dealflow.com/whitepapers/Dealflow_White_Paper_)

*Q1\_2014.pdf*; Unregistered Offerings White Paper; Warren 2017 Study.

<sup>270</sup> See Section II.B.1.a.

Alternatively, should we retain Rules 506(b) and 506(c) as they are?

34. Should we combine the requirements for Rule 506(b) and Rule 506(c) offerings in one exemption? If so, what aspects of each rule should be retained in the combined exemption and why? Would legislative changes be necessary or beneficial to make such changes?

35. Is it important to continue to allow non-accredited investors to participate in Rule 506(b) offerings? Are the information requirements having an impact on the willingness of issuers to allow non-accredited investors to participate?

36. Are the current information requirements in Rule 506(b) appropriate or should they be modified? Should we revise the information requirements contained in Rule 502(b) to align those requirements with those of another type of exempt offering, such as Regulation Crowdfunding, Tier 1 of Regulation A, Tier 2 of Regulation A, or Rule 701?<sup>271</sup> How would such changes affect capital raising under Rule 506(b)? Should we consider eliminating or scaling the information requirements depending on the characteristics of the non-accredited investors participating in the offering, such as if all non-accredited investors are advised by a financial professional or a purchaser representative? Should the information requirements vary if the non-accredited investors can only invest a limited amount or if they invest alongside a lead accredited investor on the same terms as the lead investor? Would there be investor protection concerns regarding any reduction in information required to be provided to non-accredited investors?

37. Should we amend Regulation D to clarify or define “general solicitation” or “general advertising”? Does the current definition pose any particular challenges? Alternatively, should we expand the list of examples provided in Rule 502(c)? Should we consider amending the definition or adding an example clarifying whether participation in a “demo-day” or similar event would be considered general solicitation?

38. If we reduce the information requirements in Rule 506(b), should we include investment limits for non-accredited investors? If so, what limits are appropriate and why? Should accredited investors be subject to investment limits?

39. Should information requirements apply to accredited investors in offerings under either Rule 506(b) or 506(c)? If so, what type of information

requirements would be appropriate? Should any such information requirements apply to all accredited investors, whether natural persons or entities?

40. Are issuers hesitant to rely on Rule 506(c), as suggested by the data on amounts raised under that exemption as compared to other exemptions? If so, why? Has the adoption of Rule 506(c) enabled issuers to reach a greater number of potential investors and/or increased their access to sources of capital? Are there changes we should consider to encourage capital formation under Rule 506(c), consistent with the protection of investors?

41. Are there data available that show an increase or decrease in fraudulent activity in the Rule 506 market as a result of the adoption of Rule 506(c)? If so, what are the causes or explanations and what should we do to address them?

42. Is the requirement to take reasonable steps to verify accredited investor status having an impact on the willingness of issuers to use Rule 506(c)? Are there additional or alternative verification methods that we should include in the non-exclusive list of reasonable verification methods that would make issuers more willing to use Rule 506(c) or would better address investor protections?

43. If we do not revise or expand the verification methods in Rule 506(c), but we expand the “accredited investor” categories (*e.g.*, to include investors that are financially sophisticated or advised by a financial professional), how would an issuer verify accredited investor status under these new categories?

44. Should we consider rule changes to allow non-accredited investors to purchase securities in an offering that involves general solicitation? If so, what types of investor protection conditions should apply? For example, should we allow non-accredited investors to participate in such an offering only if: (1) Such non-accredited investors had a pre-existing substantive relationship with the issuer or were not made aware of the offering through the general solicitation; (2) the offering is done through a registered intermediary; or (3) a minimum percentage of the offering is sold to institutional accredited investors that have experience in exempt offerings and the terms of the securities are the same as those sold to the non-accredited investors? How would such changes affect capital formation and investor protection? Would legislative changes be necessary or beneficial to make such changes?

45. What other changes to Rule 506 should we consider when harmonizing

our exempt offering rules? For example, should we amend Rule 503 to provide a deadline to file the Form D other than the current requirement to file the Form D no later than 15 calendar days after the first sale of securities in the offering? If so, what deadline would be more appropriate? Would a different deadline, or a deadline tied to the completion of the offering, facilitate issuers’ compliance with the Form D filing requirement? What impact would any such changes have on the utility of Form D for the Commission, investors, or state securities regulators? Is the Form D information useful to investors? Should we consider any changes to the information required in Form D?

46. How frequently are issuers relying on the Section 4(a)(2) exemption or otherwise conducting private offerings where no Form D is required to be filed? We request data on such offerings where no Form D is available.

### C. Regulation A

Regulation A was originally adopted by the Commission in 1936 as an exemption for small issues under the authority of Section 3(b) of the Securities Act.<sup>272</sup> Section 401 of the JOBS Act<sup>273</sup> amended Section 3(b) of the Securities Act by designating Section 3(b), the Commission’s exemptive authority for offerings of up to \$5 million, as Section 3(b)(1), and adding new Sections 3(b)(2) through 3(b)(5) to the Securities Act.<sup>274</sup> Section 3(b)(2) directed the Commission to adopt rules adding a class of securities exempt from the registration requirements of the Securities Act for offerings of up to \$50 million of securities within a 12-month period. Sections 3(b)(2) through (5) specify mandatory terms and conditions for such exempt offerings and authorize the Commission to adopt other terms, conditions, or requirements as necessary in the public interest and for the protection of investors. On March 25, 2015, the Commission adopted final rules to implement Section 401 of the JOBS Act by creating two tiers of Regulation A offerings: Tier 1, for offerings of up to \$20 million in a 12-month period; and Tier 2, for offerings

<sup>272</sup> See SEC Release No. 33-632 (Jan. 21, 1936). Prior to codification as such, Regulation A was a collection of individual rules issued by the Federal Trade Commission and the Commission during the period of 1933-1936. Each such rule exempted particular classes of securities from registration under the Securities Act. Regulation A’s initial annual offering limit was raised from \$100,000 to \$300,000 in 1945, \$500,000 in 1970, \$1.5 million in 1978, and to \$5 million in 1992.

<sup>273</sup> See Public Law 112-106, sec. 401(a), 126 Stat. 306, 313 (Apr. 5, 2012).

<sup>274</sup> See 15 U.S.C. 77c(b)(2) through (5).

<sup>271</sup> See note 512 for a brief discussion of Rule 701.

of up to \$50 million in a 12-month period.<sup>275</sup> In adopting the two-tiered structure, the Commission indicated that it expected the requirements for Tier 1 to result in securities offerings that would be more local in character, while Tier 2 offerings would likely be more national in character.<sup>276</sup> Certain basic requirements are applicable to both tiers, but Tier 2 issuers are subject to significant additional requirements. For example, Tier 2 issuers are always required to include audited financial statements in their offering circulars<sup>277</sup> and must provide ongoing reports on an annual and semiannual basis with additional requirements for interim current event updates, assuring a continuous flow of information to investors and the market.<sup>278</sup> In consideration of these requirements, which are discussed in more detail below, and the likely more national nature of Tier 2 offerings, Commission rules preempt state securities law registration and qualification requirements for Tier 2 offerings, while

Tier 1 offerings remain subject to those state requirements.<sup>279</sup> An issuer of \$20 million or less of securities can elect to proceed under either Tier 1 or Tier 2.

In addition to expanding the Regulation A offering limit, the 2015 amendments sought to modernize the Regulation A filing process, align practice in certain areas with prevailing practice for registered offerings, create additional flexibility for issuers in the offering process, and establish an ongoing reporting regime for certain Regulation A issuers.<sup>280</sup> On December 19, 2018, the Commission further amended the issuer eligibility and related provisions pursuant to the Economic Growth Act to allow issuers that are subject to the ongoing reporting requirements of Section 13 or 15(d) of the Exchange Act to use the exemption.<sup>281</sup>

The Commission is required by Section 3(b)(5) of the Securities Act to review the Tier 2 offering limit every two years. In addition to revisiting the Tier 2 offering limit, the Commission stated that the staff would undertake to

review the Tier 1 offering limit at the same time.<sup>282</sup> Following completion of the staff reviews of the offering limits in 2016 and 2018, the Commission determined not to propose to increase the offering limit for either Tier at that time. At the time of adoption of the 2015 amendments, the Commission also stated that the staff would study and submit a report to the Commission no later than five years following the adoption of the amendments on the impact of both Tier 1 and Tier 2 offerings on capital formation and investor protection.<sup>283</sup> The Commission indicated in the 2015 Regulation A Release that, based on the information contained in the report, it may propose either to decrease or to increase the offering limit for Tier 1, as appropriate.

1. Scope of the Exemption

In order to conduct offerings pursuant to Tier 1 or Tier 2 of Regulation A, issuers must meet certain requirements. Table 7 broadly summarizes the Commission requirements for each tier.

TABLE 7—OVERVIEW OF REGULATION A REQUIREMENTS

	Tier 1	Tier 2
Issuer Requirements .....	U.S. or Canadian issuers; excludes blank check companies, registered investment companies, business development companies, issuers of certain securities, and certain issuers subject to a Section 12(j) order.	
Offering Limit within a 12-month Period.	\$20 million .....	\$50 million.
Offering Communications ....	Testing the waters permitted before and after the offering statement is filed.	
Investor Limits .....	No limits .....	Non-accredited investors are subject to investment limits based on annual income and net worth, unless securities will be listed on a national securities exchange.
SEC Filing Requirements ....	Form 1–A filed with the Commission, including two years of financial statements (which may be unaudited in most cases).	Form 1–A filed with the Commission, including two years of audited financial statements.
Restrictions on Resale .....	No .....	No.
Disqualification Provisions ...	Felons and bad actors disqualified in accordance with Rule 262.	
Preemption of State Registration and Qualification.	No .....	Yes.

<sup>275</sup> See 2015 Regulation A Release.

<sup>276</sup> See *id.*

<sup>277</sup> See Part F/S of Form 1–A.

<sup>278</sup> See 17 CFR 230.257 (“Rule 257”).

<sup>279</sup> See 2015 Regulation A Release.

Based on the analysis of information from Part I of Form 1–A offering statements qualified between June 19, 2015 (the effective date of Regulation A amendments) and December 31, 2018, for Tier 1 offerings with qualified offering statements, the median number of U.S. jurisdictions in which the issuer (and if applicable, underwriters, dealers, or sales persons) intended to offer securities was six states, whereas among Tier 2 offerings with

qualified offering statements, the median was 51. These estimates include 50 U.S. states and the District of Columbia, but exclude U.S. territories, Canadian provinces, and foreign jurisdictions other than Canada (which has a minimal effect on these estimates). We recognize that this differential observed in the data may be related to the fact that, under the 2015 Regulation A amendments, state registration requirements apply to Tier 1 but not to Tier 2 offerings.

<sup>280</sup> See *id.*

<sup>281</sup> See Amendments to Regulation A, Release No. 33–10591 (Dec. 19, 2018) [84 FR 520 (Jan. 31, 2019)] (“2018 Regulation A Release”).

<sup>282</sup> See 2015 Regulation A Release at 21809.

<sup>283</sup> See 2015 Regulation A Release. The 2015 Regulation A Release stated that the report would include, but not be limited to, a review of: (1) The amount of capital raised under the amendments; (2) the number of issuances and amount raised by both Tier 1 and Tier 2 offerings; (3) the number of placement agents and brokers facilitating the Regulation A offerings; (4) the number of federal, state, or any other actions taken against issuers, placement agents, or brokers with respect to both Tier 1 and Tier 2 offerings; and (5) whether any additional investor protections are necessary for either Tier 1 or Tier 2.

TABLE 7—OVERVIEW OF REGULATION A REQUIREMENTS—Continued

	Tier 1	Tier 2
Ongoing Reporting .....	Exit report due within 30 calendar days after termination or completion of an offering.	Annual report on Form 1–K due within 120 calendar days of issuer’s fiscal year end; Semi-annual report on Form 1–SA due within 90 calendar days of after the end of the first six months of issuer’s fiscal year; Current reports on Form 1–U due within four business days of one of the items specified in that form; and If applicable, an Exit report on Form 1–Z to terminate an issuer’s reporting obligations.

#### a. Eligible Issuers and Securities; Offering Process

Regulation A is available only to issuers organized in, and with their principal place of business in, the United States or Canada.<sup>284</sup>

It is, however, not available to:

- Investment companies registered or required to be registered under the Investment Company Act or BDCs;
- Blank check companies;<sup>285</sup>
- Issuers of fractional undivided interests in oil or gas rights, or similar interests in other mineral rights;
- Issuers that are required to, but that have not, filed with the Commission the ongoing reports required by the rules under Regulation A during the two years immediately preceding the filing of a new offering statement (or for such shorter period that the issuer was required to file such reports);
- Issuers that are or have been subject to an order by the Commission denying, suspending, or revoking the registration of a class of securities pursuant to Section 12(j) of the Exchange Act that was entered within five years before the filing of the offering statement; or
- Issuers subject to “bad actor” disqualification under 15 CFR 230.262 (“Rule 262”).<sup>286</sup>

The types of securities eligible for sale under Regulation A are limited to the enumerated list in Section 3(b)(3) of the Securities Act, which includes equity securities, debt securities, and debt securities convertible or exchangeable to equity interests, including any guarantees of such securities.<sup>287</sup>

<sup>284</sup> See 17 CFR 230.251(b).

<sup>285</sup> See 17 CFR 230.251(b)(3). See also note 25.

<sup>286</sup> Regulation A includes disqualification provisions that are substantially similar to those in Rule 506(d). See Section II.B.2.e. Disqualification will not arise as a result of disqualifying events relating to final orders of certain state and federal regulators or certain SEC cease-and-desist orders that occurred before June 19, 2015, the effective date of the Regulation A amendments. Matters that existed before the effective date of the rule and that would otherwise be disqualifying are, however, required to be disclosed in writing to investors in Part II of Form 1–A.

<sup>287</sup> See 15 U.S.C. 77c(b)(3)

Regulation A also specifically excludes asset-backed securities.<sup>288</sup>

Continuous or delayed offerings are permitted, although Regulation A limits the types of delayed offerings permitted under the exemption<sup>289</sup> and is not available for at-the-market offerings.<sup>290</sup> Regulation A includes no specific limitations on, requirements for, or other provisions regarding the use of a registered broker-dealer or another intermediary to facilitate the offering.

Since adoption of the 2015 amendments, we have received comments and recommendations from a variety of sources, including a number of the annual Small Business Forums. For example, the 2017 and 2018 Small Business Forums recommended that the Commission amend its rules to allow at-the-market offerings under Regulation

<sup>288</sup> See 17 CFR 230.251. An asset-backed security generally means a security that is primarily serviced by the cash flows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period, plus any rights or other assets designed to assure the servicing or timely distributions of proceeds to the security holders. See 17 CFR 229.1101(c).

<sup>289</sup> See 17 CFR 230.251(d)(3)(i) (providing that continuous or delayed offerings may rely on Regulation A only if they pertain to securities (1) offered or sold by a person other than the issuer, (2) offered and sold pursuant to certain reinvestment or employee benefit plans, (3) issued on the exercise or conversion of certain other securities, (4) pledged as collateral, or (5) offered within two calendar days after qualification of the offering statement on a continuous basis in an amount that is reasonably expected to be offered and sold within two years from qualification and offered and sold no more than three years after qualification unless included on a subsequent offering statement).

<sup>290</sup> See 17 CFR 230.251(d)(3)(ii) (defining at-the-market offering to mean an offering of equity securities into an existing trading market for outstanding shares of the same class at other than a fixed price). In the 2015 Regulation A Release, the Commission acknowledged that a market in Regulation A securities may develop that is capable of supporting primary and secondary at-the-market offerings, but rather than permit such offerings at the outset, the Commission stated that it would defer any determination as to whether Regulation A would be an appropriate method for such offerings. The Commission also noted that an offering at fluctuating market prices may not be appropriate under an exemption subject to a maximum offering size. See 2015 Regulation A Release.

A.<sup>291</sup> The 2017 and 2018 Small Business Forums requested guidance for broker-dealers, transfer agents, and clearing firms, regarding Regulation A securities and OTC securities.<sup>292</sup> In addition, both those Forums recommended that the Commission require any portal that is conducting Regulation A offerings to be registered and subject to appropriate disclosure requirements.<sup>293</sup> Prior Small Business Forums also recommended that BDCs<sup>294</sup> and SBICs<sup>295</sup> be eligible to use the exemption. In addition, one commenter to the 2018 Regulation A Release suggested “certain amendments to alleviate the paperwork and regulatory burdens of certain filing requirements and offering amount limitations on Tier 2 issuers filing under Regulation A.”<sup>296</sup>

#### b. Offering Limits and Secondary Sales

As noted above, issuers may elect to conduct a Regulation A offering pursuant to the requirements of either Tier 1 or Tier 2. Tier 1 is available for offerings of up to \$20 million in a 12-month period, including no more than \$6 million on behalf of selling security holders that are affiliates of the issuer.<sup>297</sup> Tier 2 is available for offerings of up to \$50 million in a 12-month period, including no more than \$15 million on behalf of selling security

<sup>291</sup> See 2017 Forum Report; 2018 Forum Report.

<sup>292</sup> See 2017 Forum Report; 2018 Forum Report.

<sup>293</sup> See 2017 Forum Report; 2018 Forum Report. See Section II.F.1.d. for a discussion of Regulation Crowdfunding and the requirements for funding portals.

<sup>294</sup> See 2014 Forum Report; 2015 Forum Report; 2016 Forum Report.

<sup>295</sup> See 2015 Forum Report.

<sup>296</sup> Letter from Mark Schonberger dated Mar. 4, 2019 available at <https://www.sec.gov/comments/s7-29-18/s72918-5007949-182974.pdf> (“Schonberger Letter”). For example, this commenter recommended that Regulation A be amended to permit issuers to: Include in an annual amendment the ability to qualify an additional \$50 million for the following 12-month period, provided such issuers may not sell more than \$50 million in any 12-month period; permit a 180-day selling extension to apply after a post-qualification amendment is filed and prior to the qualification of that amendment; and forward incorporate periodic and current reports, including updated financial statements.

<sup>297</sup> See 17 CFR 230.251(a)(1).

holders that are affiliates of the issuer.<sup>298</sup> Additionally, sales by all selling security holders in a Regulation A offering are limited to no more than 30% of the aggregate offering price in an issuer's first Regulation A offering and any subsequent Regulation A offerings in the following 12-month period.<sup>299</sup>

In the 2015 Regulation A Release, the Commission noted that some commenters suggested that the Commission raise the proposed \$50 million Tier 2 offering limit to an amount above the statutory limit set forth in Section 3(b)(2); however, the Commission did not believe an increase was warranted at the time.<sup>300</sup> The Commission explained that, while Regulation A had existed as an exemption from registration for some time, the 2015 amendments were significant. Accordingly, the Commission believed that the 2015 amendments would provide for a meaningful addition to the existing capital formation options of smaller issuers while maintaining important investor protections. The Commission expressed its concern, however, about expanding the offering limit of the exemption beyond the level directly contemplated in Section 3(b)(2) at the outset of the adoption of the rules.

While the Commission determined to adopt the proposed \$50 million offering limit for a Regulation A Tier 2 offering, it noted that it would revisit the limit in 2016 in its bi-annual review of the limit, as required by Securities Act Section 3(b)(5).<sup>301</sup> The \$50 million offering limit was reviewed in 2016 and 2018, and neither review resulted in a proposal to increase the \$50 million offering limit. At the time of the 2018 review, approximately 80% of filers with qualified Regulation A offerings had not yet completed their offerings or reported amounts raised in completed offerings, so the staff determined that there was insufficient data to derive definitive conclusions as to the adequacy of the \$50 million offering limit or to forecast the amount of capital that might be raised in Regulation A offerings in the future. Since that time, the staff has continued to monitor the Regulation A market and gather additional information about the use of Regulation A, to determine whether to recommend proposing to increase the Regulation A aggregate annual offering limit in advance of the next review required under Section 3(b)(5). The Commission

is required to review the limit in 2020; however, the Chairman has requested that the staff conduct the review in 2019.

Since adoption of the 2015 amendments, the 2017 and 2018 Small Business Forums have recommended that the Commission increase the maximum offering amount under Tier 2 of Regulation A from \$50 million to \$75 million.<sup>302</sup> The 2017 Treasury Report also recommended that the Tier 2 offering limit be increased to \$75 million.<sup>303</sup> One commenter has suggested, in connection with the 2018 Regulation A Release, that the offering limit be raised to \$100 million.<sup>304</sup>

#### c. Investment Limits in Tier 2 Offerings

Regulation A limits the amount of securities that an investor that is not an accredited investor under Rule 501(a) of Regulation D can purchase in a Tier 2 offering to no more than: (a) 10% of the greater of annual income or net worth (for natural persons); or (b) 10% of the greater of annual revenue or net assets at fiscal year-end (for non-natural persons).<sup>305</sup> This limit does not, however, apply to purchases of securities that will be listed on a national securities exchange upon qualification.<sup>306</sup>

#### d. Conditional Exemption From Section 12(g)

Section 12(g) of the Exchange Act requires, among other things, that an issuer with total assets exceeding \$10 million and a class of equity securities held of record by either 2,000 persons, or 500 persons who are not accredited investors, register such class of securities with the Commission.<sup>307</sup> Regulation A, however, conditionally exempts securities issued in a Tier 2 offering from the mandatory registration provisions of Section 12(g)<sup>308</sup> if the issuer:

<sup>302</sup> See 2018 Forum Report; 2017 Forum Report.

<sup>303</sup> See 2017 Treasury Report.

<sup>304</sup> See Schonberger Letter.

<sup>305</sup> See 17 CFR 230.251(d)(2)(i)(C).

<sup>306</sup> See *id.* Tier 2 issuers that seek to list their securities on a national securities exchange or otherwise register a class of Regulation A securities under the Exchange Act may do so by filing a Form 8-A short form registration statement concurrently with the qualification of a Regulation A offering statement that includes Part I of Form S-1 or Form S-11 narrative disclosure in Form 1-A. See Form 8-A, General Instructions A(c) [17 CFR 249.208a]. Such issuers must meet listing standards of, and be certified by, the exchange before the Form 8-A will be declared effective. In order to be approved for listing on an exchange, issuers generally must meet certain size, financial, minimum securities distribution (or liquidity), and corporate governance criteria.

<sup>307</sup> 15 U.S.C. 78l.

<sup>308</sup> See Section II.C.5 for an analysis of the limited available data related to this conditional exemption.

- Remains subject to, and is current (as of its fiscal year-end) in, its Regulation A periodic reporting obligations;

- Engages the services of a transfer agent registered with the Commission pursuant to Section 17A of the Exchange Act;<sup>309</sup> and

- Had a public float of less than \$75 million as of the last business day of its most recently completed semiannual period, or, in the absence of a public float, had annual revenues of less than \$50 million as of its most recently completed fiscal year.<sup>310</sup>

One commenter responding to the 2018 Regulation A Release suggested that the Commission amend Rule 12g5-1 to tie the revenue limit in the conditional exemption from Section 12(g) to the revenue threshold for smaller reporting companies.<sup>311</sup>

## 2. Disclosure Requirements

### a. Offering Statement

All issuers that conduct offerings pursuant to Regulation A are required to file an offering statement on Form 1-A with the Commission. Issuers are only permitted to begin selling securities pursuant to Regulation A once the offering statement has been qualified by the Commission. The Commission does not charge any fee to file or amend a Form 1-A.

Among other things, Form 1-A contains the primary disclosure document used in connection with the offering, called an "offering circular." Consistent with similar delivery requirements for registered offerings, Regulation A provides that access equals delivery.<sup>312</sup> Accordingly, where sales of Regulation A securities occur after qualification on the basis of offers made using a preliminary offering circular, issuers and intermediaries may satisfy their delivery requirements for the final offering circular by filing it on EDGAR.<sup>313</sup> Issuers are, however, required to include a notice in any preliminary offering circular that will inform potential investors that the

<sup>309</sup> 15 U.S.C. 78q-1.

<sup>310</sup> See 17 CFR 240.12g5-1(a)(7). An issuer that exceeds these thresholds is granted a two-year transition period before it would be required to register its class of securities pursuant to Section 12(g), provided it timely files all ongoing reports due during such period.

<sup>311</sup> See Schonberger Letter. A smaller reporting company is defined in Securities Act Rule 405, Exchange Act Rule 12b-2, and Item 10 of Regulation S-K [15 CFR 229.10(f)] to include an issuer with (1) public float of less than \$250 million or (2) revenues of less than \$100 million and either no public float or a public float of less than \$700 million.

<sup>312</sup> See 2015 Regulation A Release.

<sup>313</sup> See 17 CFR 230.251(d)(2)(ii).

<sup>298</sup> See 17 CFR 230.251(a)(2).

<sup>299</sup> See 17 CFR 230.251(a)(3).

<sup>300</sup> See 2015 Regulation A Release, at text accompanying note 93.

<sup>301</sup> See *id.*

issuer may satisfy its delivery obligations for the final offering circular electronically.<sup>314</sup> Issuers, underwriters, and dealers must provide purchasers with a copy of the final offering circular or a notice stating that the sale occurred pursuant to a qualified offering statement not later than two business days after completion of a sale.<sup>315</sup> The notice must include the website address where the final offering circular, or the offering statement including the final offering circular, may be obtained on EDGAR. In the case of an electronic-only offering, the notice must include an active hyperlink to the final offering circular or to the offering statement.<sup>316</sup> The 2018 Small Business Forum recommended that the Commission permit the use of quick response (“QR”) codes, which are machine-readable images that contain data and can direct the user to a website or application,<sup>317</sup> in lieu of a hyperlink to an offering circular after qualification.<sup>318</sup>

Form 1–A requires financial disclosure as well as narrative disclosure in one of two formats: (a) The Offering Circular format or (b) a format that follows the requirements of Part I of Form S–1 or, in certain circumstances, Part I of Form S–11,<sup>319</sup> which contains the narrative disclosure requirements for registration statements filed by issuers in registered offerings.

Form 1–A requires issuers in both Tier 1 and Tier 2 offerings to file balance sheets and related financial statements for the issuers’ two previous fiscal year ends (or for such shorter time that they have been in existence). Financial statements in Form 1–A must be dated not more than nine months before the date of filing or qualification, with the most recent annual or interim balance sheet being not older than nine months. If interim financial statements are required, they must cover a period of at least six months. For Tier 1 offerings, Regulation A does not require issuers to provide audited financial statements unless the issuer has already

prepared them for other purposes.<sup>320</sup> Issuers in Tier 2 offerings are required to include financial statements in their offering circulars that are audited in accordance with either the auditing standards of the American Institute of Certified Public Accountants (AICPA) (“U.S. Generally Accepted Auditing Standards” or “U.S. GAAS”) or the standards of the Public Company Accounting Oversight Board (“PCAOB”).

Issuers whose securities previously have not been sold pursuant to a qualified offering statement under Regulation A or an effective registration statement under the Securities Act are allowed to submit to the Commission electronically through EDGAR a draft offering statement for non-public review by the staff.<sup>321</sup> The initial non-public submission, all non-public amendments thereto, and correspondence submitted by or on behalf of the issuer to the Commission staff regarding such submissions must be publicly filed and available on EDGAR not less than 21 calendar days before qualification of the offering statement.<sup>322</sup>

For ongoing offerings, post-qualification amendments must be filed:

- At least every 12 months after the qualification date to include the financial statements that would be required by Form 1–A as of such date; or
- To reflect any facts or events arising after the qualification date of the offering statement (or the most recent post-qualification amendment thereof) that, individually or in the aggregate, represent a fundamental change in the information set forth in the offering statement.<sup>323</sup>

#### b. Ongoing Reporting

Issuers in Tier 1 offerings are required to provide information about sales in such offerings and to update certain issuer information by electronically filing a Form 1–Z exit report with the Commission not later than 30 calendar days after termination or completion of an offering.<sup>324</sup>

Issuers in Tier 2 offerings are required to electronically file annual and semiannual reports, as well as current reports and, in certain circumstances, an exit report on Form 1–Z, with the Commission.<sup>325</sup> Annual reports must include, among other things: Disclosure relating to the issuer’s business operations for the preceding three fiscal years (or, if in existence for less than three years, since inception); two years of audited financial statements; and management’s discussion and analysis (“MD&A”) of the issuer’s liquidity, capital resources, and results of operations. Semiannual reports require disclosure primarily relating to the issuer’s interim financial statements and MD&A. Issuers are required to file current reports on Form 1–U with the Commission within four business days of the occurrence of certain events.

An issuer in a Tier 2 offering that has filed all ongoing reports required by Regulation A for the shorter of (1) the period since the issuer became subject to such reporting obligation or (2) its most recent three fiscal years and the portion of the current year preceding the date of filing Form 1–Z, may immediately suspend its ongoing reporting obligations under Regulation A at any time after completing reporting for the fiscal year in which the offering statement was qualified if the securities of each class to which the offering statement relates are held of record by fewer than 300 persons and offers or sales made in reliance on a qualified Tier 2 offering statement are not ongoing.<sup>326</sup>

In the 2018 amendments to Regulation A, as directed by the Economic Growth Act, the Commission revised Rule 257 to provide that entities meeting the reporting requirements of Section 13 or 15(d) of the Exchange Act will be deemed to have met the reporting requirements of Regulation A.<sup>327</sup>

#### 3. Solicitation of Interest

Regulation A permits issuers to “test the waters” with, or solicit interest in a potential offering from, the general public either before or after the filing of the offering statement, provided that all solicitation materials include certain required legends and, after publicly filing the offering statement, are preceded or accompanied by a preliminary offering circular or contain a notice informing potential investors where and how the most current

<sup>314</sup> See 17 CFR 230.254(a).

<sup>315</sup> See 17 CFR 230.251(d)(2)(ii).

<sup>316</sup> See *id.*

<sup>317</sup> *QR Code Essentials* (2011), Denso ADC, available at <http://www.nacs.org/LinkClick.aspx?fileticket=D1FpVAvjuo%3D&tabid=1426&mid=4802>.

<sup>318</sup> See 2018 Forum Report.

<sup>319</sup> While Form S–1 is generally available for all types of issuers and transactions, Form S–11 is only available for offerings of securities issued by (i) real estate investment trusts, or (ii) issuers whose business is primarily that of acquiring and holding for investment real estate or interests in real estate or interests in other issuers whose business is primarily that of acquiring and holding real estate or interest in real estate for investment.

<sup>320</sup> Offerings under Tier 1 of Regulation A must also comply with state qualification requirements. See Section II.C.4.a. Several jurisdictions may require Tier 1 issuers to include audited financial statements prior to qualifying the offering. See, e.g., Wash. Rev. Code 21.20.220 (1994) available at <https://apps.leg.wa.gov/rcw/default.aspx?Cite=21.20.210>. See also Coordinated Review FAQs, available at <http://www.nasaa.org/industry-resources/corporation-finance/coordinated-review/regulation-a-offerings/coordinated-review-faqs/>.

<sup>321</sup> See 17 CFR 230.252(d).

<sup>322</sup> See *id.*

<sup>323</sup> 17 CFR 230.252(f)(2).

<sup>324</sup> See 17 CFR 230.257(a).

<sup>325</sup> See 17 CFR 230.257(b).

<sup>326</sup> See 17 CFR 230.257(d).

<sup>327</sup> See 17 CFR 230.257(b); 2018 Regulation A Release.

preliminary offering circular can be obtained.<sup>328</sup> Test-the-waters materials must be filed as exhibits if the issuer proceeds to file a Form 1-A.<sup>329</sup>

We note, however, that paragraph (a) of 17 CFR 230.255 (“Rule 255”) specifically provides that these solicitations of interest are deemed to be offers of a security for sale for purposes of the antifraud provisions of the federal securities laws. Accordingly, if these solicitations of interest fail to satisfy the conditions of Rule 255(b), the solicitations must either be registered under the Securities Act or rely on another exemption from registration.<sup>330</sup>

After adoption of the 2015 amendments, the 2016 Small Business Forum recommended that the Commission provide a clearer definition of what constitutes “testing the waters materials” and permissible media activities.<sup>331</sup>

#### 4. Relationship With State Securities Laws

##### a. Tier 1 Offerings

In addition to qualifying a Regulation A offering with the Commission, issuers in Tier 1 offerings must register or qualify their offering in any state in which they seek to offer or sell securities pursuant to Regulation A.<sup>332</sup> Registration or qualification of a Tier 1 offering in some jurisdictions may require additional disclosure to that required under Commission rules. For example, several jurisdictions require an issuer to provide audited financial statements prior to qualifying an offering in that jurisdiction.<sup>333</sup> In addition, while Regulation A permits issuers to test the waters and make offers in the pre-qualification period at the federal level, given what the Commission anticipated to be the generally more local nature of Tier 1 offerings, the rules preserve the states’ oversight over how these offerings are conducted, including how solicitation materials are used.<sup>334</sup> The Commission contemplated that issuers conducting Tier 1 offerings would be smaller companies whose businesses revolved around products and services, and whose customer base likely would be located within a single state or region or

a small number of states.<sup>335</sup> The Commission did not expect Tier 1 issuers generally to seek or, on the basis of their business models, be able to: (a) Raise capital on a national scale; or (b) create a secondary trading market in their Regulation A securities.<sup>336</sup>

##### b. Tier 2 Offerings

While issuers in Tier 2 offerings are required to qualify offerings with the Commission before sales can be made pursuant to Regulation A, they are not required to register or qualify their offerings with state securities regulators. Section 18 of the Securities Act generally provides for preemption of state law registration and qualification requirements for “covered securities.”<sup>337</sup> Section 18(b)(4)(D) of the Securities Act further provides that securities issued pursuant to Section 3(b)(2) of the Securities Act are covered securities if they are listed, or will be listed, on a national securities exchange or if they are offered or sold to a “qualified purchaser,”<sup>338</sup> which the Commission has defined to include any person to whom securities are offered or sold in a Tier 2 offering.<sup>339</sup>

As discussed above, given the significant additional requirements for Tier 2 issuers, including the requirement to provide audited financial statements, the ongoing reporting requirements, and the investment limits for non-accredited investors, the Commission expected Tier 2 offerings to be national rather than local in nature.<sup>340</sup> Accordingly, the Commission determined that preemption of state securities law registration and qualification requirements is appropriate for purchasers in these offerings.<sup>341</sup>

Tier 2 offerings remain subject to state law enforcement and antifraud authority. Additionally, issuers in Tier 2 offerings may be subject to filing fees in the states in which they intend to offer or sell securities and may be required to file with such states any materials that the issuer has filed with the Commission as part of the offering.<sup>342</sup>

Since adoption of the 2015 amendments, we have received

comments and recommendations from the Commission’s Advisory Committee on Small and Emerging Companies,<sup>343</sup> a number of the annual Small Business Forums, and the 2017 Treasury Report on the preemption of state requirements for Regulation A offerings. The 2016 Small Business Forum recommended that Commission adopt rules that preempt state registration requirements for all primary and secondary trading of securities sold in offerings registered with the Commission.<sup>344</sup> Similarly, the 2017 and 2018 Small Business Forums recommended that the Commission provide for blue sky preemption for secondary trading of securities issued in Regulation A Tier 2 offerings.<sup>345</sup> The 2017 Treasury Report also recommended that state securities regulators update their regulations to exempt from state registration and qualification requirements secondary trading of securities issued under Tier 2 of Regulation A or, alternatively, that the Commission use its authority to preempt state registration requirements for such transactions.<sup>346</sup> The Commission’s Advisory Committee on Small and Emerging Companies and the 2014, 2015, and 2017 Small Business Forums all recommended preemption for secondary trading of securities of Regulation A Tier 2 issuers that are current in their ongoing reports.<sup>347</sup> The 2017 and 2018 Small Business Forums also recommended that the Commission consider overriding advance notice requirements of state regulators in Regulation A offerings and limiting state filing fees for these offerings.<sup>348</sup>

#### 5. Analysis of Regulation A in the Exempt Market

Table 8 below summarizes offerings initiated and offering statement qualified under Regulation A.

<sup>343</sup> See Advisory Committee on Small and Emerging Companies: Recommendations Regarding Secondary Market Liquidity for Regulation A, Tier 2 Securities (May 15, 2017) available at <https://www.sec.gov/info/smallbus/acsec/acsec-recommendation-051517-secondary-liquidity-recommendation.pdf> (“ACSEC Secondary Market Liquidity Recommendation”).

<sup>344</sup> See 2016 Forum Report. For a discussion of secondary trading of Regulation A and other exempt offering securities, see Section V.

<sup>345</sup> See 2017 Forum Report; 2018 Forum Report.

<sup>346</sup> See 2017 Treasury Report.

<sup>347</sup> See ACSEC Secondary Market Liquidity Recommendation; 2014 Forum Report (recommending that the Commission define “qualified purchaser” under Section 18(b)(3) to include any purchaser of a class of security that has been offered and sold pursuant to Section 4(a)(1) or (3), provided that, the issuer files reports pursuant to Rule 257(b) in order to preempt state blue sky regulation of after-market resale trading of securities issued pursuant to Tier 2 Regulation A offerings); 2015 Forum Report; 2017 Forum Report.

<sup>348</sup> See 2017 Forum Report; 2018 Forum Report.

<sup>335</sup> See 2015 Regulation A Release, at text accompanying note 830.

<sup>336</sup> See *id.*

<sup>337</sup> See 15 U.S.C. 77r(c).

<sup>338</sup> See 15 U.S.C. 77r(b)(4)(D).

<sup>339</sup> See 17 CFR 230.256.

<sup>340</sup> See 2015 Regulation A Release, at text accompanying note 830.

<sup>341</sup> See *id.*, at text accompanying note 799.

<sup>342</sup> See information from NASAA about states’

filing requirements available at <http://www.nasaa.org/industry-resources/corporation-finance/coordinated-review/regulation-a-offerings/state-filing-requirements/>.

<sup>328</sup> See 17 CFR 230.255.

<sup>329</sup> See Instructions to Form 1-A.

<sup>330</sup> See 17 CFR 230.255.

<sup>331</sup> See 2016 Forum Report.

<sup>332</sup> See information from NASAA about states’ coordinated review available at <http://www.coordinatedreview.org/regulation-a/>.

<sup>333</sup> See note 320.

<sup>334</sup> See 2015 Regulation A Release, at text accompanying note 799.



TABLE 8—OFFERINGS UNDER REGULATION A, JUNE 19, 2015–DECEMBER 31, 2018

	Tier 1	Tier 2	Tiers 1 and 2
Offering statements filed .....	119 .....	240 .....	359.
Aggregate dollar amount sought .....	\$1,014 million .....	\$6,732 million .....	\$7,746 million.
Average amount sought .....	\$8.5 million .....	\$28.0 million .....	\$21.6 million.
Offering statements qualified <sup>349</sup> .....	86 .....	191 .....	277.
Aggregate amount sought .....	\$742 million .....	\$5,139 million .....	\$5,881 million.
Average amount sought .....	\$8.6 million .....	\$26.9 million .....	\$21.2 million.
Issuers reporting proceeds <sup>350</sup> .....	27 .....	105 .....	132.
Aggregate amount reported raised .....	\$186.5 million .....	\$1,218 million .....	\$1,404 million.
Average amount reported raised <sup>351</sup> .....	\$6.9 million .....	\$11.6 million .....	\$10.6 million.

Based on staff analysis of Form 1–A filings, approximately 60% of issuers with Regulation A offering statements qualified during the sample period had undertaken another exempt offering in the prior year, most of them in reliance on Section 4(a)(2) or Regulation D, suggesting that most issuers in the Regulation A market tend to engage in more than one type of exempt offering.

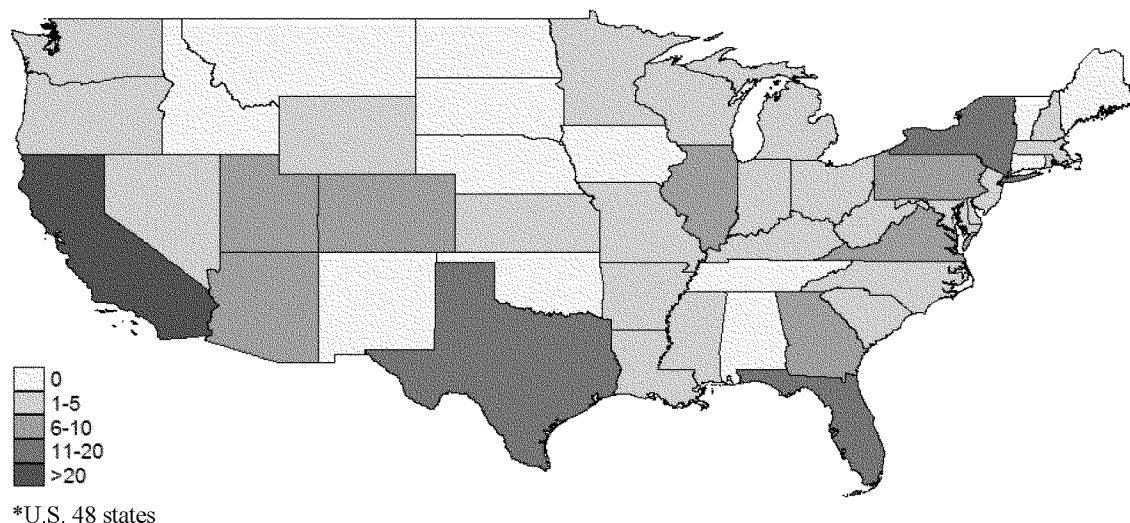
While the average amount reported raised by Regulation A issuers is higher than the average amount reported raised by Regulation D issuers during this period, significantly more capital was reported raised in the aggregate across all Regulation D offerings because Regulation D offerings are much more common. Compared to Regulation A offerings, over the same period (from

June 19, 2016 to December 31, 2018), approximately 36,900 issuers, other than pooled investment funds, each reported raising up to \$50 million in reliance on Regulation D, totaling approximately \$181 billion, with the average reported proceeds of approximately \$4.9 million per issuer.

The typical Regulation A issuer was relatively small and early-stage. Regulation A issuers reported median total assets of approximately \$0.4 million and average total assets of approximately \$38 million. The median issuer reported no revenues (just over half of the offerings were by issuers with no revenues) and was incorporated 3.0 years earlier (compared to an average of 6.5 years for all Regulation A issuers). Approximately 20% of Regulation A

offerings were by issuers that had attained profitability in the most recent fiscal year prior to the offering. There was significant industry and geographic concentration among issuers. Based on primary Standard Industry Classification codes disclosed in Form 1–A filings, approximately 36% of qualified Regulation A offering statements during this period were by issuers in the financial sector, and approximately 15% were by issuers in business services (including software). Approximately 24% of issuers were located in California, 10% in Florida, and 8% in New York. Figure 7 reflects the geographic concentration of offerings based on the number of qualified offering statements by issuer location.

Figure 7: Number of qualified Regulation A offerings by issuer location



<sup>349</sup> Unique offerings were identified based on CIK and file number; offerings that were withdrawn or abandoned were excluded; and offerings identified as duplicates were consolidated. Amendments are consolidated with the original offering statement for purposes of the number of offering statements. These estimates exclude post-qualification amendments. Rounding affects totals.

<sup>350</sup> If an issuer reported proceeds from both a Tier 1 and a Tier 2 offering, that issuer is counted twice (once under Tier 1 and once under Tier 2).

<sup>351</sup> Average amounts are among offerings that reported proceeds. The distribution of reported proceeds has a right tail, so average proceeds are larger than median proceeds. Median reported proceeds were approximately \$4.9 million for Tier

1 issuers and approximately \$3.9 million for Tier 2 issuers. Tier 1 issuers only report proceeds upon offering completion. Many Tier 2 issuers report proceeds in ongoing offerings, which are subsequently revised upward. Thus, proceeds reported by Tier 1 and Tier 2 issuers are not directly comparable.

Based on staff analysis of information provided in Form 1–A filings as of December 31, 2018, we estimate that approximately 48 issuers, 28 of which are Tier 2 issuers, with qualified offering statements under Regulation A reported assets greater than \$10 million and have not filed a Securities Act registration statement, reports under Section 13 or 15(d) of the Exchange Act, or, for Tier 2 issuers, an exit report on Form 1–Z. A portion of these Regulation A issuers may have, or may be approaching, the number of holders of record that would require registration under the Exchange Act, and a portion of the Tier 2 issuers may be relying on the conditional exemption in Rule 12g5–1. However, we do not have sufficient data available to estimate the number of holders of record or the public float for these issuers, so we cannot provide a more accurate estimate of the number of Tier 2 issuers that may be using the conditional exemption from Section 12(g).

#### 6. Request for Comment

47. Do the requirements of Regulation A appropriately address capital formation and investor protection considerations? Is the process for qualifying Regulation A offerings appropriately tailored to the needs of investor protection? Is there anything about the process that is unduly burdensome? Do the costs associated with conducting a Regulation A offering dissuade issuers from relying on the exemption? If so, can we alleviate burdens in our rules or reduce costs for issuers while still providing adequate investor protection? Alternatively, should we retain Regulation A as it is?

48. Should we increase the \$50 million Tier 2 offering limit? Should we increase the \$20 million Tier 1 offering limit? If so, what limits would be appropriate? For example, as recommended by the 2017 Treasury Report and by the 2017 and 2018 Small Business Forums, should we increase the Tier 2 offering limit to \$75 million? Alternatively, as suggested by one commenter, should we increase the Tier 2 offering limit to \$100 million? Would another higher limit be appropriate? What are the appropriate considerations in determining a maximum offering size? In connection with an increase in either or both of the limits, should we consider additional investor protections—for example, aligning standards for when an amendment is required in an ongoing Regulation A offering with registered offering standards? Should we periodically adjust the offering limits for inflation? If so, how often should the adjustment be

made? Would increasing the maximum offering size encourage issuers to undertake the cost of conducting a Regulation A offering?

49. Should we extend eligibility to rely on Regulation A to additional categories of issuers, such as those organized and with a principal place of business outside of the United States and Canada, investment companies, or blank check companies? Should we, as recommended by the 2014, 2015, and 2016 Small Business Forums, allow BDCs to be eligible to rely on Regulation A? Should we, as recommended by the 2015 Small Business Forum, allow SBICs to be eligible to rely on Regulation A? Should we allow rural business investment companies (“RBICs”) to be eligible to rely on Regulation A?<sup>352</sup> Should we exclude any additional categories of issuers from Regulation A eligibility? What changes, if any, would need to be made to the offering statement disclosure requirements to accommodate these additional categories of issuers? What would be the effect on investors of permitting these additional categories of issuers?

50. Should we expand the types of eligible securities issuable under Regulation A? If so, what additional types of securities would be appropriate? What would be the effect on issuers, investors, and the market of permitting these additional categories of securities? Would legislative changes be necessary or beneficial in order to expand the types of eligible securities issuable under Regulation A?

51. Should we eliminate or change the individual investment limits for non-accredited investors in Tier 2 offerings? If we change the investment limits, what limits would be appropriate?

52. Are there any data available that show an increase or decrease in fraudulent activity in the Regulation A market as a result of the 2015 or 2018 amendments? If so, is any change the direct result of an increase in the number of offerings since the amendments? If there has been an increase in fraud but the cause is not attributable to the overall increase of offerings, what are the causes or explanations and what should we do to address them?

53. Should we, as recommended by the 2018 Small Business Forum, permit the use of QR codes in lieu of a hyperlink to the most recent offering circular? Are there other technological solutions that we should consider, such as use of the issuer’s website address, other URL addresses, or other methods

or technologies that would facilitate access to such information? Should we define permissible delivery methods more broadly so as to allow subsequently developed delivery technologies that become generally accepted elsewhere in the marketplace to be used in lieu of a hyperlink to a qualified offering circular? If so, how should we define permissible delivery methods?

54. Are the ongoing reporting requirements of Rule 257 appropriate from the perspective of issuers and investors? Should we consider changes to these requirements? If so, what changes should we consider?

55. Are the financial statement requirements in Form 1–A for each tier appropriate? Should we consider different financial statement requirements for Exchange Act reporting companies filing Forms 1–A? If so, what requirements should we consider?

56. Should we, as recommended by the 2018 Small Business Forum, amend Regulation A to permit at-the-market offerings?<sup>353</sup>

57. Should we amend Regulation A to allow incorporation by reference of the issuer’s financial statements in the Form 1–A?

58. Should we, as recommended by the 2016 Small Business Forum, provide additional guidance on what constitutes testing the waters materials and permissible media activities? If so, what materials should be covered?

59. Are there other changes that should be considered specifically with respect to the use of Regulation A by Exchange Act reporting companies, in light of the recent amendments to allow such issuers to rely on the exemption? If so, what changes should we consider?

60. For Tier 1 issuers, how is the dual Commission staff and state review process working? If issuers find the Tier 1 dual review process burdensome, should we eliminate the staff’s review and qualification of Tier 1 offering statements given the concurrent state review and qualification of the same offering statement? If the Commission staff does not review and qualify the offering, should we replace the requirement to file a Tier 1 offering statement with a requirement to comply with the appropriate state filing requirements and file only a notice with the Commission? Alternatively, should we use such an approach only if the issuer is required to register or qualify the offering based on a substantive disclosure document in at least one state, and not where the issuer is relying

<sup>352</sup> See note 555 for a discussion of RBICs.

<sup>353</sup> See note 290 and accompanying text for a discussion of at-the-market offerings.

exclusively on state exemptions from registration or qualification that do not require state review of a substantive disclosure document?

61. Do issuers find state advance notice and filing fee requirements burdensome? If so, are there changes it would be possible and appropriate for us to consider to alleviate such burdens or would legislative changes be necessary or beneficial in order to do so?

62. Should the conditional Section 12(g) exemption for Regulation A Tier 2 securities be modified? If so, in what way? For example, should we increase the thresholds in Exchange Act Rule 12g5-1(a)(7)? Should we, as recommended by one commenter, amend Rule 12g5-1 to tie the thresholds to those in the smaller reporting company definition? If we were to broaden the Section 12(g) exemption or make it permanent, would potential issuers be more likely to use Regulation A? What investor protection concerns could arise from such a change?

63. Should we, as recommended by the 2017 and 2018 Small Business Forums, require any intermediary that is in the business of facilitating Regulation A offerings to register as a broker-dealer and comply with requirements similar to the requirements for intermediaries under Regulation Crowdfunding, such as required disclosure of compensation and the amount thereof?

64. Should we, as recommended by the 2017 and 2018 Small Business Forums, provide any additional guidance for broker-dealers, transfer agents, clearing firms, or intermediaries regarding Regulation A securities? If so, in which areas and why?

#### *D. Limited Offerings—Rule 504 of Regulation D*

Rule 504 of Regulation D provides an exemption from registration under the Securities Act of 1933 for the offer and sale of up to \$5 million of securities in a 12-month period.<sup>354</sup> Rule 504 was adopted pursuant to the Commission's authority under Section 3(b)(1) of the Securities Act.<sup>355</sup> Prior to rule changes adopted by the Commission in 2016, the aggregate amount of securities that could be offered and sold in a 12-month period under Rule 504 was \$1 million. At the time Rule 504 was amended to increase this offering limit, the

Commission also repealed the Rule 505 exemption from registration.<sup>356</sup> Rule 505 was an exemption from Securities Act registration that had been available to both non-reporting and reporting companies so long as the aggregate offering amount did not exceed \$5 million in a 12-month period and certain other conditions were met.

#### 1. Scope of the Exemption

##### a. Eligible Issuers

The following categories of issuers are not eligible to use the Rule 504 exemption:

- Issuers that are required to file reports under Exchange Act Section 13(a) or 15(d);<sup>357</sup>
- Investment companies;<sup>358</sup>
- Blank check companies;<sup>359</sup> and
- Issuers that are disqualified under Rule 504's "bad actor" disqualification provisions.<sup>360</sup>

##### b. Offering and Investment Limits

As noted above, in 2016, the Commission amended Rule 504 to raise the aggregate amount of securities an issuer may offer and sell in any 12-month period from \$1 million to \$5 million, which is the maximum statutorily allowed under Section 3(b)(1).<sup>361</sup> As discussed in the adopting release for that rule change, while a few commenters<sup>362</sup> and the 2015 Small Business Forum<sup>363</sup> recommended that the Commission increase the Rule 504 offering limit to \$10 million, the Commission determined not to use its exemptive authority under Section 28 of the Securities Act to raise the maximum offering amount above \$5 million.

There are no limits on the amount an investor can invest in an offering under Rule 504.

#### c. General Prohibition on General Solicitation and Limitations on Resale

In general, issuers relying on Rule 504 may not use general solicitation or advertising to market the securities, and purchasers in a Rule 504 offering will receive "restricted securities" subject to the limitations in Rule 502(d) on the resale of the securities acquired in the transaction.<sup>364</sup> However, general solicitation and advertising is permitted and there are no resale limitations on the securities acquired in the transaction<sup>365</sup> if the issuer offers and sells the securities:

- Exclusively under one or more state laws that require registration and the public filing and delivery to investors of a substantive disclosure document before sale;

- In one or more states that do not have a provision requiring registration or the public filing and delivery of a disclosure document before sale, so long as:

- The securities have been registered in at least one other state that provides for such registration, public filing, and delivery before sale;

- The issuer offers and sells securities in that other state under those provisions;

- And the issuer delivers to all purchasers in any state the disclosure documents mandated by the state in which it registered the securities; or

- Exclusively in a state according to an exemption in such state that permits general solicitation and advertising, so long as sales are made only to "accredited investors."<sup>366</sup>

<sup>364</sup> See 17 CFR 230.502(d); 17 CFR 230.144(a)(3)(ii). See Section II.B.1.b for a discussion of restricted securities and the resale limitations of Rule 502(d).

<sup>365</sup> An investor who wishes to sell securities that are not restricted must either register the transaction or have an exemption for the transaction. See Section IV.

<sup>366</sup> 17 CFR 230.504(b)(1). State exemptions of this nature include those based on the "Model Accredited Investor Exemption," which was adopted by NASAA in 1997. See CCH NASAA Reporter Para. 361. Generally, the model rule exempts offers and sales of securities from state registration requirements if, among other matters, the securities are sold only to persons who are, or are reasonably believed to be, "accredited investors" as defined in Rule 501(a) of Regulation D. 17 CFR 230.501(a). The model rule restricts transfer of the securities for 12 months after issuance except to other accredited investors or if registered. General solicitations by any means under that provision are generally limited to a type of "tombstone" ad. See Model Accredited Investor Exemption, available at [http://www.nasaa.org/wp-content/uploads/2011/07/24-Model\\_Accredited\\_Investor\\_Exemption.pdf](http://www.nasaa.org/wp-content/uploads/2011/07/24-Model_Accredited_Investor_Exemption.pdf).

See Section II.A for a discussion of the definition "accredited investor."

<sup>356</sup> See Exemptions to Facilitate Intrastate and Regional Securities Offerings, Release No. 33-10238 (Oct. 26, 2016) [81 FR 83494 (Nov. 21, 2016)] ("Intrastate and Regional Offerings Release"). The removal of Rule 505 was effective on May 22, 2017.

<sup>357</sup> See 17 CFR 230.504(a)(1).

<sup>358</sup> See 17 CFR 230.504(a)(2).

<sup>359</sup> See 17 CFR 230.504(a)(3). See also note 25.

<sup>360</sup> 17 CFR 230.504(b)(3). Generally, offerings under Rule 504 are subject to the disqualification provisions found in Rule 506(d) of Regulation D. See Section II.B.2.e. Disqualification under Rule 504, however, will not arise as a result of disqualifying events relating to any conviction, order, judgment, decree, suspension, expulsion or bar that occurred before January 20, 2017, the effective date of the Rule 504 amendment that added the disqualification provisions. Events that occurred prior to January 20, 2017 that are within the relevant look-back period and would otherwise be disqualifying are, however, required to be disclosed in writing to each purchaser.

<sup>361</sup> See Intrastate and Regional Offerings Release. See also note 355.

<sup>362</sup> See Intrastate and Regional Offerings Release at n. 272.

<sup>363</sup> See 2015 Forum Report.

<sup>354</sup> 17 CFR 230.504.

<sup>355</sup> 15 U.S.C. 77c(b)(1). Section 3(b)(1) gives the Commission authority to adopt an exemption for offerings not exceeding \$5 million where the Commission believes registration under the Securities Act is not necessary by reason of the small amount involved or the limited character of the public offering.

## 2. Filing Requirements and Relationship With State Securities Laws

An issuer conducting an offering under Rule 504 is required to file a notice with the Commission on Form D within 15 days after the first sale of securities in the offering.<sup>367</sup> The Commission does not charge any fee to file or amend a Form D.

Offerings conducted pursuant to Rule 504 must be registered in each state in which they are offered or sold unless an exemption to state registration is available under state securities laws.<sup>368</sup> Each state has its own registration requirements and exemptions to registration requirements. The vast majority of states have adopted a

uniform registration form for offerings relying on Rule 504.<sup>369</sup> At least one state, however, has adopted a form of state-based crowdfunding that permits the use of general solicitation but has provided for an abbreviated state registration procedure where, in addition to following various state-specific requirements for registration, an issuer also complies with Rule 504 of Regulation D.<sup>370</sup>

## 3. Analysis of Rule 504 in the Exempt Market

From 2009–2018, two percent of the capital raised in Regulation D offerings under \$5 million by non-investment companies was offered under Rule 504

(and under Rule 505, prior to its repeal), and 98% of the capital raised was offered under Rule 506.<sup>371</sup> As illustrated in Table 9, in 2018, there were 85 additional new offerings that claimed a Rule 504 exemption as compared to 2017;<sup>372</sup> however, the increased number of Rule 504 filings generally aligns with the decrease in the number of Rule 505 offerings over the same period (83 offerings). In repealing Rule 505, the Commission noted that it believed that, due to the increase in Rule 504's aggregate offering amount, almost all of the offerings that were conducted under Rule 505 would qualify for an exemption under amended Rule 504.<sup>373</sup>

TABLE 9—NUMBER OF NEW OFFERINGS UNDER RULES 504 AND 505

	2016	Change from 2016 to 2017	2017	Change from 2017 to 2018	2018
Rule 504 .....	443	93	536	85	621
Rule 505 .....	173	–90	83	–83	0
Rules 504 and 505 .....	616	3	619	2	621

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<sup>367</sup> See 17 CFR 230.503. Filing a Form D notice is required, but a failure to file the notice does not invalidate the Rule 504 exemption.

<sup>368</sup> Securities issued pursuant to Rule 504 are not covered securities as this exemption is adopted pursuant to the Commission's authority under Section 3(b)(1) of the Securities Act.

<sup>369</sup> See CCH Blue Sky Law Reporter, Blue Sky Finding Lists, Small Corporate Offering Registration Program and Form U–7, ¶ 6461 (2016). As of 2016, 43 states, the District of Columbia, and the Commonwealth of Puerto Rico have adopted some form of the SCOR program or recognize the filing of Form U–7 (also referred to as uniform limited offering registration (“ULOR”). *Id.* SCOR and Form U–7 were developed by NASAA as a registration format for issuers registering securities under state securities laws when relying on an exemption from Securities Act registration, including Rule 504. An issuer may not use the SCOR Form to offer and sell its securities if the issuer or any of its officers,

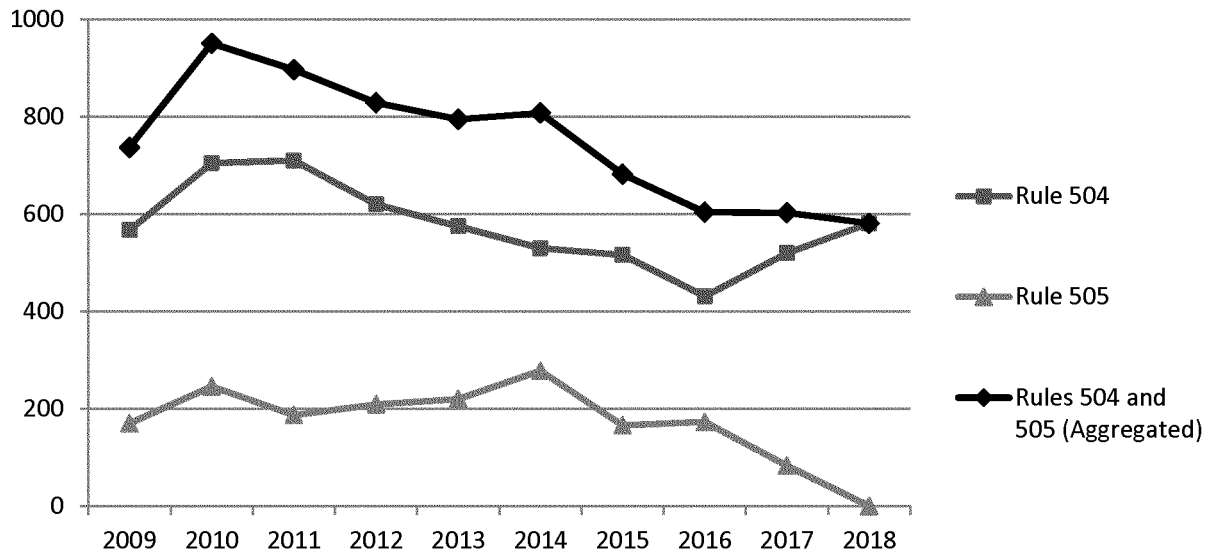
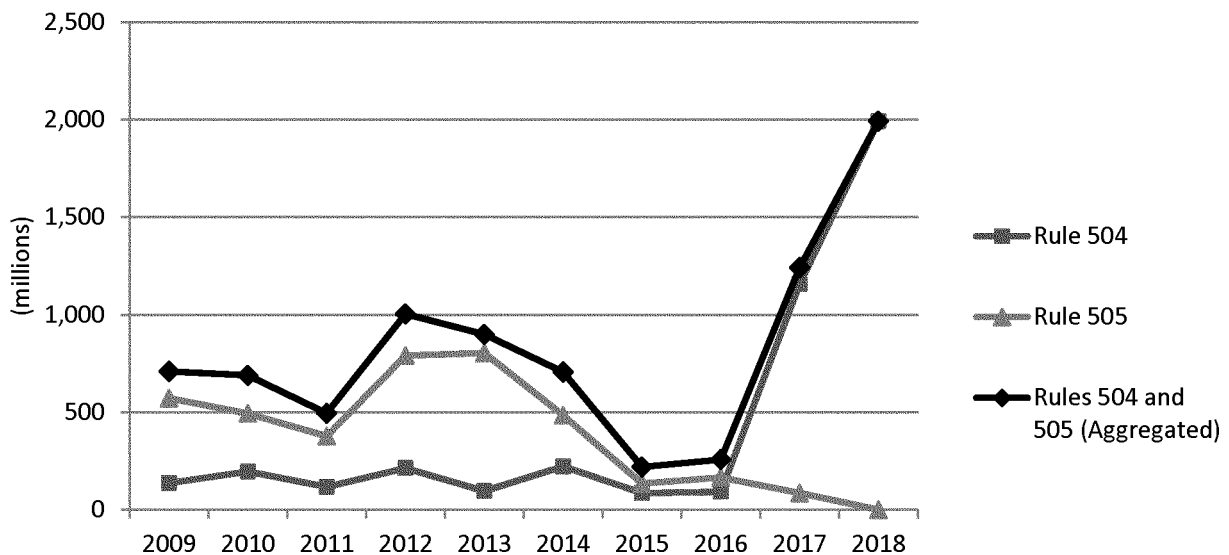
directors, principal stockholders, or promoters are disqualified because of prior violations of the securities laws. An issuer also may not use salespersons who are disqualified because of prior violations of the securities laws. See information from NASAA about SCOR and states' coordinated review available at <http://www.nasaa.org/industry-resources/corporation-finance/scor-overview/> and <http://www.coordinatedreview.org/cr-scor/>.

<sup>370</sup> Based on the “Intrastate Crowdfunding Legislation” summary prepared by NASAA, dated Jan. 2, 2018 available at <http://www.nasaa.org/wp-content/uploads/2018/01/NASAA-Crowdfunding-Index-1-2-2018.pdf>, of the 35 jurisdictions that adopted intrastate crowdfunding provisions, as of Jan. 2, 2018, Maine allows an issuer to rely on Rule 504 of Regulation D when the issuer complies with an abbreviated registration procedure. See Me. Rev. Stat. tit. 32, § 16304(6–A)(D) (2013) available at <https://www.maine.gov/pfr/securities/documents/title32sec16304.pdf>.

<sup>371</sup> See note 37 and accompanying text. The Commission repealed Rule 505 in the Intrastate and Regional Offerings Release, effective on May 22, 2017.

<sup>372</sup> Rule 504 offerings had declined by 16% from 2016 to 2017 and by 4% from 2015 to 2016. See Unregistered Offerings White Paper at Table 6.

<sup>373</sup> See Intrastate and Regional Offerings Release at the text accompanying n. 432 (“[I]f issuers switch [from Rule 505 offerings] to offerings under amended Rule 504, they could replicate most characteristics of an offering under existing Rule 505 and receive some additional benefits, such as access to an unlimited number of non-accredited investors and the ability to engage in general solicitation in certain situations. However, reporting companies, albeit a small proportion of all Rule 505 issuers, are not permitted to use the Rule 504 exemption.”).

**Figure 8: Number of new offerings under Rules 504 and 505****Figure 9: Capital raised under Rules 504 and 505**

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**4. Request for Comment**

65. Should we consider any changes to the Rule 504 exemption? Do the requirements of Rule 504 appropriately address capital formation and investor protection considerations? Is the Rule 504 exemption useful to help issuers meet their capital-raising needs? Alternatively, should we retain Rule 504 as it is?

66. Are there any data available that show an increase or decrease in fraudulent activity in the Rule 504 market as a result of recent amendments? If so, what are the causes

or explanations and what should we do to address them?

67. Should we increase the \$5 million offering limit? If so, what limit is appropriate? For example, as recommended by the 2015 Small Business Forum prior to the Commission's 2016 amendments, should we increase the Rule 504 offering limit to \$10 million? What are the appropriate considerations in determining a maximum offering size? In connection with any increase in the limit, should we consider imposing additional investor protections, such as individual investment limits?

68. Should we extend eligibility to rely on Rule 504 to additional categories of issuers, such as Exchange Act reporting companies or investment companies? Should we exclude any additional categories of issuers from Rule 504 eligibility?

69. Is the offering exemption under Rule 504 duplicative of Regulation A Tier 1? If we were to eliminate the staff's review and qualification of Regulation A Tier 1 offerings in light of the concurrent state-level review and qualification of the offering (as described in Question 60 above), should we also eliminate Rule 504? Would Rule

504 continue to have utility in such a circumstance?

70. Are there any regulatory or legislative changes that are necessary or beneficial to encourage regional offerings across two or more jurisdictions?

### E. Intrastate Offerings

#### 1. Section 3(a)(11) of the Securities Act

Section 3(a)(11) of the Securities Act is generally known as the “intrastate offering exemption.”<sup>374</sup> To qualify for the intrastate offering exemption, an issuer<sup>375</sup> must:

- Be organized in the state where it is offering the securities;
- Carry out a significant amount of its business in that state;<sup>376</sup> and
- Make offers and sales only to residents of that state.

The Commission has stated that the “legislative history of the Securities Act shows that this exemption was designed to apply only to local financing that may practicably be consummated in its entirety within the state or territory in which the issuer is both incorporated and doing business.”<sup>377</sup> Section 3(a)(11) does not limit the size of the offering or the number of investors, so long as “the entire issue of securities [is] offered and sold exclusively to residents of the state in question.”<sup>378</sup> However, the Commission has noted that “[a]n offering may be so large that its success as a local offering appears doubtful from the outset.”<sup>379</sup> An issuer must determine the residence of each offeree

<sup>374</sup> 15 U.S.C. 77c(a)(11) (providing an exemption from registration under the Securities Act for “[a]ny security which is part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory”).

<sup>375</sup> Issuers registered or required to be registered under the Investment Company Act are not eligible to conduct offerings pursuant to Section 3(a)(11). Under Section 24(d) of the Investment Company Act [15 U.S.C. 80a-24(d)], the Section 3(a)(11) exemption is not available for an investment company registered or required to be registered under the Investment Company Act. See Section 3(a)(11) Exemption for Local Offerings, Release No. 33-4434 (Dec. 6, 1961) [26 FR 11896 (Dec. 13, 1961)] (“Section 3(a)(11) Release”), at note 1; see also Intrastate and Regional Offerings Release at text accompanying note 240.

<sup>376</sup> See Section 3(a)(11) Release at 2 (“In view of the local character of the Section 3(a)(11) exemption, the requirement that the issuer be doing business in the state can only be satisfied by the performance of substantial operational activities in the state of incorporation. The doing business requirement is not met by functions in the particular state such as bookkeeping, stock record and similar activities or by offering securities in the state.”).

<sup>377</sup> Section 3(a)(11) Release at 1.

<sup>378</sup> *Id.* (emphasis in original).

<sup>379</sup> *Id.* at 3.

and purchaser. If the issuer offers or sells any of the securities to even one out-of-state person, the exemption may be lost. Without the exemption, the issuer would be in violation of the Securities Act if the offering does not qualify for another exemption and was not registered under the Securities Act.

#### a. Restrictions on Resales

Although Section 3(a)(11) does not have explicit resale restrictions, the Commission has explained that “to give effect to the fundamental purpose of the exemption, it is necessary that the entire issue of securities shall be offered and sold to, and come to rest only in the hands of residents within the state.”<sup>380</sup> State securities laws also may have specific resale restrictions. In addition, like any securities transaction, persons reselling the securities nonetheless will need to register the resale transaction with the Commission or have an exemption from registration under federal law.<sup>381</sup>

#### b. Filing Requirements and Relationship With State Securities Laws

Issuers conducting an offering pursuant to Section 3(a)(11) are not required to file any information with or pay any fees to the Commission. Offerings conducted pursuant to Section 3(a)(11) must be registered in the state in which the securities are offered or sold unless an exemption to state registration is available under the state’s securities laws.<sup>382</sup>

#### 2. Securities Act Rules 147 and 147A

17 CFR 230.147 (“Rule 147”) is considered a “safe harbor” under Section 3(a)(11) of the Securities Act, providing objective standards that an issuer can rely on to meet the requirements of that exemption.<sup>383</sup> The Rule 147 safe harbor was intended to provide assurances that the intrastate offering exemption would be used for the purpose Congress intended in

<sup>380</sup> *Id.* at 4.

<sup>381</sup> See Section V.A.

<sup>382</sup> A security issued pursuant to Section 3(a)(11) is not a “covered security” under Section 18. The intrastate exemptions provide the states with “the flexibility to adopt requirements that are consistent with their respective interests in facilitating capital formation and protecting their resident investors in intrastate securities offerings, including the authority to impose additional disclosure requirements regarding offers and sales made to persons within their state or territory, or the authority to limit the ability of certain bad actors from relying on applicable state exemptions.” See Intrastate and Regional Offerings Release at Section I.

<sup>383</sup> See SEC Release No. 33-5450 (Jan. 7, 1974) [39 FR 2353 (Jan. 21, 1974)] (“Rule 147 Adopting Release”). See also SEC Release No. 33-5349 (Jan. 8, 1973) [38 FR 2468 (Jan. 26, 1973)] (“Rule 147 Proposing Release”).

enacting Section 3(a)(11), namely the local financing of issuers by investors within the issuer’s state or territory.<sup>384</sup> Under Rule 147, states retain the flexibility to adopt requirements that are consistent with their respective interests in facilitating capital formation and protecting their resident investors in intrastate securities offerings, including the authority to impose additional disclosure requirements for offers and sales made to persons within their state or territory, and the authority to limit the ability of certain bad actors to rely on applicable state exemptions.

17 CFR 230.147A (“Rule 147A”) is a new intrastate offering exemption adopted by the Commission in 2016 that seeks to accommodate modern business practices and communications technology and provide an alternative means for smaller issuers to raise capital locally, including through offerings relying on intrastate crowdfunding provisions.<sup>385</sup> Rule 147A was adopted pursuant to the Commission’s general exemptive authority under Section 28 of the Securities Act, and therefore, Rule 147A is not subject to the statutory limitations of Section 3(a)(11). Accordingly, Rule 147A has no restriction on offers, but requires that all sales be made only to residents of the issuer’s state or territory to ensure the intrastate nature of the exemption. Rule 147A also does not require issuers to be incorporated or organized in the same state or territory where the offering occurs so long as issuers can demonstrate the in-state nature of their business. Consistent with Rule 147, states retain the flexibility to adopt requirements that are consistent with their respective interests in facilitating capital formation and protecting their resident investors in intrastate securities offerings, including the authority to impose additional disclosure requirements for offers and sales made to persons within their state or territory, or the authority to limit the ability of certain bad actors to rely on applicable state exemptions.

In order to conduct offerings pursuant to Rule 147 or Rule 147A, issuers<sup>386</sup> must meet certain requirements. Table 10 broadly summarizes the Commission requirements for each rule. We refer to “in-state” as the state or territory in which the issuer is resident and doing

<sup>384</sup> See Rule 147 Adopting Release. See also H.R. Rep. No. 73-85, at 6-7 (1933), H.R. Rep. No. 73-1838, at 40-41 (1934) (Conf. Rep.) and Section 3(a)(11) Release.

<sup>385</sup> See Intrastate and Regional Offerings Release.

<sup>386</sup> As with Section 3(a)(11) and Rule 147, issuers registered or required to be registered under the Investment Company Act are not eligible to conduct offerings pursuant to Rule 147A.

business at the time of the sale of the security.

TABLE 10—OVERVIEW OF RULE 147 AND RULE 147A REQUIREMENTS

	Requirements of Rule 147 (safe harbor under section 3(a)(11))	Requirements of Rule 147A
The issuer is organized in-state. <sup>387</sup>	.....	.....
The officers, partners, or managers of the issuer primarily direct, control and coordinate the issuer's activities ("principal place of business") in-state. <sup>388</sup>	.....	.....
The issuer satisfies at least one of the "doing business" requirements described below. <sup>389</sup>	.....	.....
Offers are limited to in-state residents <sup>390</sup> or persons who the issuer reasonably believes are in-state residents. <sup>391</sup>	.....	.....
Sales are limited to in-state residents or persons who the issuer reasonably believes are in-state residents. <sup>392</sup>	.....	.....
The issuer obtains a written representation from each purchaser as to residency. <sup>393</sup>	.....	.....

a. "Doing Business" In-State

Issuers conducting an offering pursuant to Rule 147 or Rule 147A must satisfy *at least one* of the following requirements in order to be considered "doing business" in-state:

- The issuer derived at least 80% of its consolidated gross revenues from the operation of a business or of real property located in-state or from the rendering of services in-state;
- The issuer had at least 80% of its consolidated assets located in-state;<sup>394</sup>
- The issuer intends to use and uses at least 80% of the net proceeds from the offering towards the operation of a business or of real property in-state, the purchase of real property located in-state, or the rendering of services in-state; or
- A majority of the issuer's employees are based in-state.<sup>395</sup>

<sup>387</sup> See 17 CFR 230.147(c)(1)(i).

<sup>388</sup> See 17 CFR 230.147(c)(1) and 17 CFR 230.147A(c)(1).

<sup>389</sup> See 17 CFR 230.147(c)(2) and 17 CFR 230.147A(c)(2).

<sup>390</sup> The residence of an offeree or purchaser that is a legal entity (e.g., corporation, partnership, or trust) is the location where, at the time of the sale, the entity has its principal place of business. However, if a legal entity was organized for the specific purpose of acquiring securities pursuant to Rule 147 or Rule 147A, all beneficial owners must be in-state residents for the entity to be considered an in-state resident. In addition, a trust that is not deemed to be a separate legal entity is a resident of each state or territory in which its trustee is, or trustees are, resident. If the purchaser is an individual, such person is deemed to be a resident of the state or territory if such person has, at the time of the offer and sale, his or her principal residence in the state or territory.

<sup>391</sup> See 17 CFR 230.147(d).

<sup>392</sup> See 17 CFR 230.147(d) and 17 CFR 230.147A(d).

<sup>393</sup> See 17 CFR 230.147(f)(1)(iii) and 17 CFR 230.147A(f)(1)(iii).

<sup>394</sup> This is measured at the end of its most recent semi-annual fiscal period prior to the first offer of securities pursuant to the exemption.

<sup>395</sup> See 17 CFR 230.147(c)(2) and 17 CFR 230.147A(c)(2).

b. Restrictions on Resales

For a period of six months from the date of the sale by the issuer to the purchaser, securities purchased in an offering pursuant to Rule 147 or Rule 147A may only be resold to persons residing in-state.<sup>396</sup> Issuers must disclose these limitations on resale to offerees and purchasers and include appropriate legends on the certificate or document evidencing the security.<sup>397</sup> Although securities purchased in an offering pursuant to Rule 147 or Rule 147A are not considered "restricted securities," persons reselling the securities nonetheless will need to register the resale transactions with the Commission or rely on an exemption from registration under federal securities law.

c. Filing Requirements and Relationship With State Securities Laws

Issuers conducting an offering pursuant to Rule 147 or Rule 147A are not required to file any information with or pay any fees to the Commission. Offerings conducted pursuant to Rule 147 or Rule 147A must be registered in the state in which they are offered or sold unless an exemption to state registration is available under the state's securities laws.<sup>398</sup> Each state has its own registration requirements and exemptions to registration requirements.<sup>399</sup>

<sup>396</sup> See 17 CFR 230.147(e) and 17 CFR 230.147A(e).

<sup>397</sup> See 17 CFR 230.147(f) and 17 CFR 230.147A(f).

<sup>398</sup> A security issued pursuant to Section 3(a)(11) and its Rule 147 safe harbor or pursuant to Rule 147A is not a "covered security" under Section 18. See *Intrastate and Regional Offerings Release at Section I*.

<sup>399</sup> See, e.g., information from NASAA about intrastate crowdfunding legislation and regulation available at <http://www.nasaa.org/industry-resources/corporation-finance/intrastate-crowdfunding-resource-center/>.

3. Request for Comment

71. To what extent are the intrastate exemptions being used? Do the requirements of the intrastate exemptions appropriately address capital formation and investor protection considerations? Are the intrastate exemptions useful to help issuers meet their capital-raising needs? We request data with respect to: (a) The use of Rule 147 and Rule 147A; (b) repeat use by the same issuers of Rule 147 or Rule 147A; (c) the use by issuers of alternative federal offering exemptions concurrently or close in time to an offer or sale under Rule 147 or Rule 147A; (d) fraud associated with, or issuer non-compliance with provisions of, Rule 147 or Rule 147A; (e) the role of intrastate broker-dealers and other intermediaries in offerings conducted pursuant to Rule 147 or Rule 147A; and (f) the application of state bad actor disqualification provisions in offerings conducted pursuant to Rule 147 or Rule 147A.

72. Are there any data available that show an increase or decrease in fraudulent activity in the intrastate offerings market as a result of recent amendments or the introduction of Rule 147A? If so, what are the causes or explanations and what should we do to address them?

73. Should we eliminate Rule 147 and retain Rule 147A? If we were to eliminate Rule 147 and Rule 504 (as described in Question 69 above), would issuers still rely on the intrastate exemption in Section 3(a)(11)?

74. Do the issuer requirements related to principal place of business and doing business appropriately capture the "intrastate" issuers for purposes of Rules 147 and 147A? If not, how should they be changed?

75. Does the requirement that an individual purchaser have his or her principal residence in a state or territory

in order to be deemed a resident of such state or territory appropriately capture the “intrastate” investors for purposes of Rules 147 and 147A? What impact does this have on potential purchasers who have more than one place of residence? Would it be appropriate to revise the definition of intrastate purchasers to include those purchasers in a state who would qualify as residents under that state’s laws and regulations regarding intrastate offers and sales of securities? What input should states have in determining whether an offering is intrastate?

76. For a legal entity that was organized for the specific purpose of acquiring securities pursuant to Rule 147 or Rule 147A to be considered an in-state resident, all beneficial owners must be in-state residents. Do issuers face challenges in determining whether an entity was organized for the specific purpose of acquiring securities? If so, should we provide guidance on such determination?

77. What regulatory or legislative changes are needed to allow regional offerings that are not limited to one jurisdiction?

78. Should we consider any changes to either Rule 147 or Rule 147A? What effects would such changes have on capital formation and investor protection?

#### F. Regulation Crowdfunding

Title III of the JOBS Act added Securities Act Section 4(a)(6), which provides an exemption from registration for certain crowdfunding transactions.<sup>400</sup> To qualify for the exemption under Section 4(a)(6), transactions must meet a number of statutory requirements that are discussed in more detail below, including limits on the amount an issuer may raise, limits on the amount an individual may invest and a requirement that the transactions be conducted through an intermediary that is registered as either a broker-dealer or a “funding portal.” In addition, Title III added Section 4A to the Securities Act, which requires, among other things, that issuers and intermediaries that facilitate transactions under Section 4(a)(6) provide certain specified information to investors and the Commission. Title III

<sup>400</sup> Crowdfunding generally refers to a method of capital raising in which an entity or individual raises funds via the internet from a large number of people typically making small individual contributions. Individuals interested in the crowdfunding campaign—members of the “crowd”—may share information about the project, cause, idea, or business with each other and use the information to decide whether to fund the campaign based on the collective “wisdom of the crowd.”

also mandated that the Commission establish bad actor provisions disqualifying certain issuers from availing themselves of the Section 4(a)(6) exemption and adopt rules to exempt from the registration requirements of Section 12(g), either conditionally or unconditionally, securities acquired pursuant to an offering under Section 4(a)(6).

In 2015, to implement the requirements of Title III, the Commission adopted Regulation Crowdfunding, which became effective on May 16, 2016.<sup>401</sup> On March 31, 2017, the Commission adjusted for inflation certain thresholds in Regulation Crowdfunding, as required by Section 4A(h).<sup>402</sup>

In the Crowdfunding Adopting Release, the Commission stated that staff would undertake to study and submit a report to the Commission (the “Crowdfunding Study”) no later than three years following the effective date of Regulation Crowdfunding on the impact of the regulation on capital formation and investor protection.<sup>403</sup> In May 2019, the staff submitted the Crowdfunding Study to the Commission.<sup>404</sup> We discuss certain relevant findings from the Crowdfunding Study later in this section.

#### 1. Scope of the Exemption

##### a. Eligible Issuers

Certain issuers are not eligible to use the Regulation Crowdfunding exemption. Section 4A, as added by Title III, specifically excludes:

- Non-U.S. issuers;

<sup>401</sup> See Crowdfunding, Release No. 33–9974 (Oct. 30, 2015) [80 FR 71387 (Nov. 16, 2015)] (“Crowdfunding Adopting Release”).

<sup>402</sup> Securities Act Section 4(a)(6) exempts offerings of up to \$1 million in a 12-month period, subject to adjustment for inflation required by Section 4A(h) at least once every 5 years. See Inflation Adjustments and Other Technical Amendments under Titles I and III of the JOBS Act (Technical Amendments; Interpretation), Release No. 33–10332 (Mar. 31, 2017) [82 FR 17545 (Apr. 12, 2017)] (“2017 Amendments”).

<sup>403</sup> See Crowdfunding Adopting Release, at 71390. The Adopting Release stated that the Crowdfunding Study will include, but not be limited to, a review of: (1) Issuer and intermediary compliance; (2) issuer offering limits and investor investment limits; (3) incidence of fraud, investor losses, and compliance with investor aggregates; (4) intermediary fee and compensation structures; (5) measures intermediaries have taken to reduce the risk of fraud, including reliance on issuer and investor representations; (6) the concept of a centralized database of investor contributions; (7) intermediary policies and procedures; (8) intermediary recordkeeping practices; and (9) secondary market trading practices.

<sup>404</sup> See Report to the Commission on Regulation Crowdfunding (Jun. 18, 2019) available at [www.sec.gov/smallbusiness/exemptofferings/regcrowdfunding/2019Report](http://www.sec.gov/smallbusiness/exemptofferings/regcrowdfunding/2019Report).

• Issuers that are required to file reports under Exchange Act Section 13(a) or 15(d);

• Certain investment companies; and

• Other issuers that the Commission, by rule or regulation, determines appropriate.<sup>405</sup>

In addition, the Commission’s rules further exclude:

• Issuers that are disqualified under Regulation Crowdfunding’s disqualification rules;<sup>406</sup>

• Issuers that have failed to comply with the annual reporting requirements under Regulation Crowdfunding during the two years immediately preceding the filing of the offering statement; and

• Blank check companies.<sup>407</sup>

As a result of the statutory investment company exclusion, special purpose vehicles or funds organized to invest in, or lend money to, a single company (“SPVs”) are not eligible to raise funds under Regulation Crowdfunding.<sup>408</sup>

Since the adoption of Regulation Crowdfunding, we have received comments and recommendations from a variety of sources, including certain of the annual Small Business Forums<sup>409</sup> and the 2017 Treasury Report,<sup>410</sup> on the inability to use an SPV to conduct a crowdfunding offering. The 2017 Small Business Forum recommended that the Commission consider promoting simplification of the capitalization table of Regulation Crowdfunding issuers by allowing the use of SPVs to aggregate investors with appropriate conditions.<sup>411</sup> Similarly, the 2017 Treasury Report recommended allowing the use of SPVs advised by a registered investment adviser, which may mitigate issuers’ concerns about vehicles having an unwieldy number of shareholders and tripping the registration thresholds

<sup>405</sup> 15 U.S.C. 77d–1.

<sup>406</sup> Regulation Crowdfunding includes disqualification provisions that are substantially similar to those in Rule 506(d). See Section II.B.2.e. Disqualification under Regulation Crowdfunding, however, will not arise as a result of disqualifying events relating to any conviction, order, judgment, decree, suspension, expulsion or bar that occurred before May 16, 2016, the effective date of Regulation Crowdfunding. Events that occurred prior to May 16, 2016 that are within the relevant look-back period and would otherwise be disqualifying are, however, required to be disclosed in writing to each purchaser.

<sup>407</sup> See 17 CFR 227.100(b). See also note 25.

<sup>408</sup> See 15 U.S.C. 77d–1(f)(3); 17 CFR 227.100(b)(3); and Crowdfunding Adopting Release at 71397. While a number of commenters raised concerns about the inability to use a SPV in a crowdfunding offering, the Commission retained the exclusion, citing the statutory exclusion of investment funds from eligibility to rely on Section 4(a)(6) and noting that investment fund issuers present considerations different from those for non-fund issuers.

<sup>409</sup> See 2014 Forum Report; 2017 Forum Report.

<sup>410</sup> See 2017 Treasury Report.

<sup>411</sup> See 2017 Forum Report.



of Section 12(g).<sup>412</sup> However, in light of what it cited as potential conflicts of interest between the issuer, lead investors, and other investors, including non-accredited investors, the 2017 Treasury Report recommended that any rulemaking in this area prioritize: (1) Alignment of interests between the lead investor and the other investors participating in the vehicle; (2) regular dissemination of information from the issuer; and (3) minority voting protections with respect to significant corporate actions.<sup>413</sup>

In addition, since the adoption of Regulation Crowdfunding, and most recently, in connection with the Crowdfunding Study, the staff has received feedback from market participants that certain issuer requirements under Regulation Crowdfunding may be preventing issuers from raising capital through the exemption. Some intermediaries have told the staff that many issuers have elected not to pursue an offering under Regulation Crowdfunding because without a SPV, a large number of investors on an issuer's capitalization table can be unwieldy and potentially impede future financing. Similarly, some intermediaries have reported that issuers are hesitant to offer voting rights to investors in offerings under this exemption because the logistical challenges of seeking any required shareholder vote are too high a risk in the event of later financing and governance of the issuer. Market participants cited other potential investor protections that a SPV structure could provide, such as allowing small investors to invest alongside a sophisticated lead investor who may negotiate better terms, protect against dilution by negotiating during subsequent financings, mentor the issuer, and represent smaller investors on the board.

#### b. Offering Limit

An issuer is permitted to raise a maximum aggregate amount of \$1.07 million in a 12-month period in reliance on Regulation Crowdfunding.<sup>414</sup> In determining the amount that may be sold in a particular offering, an issuer should count:

- The amount it has already sold (including amounts sold by entities controlled by, or under common control with, the issuer, as well as any amounts sold by any predecessor of the issuer) in reliance on Regulation Crowdfunding

during the 12-month period preceding the expected date of sale, plus

- The amount the issuer intends to raise in reliance on Regulation Crowdfunding in its current offering.

We have received feedback from several market participants on the issuer offering limits. The 2017 Small Business Forum, the 2017 Treasury Report, and other market participants in connection with the Crowdfunding Study have stated that the offering limit should be higher, recommending limits from \$5 million to \$20 million.<sup>415</sup> On the other hand, one intermediary stated that the current \$1.07 million offering limit is appropriate, noting that most offerings are well below that level. Another intermediary stated that very few potential issuers expressed interest in raising over \$107,000. Some of the intermediaries that recommended an increased offering limit stated their view that while few offerings reach the current limit, many issuers choose not to rely on the crowdfunding exemption because the limit is too low. According to some of these intermediaries, some issuers choose to raise funds needed in excess of the offering limit through a separate offering, which they consider to be a less optimal experience for investors and a more costly and potentially riskier approach for issuers. Another market participant noted that many early-stage issuers require more than \$1.07 million and that, but for the offering limit, Regulation Crowdfunding would provide a better solution than other available exemptions. Some of these market participants stated that the existing offering limit may deter some "high-quality," high-growth issuers with substantial financing needs from relying on Regulation Crowdfunding, thereby lowering the average quality of issuers in the Regulation Crowdfunding market. One intermediary stated that raising the offering limit could attract more issuers and expand opportunities for non-accredited investors. Another intermediary stated that the few issuers that had raised the maximum offering amount through its platform would have sought to raise additional capital had they been permitted to do so, and that high-quality issuers may have significant upfront capital needs that exceed the existing limit.

<sup>415</sup> See, e.g., 2017 Treasury Report, at 41 (recommending "increasing the limit on how much can be raised over a 12-month period from \$1 million to \$5 million, as it will potentially allow companies to lower the offering costs per dollar raised") and 2017 Forum Report, at 18 (recommending a \$5 million limit).

#### c. Investment Limits

Individual investors are limited in the amounts they are allowed to invest in all Regulation Crowdfunding offerings over the course of a 12-month period, as follows:

- If either of an investor's annual income or net worth is less than \$107,000, then the investor's investment limit is the greater of:

- \$2,200 or
- 5% of the lesser of the investor's annual income or net worth.

- If both annual income and net worth are equal to or more than \$107,000, then the investor's limit is 10% of the lesser of his or her annual income or net worth.

- During the 12-month period, the aggregate amount of securities sold to an investor through all Regulation Crowdfunding offerings may not exceed \$107,000, regardless of the investor's annual income or net worth.<sup>416</sup>

Spouses are allowed to calculate their net worth and annual income jointly.

A number of market participants have expressed concerns about the investment limits.<sup>417</sup> The 2018 Small Business Forum recommended that the Commission increase the investment limit for all investors, suggesting that doing so would help the market grow as it would allow more individual investments into the marketplace.<sup>418</sup>

The 2017 and 2018 Small Business Forums and the 2017 Treasury Report along with other market participants also recommended that the investment limits not apply to accredited investors, who face no such limits under other exemptions.<sup>419</sup> The 2018 Small Business Forum stated that removing the individual accredited investor limits would make crowdfunding offerings more attractive to accredited investors and make it easier for offerings to reach their maximum offering goals.<sup>420</sup> In conjunction with removing the investment limits for individual accredited investors, the 2018 Small Business Forum recommended verification of accredited investor status.<sup>421</sup> Similarly, some intermediaries recommended that intermediaries be required to verify accredited investor status, income, or net worth for certain larger investments, such as those over \$25,000 in a 12-month period. In addition, some intermediaries stated

<sup>416</sup> See 17 CFR 227.100(a)(2).

<sup>417</sup> See, e.g., 2017 Treasury Report, 2018 Forum Report.

<sup>418</sup> See 2018 Forum Report.

<sup>419</sup> See 2017 Forum Report; 2018 Forum Report; and 2017 Treasury Report.

<sup>420</sup> See 2018 Forum Report.

<sup>421</sup> See *id.*

<sup>412</sup> See 2017 Treasury Report.

<sup>413</sup> See *id.*

<sup>414</sup> See 17 CFR 227.100(a)(1). See also note 402.

that conducting a separate Regulation D offering to allow accredited investors to invest greater amounts was unnecessarily confusing to investors and more costly to issuers.

The 2017 Small Business Forum and some intermediaries in connection with the Crowdfunding Study also recommended that the investment limits should apply on a per-investment basis rather than across all crowdfunding offerings in a 12-month period.<sup>422</sup> The 2017 Small Business Forum also recommended rationalizing the investment limit as it applies to entities by basing the limit on entity type rather than income.<sup>423</sup>

The 2015 Small Business Forum, the 2017 Treasury Report, and several market participants recommended basing the 5% or 10% limit on the greater of the investor's net worth or income rather than the lesser of those two amounts.<sup>424</sup> Some stated that allowing investors to invest the higher 10% amount only if both their net worth and income exceed the \$107,000 threshold is inconsistent with the accredited investor definition, which requires the investor only to meet *either* the net worth *or* the income standard.<sup>425</sup> The 2017 Treasury Report stated that the current rules unnecessarily limit investors who have a high net worth relative to annual income, or vice versa, which it noted is inconsistent with the approach taken for Regulation A Tier 2 offerings. One market participant noted that requiring that both net worth and income meet the \$107,000 threshold could result in an accredited investor being subject to the lower 5% investment limit.

#### d. Transactions Conducted Through an Intermediary and Intermediary Requirements

Each Regulation Crowdfunding offering must be exclusively conducted through an online platform. The intermediary operating the platform must be a broker-dealer or a funding portal<sup>426</sup> that is registered with the Commission and a member of a registered national securities

association.<sup>427</sup> Under Regulation Crowdfunding, intermediaries, whether registered broker-dealers or funding portals, are required, among other things:

- To provide investors with educational materials;<sup>428</sup>
- To take measures to reduce the risk of fraud;<sup>429</sup>
- To make available information about the issuer and the offering;<sup>430</sup>
- To provide communication channels to permit investors to communicate with each other and with representatives of the issuer about offerings on the platform;<sup>431</sup> and
- To facilitate the offer and sale of crowdfunding securities.<sup>432</sup>

An intermediary is prohibited from engaging in certain activities under the rules, including but not limited to:

- Providing access to its platform to an issuer if the intermediary has a reasonable basis for believing that the issuer or any of its officers, directors (or any person occupying a similar status or performing a similar function), or beneficial owners of 20% or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power, is subject to a disqualification;
  - Providing access to its platforms to any issuer that the intermediary has a reasonable basis for believing presents the potential for fraud or raises other investor protection concerns;
  - Taking a financial interest in an issuer that is offering or selling securities on its platform unless:
    - The intermediary receives the financial interest as compensation for the services provided to or for the benefit of the issuer in connection with the offer or sale of securities in a crowdfunding offering; and
    - The financial interest consists of securities of the same class and having the same terms, conditions, and rights as the securities being offered or sold in the crowdfunding offering through the intermediary's platform;
  - Compensating any person for providing the intermediary with personally identifiable information of any investor or potential investor; and
  - Participating in the communication channel on its platform, other than to establish guidelines for communication

and to remove abusive or potentially fraudulent communications.<sup>433</sup>

In addition, Regulation Crowdfunding specifically prohibits funding portals (as opposed to broker-dealers) from: (a) Offering investment advice or recommendations; (b) soliciting purchases, sales, or offers to buy securities offered or displayed on its platform; (c) compensating employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its platform; or (d) holding, managing, possessing, or otherwise handling investor funds or securities.<sup>434</sup> The rules provide a non-exclusive conditional safe harbor under which funding portals can engage in certain activities, consistent with these restrictions.<sup>435</sup>

Issuers may rely on the efforts of the intermediary to determine that the aggregate amount of securities purchased by an investor does not cause the investor to exceed the investment limits, so long as the issuer does not have knowledge that the investor would exceed the investment limits as a result of purchasing securities in the issuer's offering.<sup>436</sup>

The 2017 and 2018 Small Business Forums recommended that the Commission allow intermediaries to receive as compensation securities of the issuer having different terms than those received by investors in the offering and to co-invest in the offerings they list.<sup>437</sup>

Some intermediaries have stated that they generally have not experienced significant challenges complying with Regulation Crowdfunding requirements. However, some also have stated that compliance with the current rules, including FINRA requirements and examinations, can be costly. One of those respondents stated that "the most expensive requirement is keeping up with the . . . volume of FINRA communications, which requires a full-time employee to communicate with them, and a dedicated engineering resource," which are costs passed on to issuers in the form of higher fees. Another intermediary stated that the prohibition against funding portals handling investor funds significantly increased costs for funding portals, as well as for issuers and investors, while reducing the quality and timeliness of the investment and fund transfer process, with what it viewed as only limited investor protection benefits.

<sup>422</sup> See 2017 Forum Report.

<sup>423</sup> See *id.*

<sup>424</sup> See 2017 Treasury Report, at 41; 2015 Small Business Forum.

<sup>425</sup> See, e.g., 2017 Treasury Report, at 41; 2018 Forum Report; 2017 Forum Report, at 17. See also 2015 Forum Report (recommending increasing the investment limit for accredited investors).

<sup>426</sup> A funding portal is a crowdfunding intermediary that, in accordance with Section 304(b) of the JOBS Act and Exchange Act Section 3(a)(80), can engage only in limited activities.

<sup>427</sup> See 15 U.S.C. 77d(a)(6)(C); 15 U.S.C. 77d-1(a)(1)-(2). FINRA is currently the only registered national securities association.

<sup>428</sup> See 17 CFR 227.302(b).

<sup>429</sup> See 17 CFR 227.301.

<sup>430</sup> See 17 CFR 227.303(a).

<sup>431</sup> See 17 CFR 227.303(c).

<sup>432</sup> See generally 17 CFR 227.303-304. See also Crowdfunding Adopting Release at 71390.

<sup>433</sup> See generally 17 CFR 227.300-305.

<sup>434</sup> See 17 CFR 227.300(c)(2).

<sup>435</sup> See 17 CFR 227.402.

<sup>436</sup> See 17 CFR 303(b)(1).

<sup>437</sup> See 2017 Forum Report; 2018 Forum Report.

#### e. Limits on Advertising and Promoters

An issuer may not advertise the terms of a Regulation Crowdfunding offering except in a notice that directs investors to the intermediary's platform and includes no more than the following information:

- A statement that the issuer is conducting an offering pursuant to Section 4(a)(6) of the Securities Act, the name of the intermediary through which the offering is being conducted, and a link directing the potential investor to the intermediary's platform;
- The terms of the offering, which means the amount of securities offered, the nature of the securities, the price of the securities, and the closing date of the offering period; and
- Factual information about the legal identity and business location of the issuer, limited to the name of the issuer of the security, the address, phone number, and website of the issuer, the email address of a representative of the issuer, and a brief description of the business of the issuer.<sup>438</sup>

Although advertising the terms of the offering other than through the intermediary's platform is limited to a brief notice, an issuer may communicate with investors and potential investors about the terms of the offering through communication channels provided on the intermediary's platform. An issuer must identify itself as the issuer, and persons acting on behalf of the issuer must identify their affiliation with the issuer, in all communications on the intermediary's platform.<sup>439</sup>

An issuer is allowed to compensate any person to promote its crowdfunding offerings through communication channels provided by an intermediary, but only if the issuer takes reasonable steps to ensure that the promoter clearly discloses the compensation with each communication.<sup>440</sup>

The 2018 Small Business Forum recommended loosening the advertising restrictions to allow issuers to market their projects more effectively, suggesting that the rules are difficult to understand and "run counter to the intent of the law: To promote the democratization of investing."<sup>441</sup> In connection with the Crowdfunding Study, some market participants recommended that the Commission ease the restrictions on advertising crowdfunding offerings to allow issuers to communicate in person with

investors and to engage with local media on their offerings.

#### f. Restrictions on Resale

Securities purchased in a crowdfunding transaction generally cannot be resold for a period of one year, unless the securities are transferred:

- To the issuer of the securities;
- To an accredited investor;
- As part of an offering registered with the Commission; or
- To a member of the family of the purchaser or the equivalent, to a trust controlled by the purchaser, to a trust created for the benefit of a member of the family of the purchaser or the equivalent, or in connection with the death or divorce of the purchaser or other similar circumstance.<sup>442</sup>

#### g. Conditional Exemption From Section 12(g)

Section 12(g) of the Exchange Act requires an issuer with total assets of more than \$10 million and a class of securities held of record by either 2,000 persons, or 500 persons who are not accredited investors, to register that class of securities with the Commission. However, securities issued pursuant to Regulation Crowdfunding are conditionally exempted from the record holder count under Section 12(g) if the following conditions are met:

- The issuer is current in its ongoing annual reports required pursuant to Regulation Crowdfunding;
- Has total assets as of the end of its most recently completed fiscal year of \$25 million or less; and
- Has engaged the services of a transfer agent registered with the Commission.<sup>443</sup>

As a result, Section 12(g) registration is required if an issuer has, on the last day of its fiscal year, total assets greater than \$25 million and the class of equity securities is held by more than 2,000 persons, or 500 persons who are not accredited investors. In that circumstance, our rules provide the issuer with a two-year transition period before it is required to register its class of securities pursuant to Section 12(g), so long as it timely files all of the annual reports required by Regulation Crowdfunding during such period.<sup>444</sup>

An issuer seeking to exclude a person from the record holder count of Section 12(g) is responsible for demonstrating that the securities held by the person were initially issued in an offering made under Section 4(a)(6).<sup>445</sup>

The 2017 Treasury Report recommended that the Commission modify the conditional exemption from Section 12(g) to raise the maximum revenue requirement from \$25 million to \$100 million to allow crowdfunded issuers to stay private longer, stating that these issuers likely lack the necessary size to be a reporting company and should not be forced to register as a reporting company until reaching higher revenues.<sup>446</sup>

In connection with the Crowdfunding Study, several intermediaries expressed concern that a large number of shareholders would result in the issuer becoming required to register its securities under Section 12(g) of the Exchange Act once it failed to meet the conditional exemption under Regulation Crowdfunding. Several intermediaries reported that, because of the risk of mandatory registration under Section 12(g), coupled with the governance concerns discussed above, issuers are often reluctant to accept more than 500 investors in a crowdfunding offering or they retain repurchase rights to the securities offered. A number of market participants have recommended expanding Regulation Crowdfunding's exemption from Section 12(g).

## 2. Disclosure Requirements

### a. Offering Statement

Any issuer conducting a Regulation Crowdfunding offering must electronically file its offering statement on Form C<sup>447</sup> with the Commission and provide it to the intermediary facilitating the crowdfunding offering prior to commencing its offering. The Commission does not charge any fee to file or amend a Form C. No offers may be made until the offering statement has been filed with the Commission and provided to the intermediary. Unlike Regulation A, issuers are not permitted to "test the waters," or solicit interest in the offering, before filing their Form C. In addition, the information in the offering statement must be publicly available for at least 21 days before any securities may be sold, although the intermediary may accept investment commitments during that time.<sup>448</sup>

The 2017 Small Business Forum recommended that the Commission amend Regulation Crowdfunding to permit an issuer to test-the-waters or solicit interest in an offering prior to filing its Form C,<sup>449</sup> allowing issuers to determine the potential market interest in their securities prior to expending the

<sup>438</sup> See 17 CFR 227.204.

<sup>439</sup> See 17 CFR 227.204(c).

<sup>440</sup> See 17 CFR 227.205.

<sup>441</sup> 2018 Forum Report.

<sup>442</sup> See 17 CFR 227.501.

<sup>443</sup> See 17 CFR 240.12g-6.

<sup>444</sup> See *id.*

<sup>445</sup> See Crowdfunding Adopting Release at 71476.

<sup>446</sup> See 2017 Treasury Report.

<sup>447</sup> 17 CFR 239.900.

<sup>448</sup> See 17 CFR 227.303(a).

<sup>449</sup> See 2017 Forum Report at 18.

time and cost required to fully comply with the regulations. Similarly, in connection with the Crowdfunding Study, several market participants recommended that the Commission permit Regulation Crowdfunding issuers to test the waters, similar to Regulation A offerings. Market participants also have expressed concerns about the burden to issuers of complying with the requirement that 21 days elapse before a security can be sold, particularly for issuers that need funds quickly.

The offering statement must include the following disclosure:

- Information about officers, directors, and owners of 20% or more of the issuer;
- A description of the issuer's business and the use of proceeds from the offering;
- The price to the public of the securities or the method for determining the price;
- The target offering amount and the deadline to reach the target offering amount;
- Whether the issuer will accept investments in excess of the target offering amount;
- Certain related-party transactions; and
- A discussion of the issuer's financial condition and financial statements.<sup>450</sup>

The financial statements requirements are based on the amount offered and sold in reliance on Regulation Crowdfunding within the preceding 12-month period:

- *For issuers offering \$107,000 or less:* Financial statements of the issuer and certain information from the issuer's federal income tax returns, both certified by the principal executive officer. If, however, financial statements of the issuer are available that have either been reviewed or audited by a public accountant that is independent of the issuer, the issuer must provide those financial statements instead and will not need to include the information reported on the federal income tax returns or the certification of the principal executive officer.
- *Issuers offering more than \$107,000 but not more than \$535,000:* Financial statements reviewed by a public accountant that is independent of the issuer. If, however, financial statements of the issuer are available that have been audited by a public accountant that is independent of the issuer, the issuer must provide those financial statements instead and will not need to include the reviewed financial statements.
- Issuers offering more than \$535,000:

- *For first-time Regulation Crowdfunding issuers:* Financial statements reviewed by a public accountant that is independent of the issuer, unless financial statements of the issuer are available that have been audited by an independent auditor.

- *For issuers that have previously sold securities in reliance on Regulation Crowdfunding:* Financial statements audited by a public accountant that is independent of the issuer.<sup>451</sup>

Some studies and market participants have expressed concern about the cost and complexity of relying on Regulation Crowdfunding.<sup>452</sup> Market participants have stated that many issuers face significant challenges due to the time and cost required of issuers to comply with the regulations, including complying with U.S. generally accepted accounting principles ("U.S. GAAP") financial statement requirements, obtaining a review report, and preparing a Form C, and that many new issuers are not able to bear those costs given the uncertainty regarding whether they would raise capital successfully.

To help reduce issuer cost and complexity, market participants have recommended several revisions to the rules. For example, the 2015 Small Business Forum recommended permitting crowdfunding issuers to provide reviewed rather than audited financial statements in subsequent offerings unless audited financial statements of the issuer that have been audited by an independent auditor are available.

A few market participants also have raised concerns about the requirements for issuers seeking to raise smaller amounts in compliance with Regulation Crowdfunding. For example, the 2017 and 2018 Small Business Forums recommended easing the requirements for smaller or debt-only crowdfunding offerings under \$250,000, including limiting the ongoing reporting

<sup>451</sup> See 17 CFR 227.201(t).

<sup>452</sup> See, e.g., 2017 Treasury Report, at 40 (stating that "market participants have expressed concerns about the cost and complexity of using crowdfunding compared to private placement offerings"); 2018 Forum Report; Statement of the U.S. Chamber of Commerce to HFSC, March 22, 2017, <https://docs.house.gov/meetings/BA/BA16/20170322/105717/HHRG-115-BA16-Wstate-QuaadmanT-20170322.pdf>, at 12–13; Lindsay M. Abate (2016) One Year of Equity Crowdfunding: Initial Market Developments and Trends, U.S. Small Business Administration Office of Advocacy Economic Research Series, [https://www.sba.gov/sites/default/files/advocacy/Crowdfunding\\_Issue\\_Brief\\_2018.pdf](https://www.sba.gov/sites/default/files/advocacy/Crowdfunding_Issue_Brief_2018.pdf) ("SBA Study"), at 12 (suggesting that "exempting businesses seeking very small amounts of capital from certain requirements may make crowdfunding a more attractive and worthwhile option for small and young firms that are otherwise a good fit for this capital raising method").

obligations to actual investors (rather than to the general public)<sup>453</sup> and scaling regulation to reduce relatively inelastic accounting, legal, and other costs.<sup>454</sup> Another intermediary stated that smaller issuers that do not have reviewed or audited financial statements may find it difficult to prepare a statement of changes of equity, because the typical accounting software does not print it automatically. This intermediary stated that these issuers also often have trouble accurately preparing a cash flow statement or accounting for stock issuances or issuances of stock options and warrants. Another intermediary similarly stated that many issuers are unfamiliar with the statement of stockholders' equity. Yet another intermediary stated that the issuer requirements of Regulation Crowdfunding are more appropriate for larger equity offerings and recommended scaling them for smaller (below \$107,000) offerings, particularly for small debt offerings, to avoid what it described as unnecessary complexity.

#### b. Amendments to Offering Statements

For any offering that has not yet been completed or terminated, an issuer can file an amendment to its offering statement on Form C/A to disclose changes, additions, or updates to information. An amendment is required for changes, additions, or updates that are material, and the issuer must reconfirm outstanding investment commitments within 5 business days after it files the amendment or the investor's commitment will be considered cancelled.<sup>455</sup>

#### c. Progress Updates

An issuer must provide an update on its progress toward meeting the target offering amount within five business days after reaching 50% and 100% of its target offering amount.<sup>456</sup> These updates are filed on Form C-U.<sup>457</sup> If the issuer will accept proceeds over the target offering amount, it also must file a final Form C-U reflecting the total amount of securities sold in the offering. If, however, the intermediary provides frequent updates on its platform regarding the progress of the issuer in meeting the target offering amount, then

<sup>453</sup> In addition, one intermediary expressed concerns about the high cost of annual reports as well as the risk of disclosing proprietary information because of the requirement to file annual reports publicly on EDGAR.

<sup>454</sup> See, e.g., 2017 Forum Report; 2018 Forum Report.

<sup>455</sup> See 17 CFR 227.304.

<sup>456</sup> See 17 CFR 227.203(a)(3).

<sup>457</sup> See *id.*

<sup>450</sup> See 17 CFR 227.201.

the issuer will need to file only a final Form C-U to disclose the total amount of securities sold in the offering.<sup>458</sup>

#### d. Annual Reports

An issuer that sold securities in a Regulation Crowdfunding offering is required to provide an annual report on Form C-AR no later than 120 days after its fiscal year-end.<sup>459</sup> The report must be filed with the Commission and posted on the issuer's website. The annual report requires information similar to what is required in the offering statement, although neither an audit nor a review of the financial statements is required.<sup>460</sup> Issuers must comply with the annual reporting requirement until one of the following occurs: (1) The issuer is required to file reports under Exchange Act Section 13(a) or 15(d); (2) the issuer has filed at least one annual

report and has fewer than 300 holders of record; (3) the issuer has filed at least three annual reports and has total assets that do not exceed \$10 million; (4) the issuer or another party purchases or repurchases all of the securities issued pursuant to Regulation Crowdfunding, including any payment in full of debt securities or any complete redemption of redeemable securities; or (5) the issuer liquidates or dissolves in accordance with state law.<sup>461</sup>

Any issuer terminating its annual reporting obligations is required to file notice on Form C-TR reporting that it will no longer provide annual reports pursuant to the requirements of Regulation Crowdfunding.<sup>462</sup>

#### 3. Relationship With State Securities Laws

Securities issued in a Regulation Crowdfunding offering are "covered

securities" for purposes of Section 18(b)(4)(C), and the issuer is not required to register or qualify the offering with state securities regulators.<sup>463</sup> Offerings by such issuers, however, remain subject to state law enforcement and antifraud authority. Additionally, issuers may be subject to filing fees in the states in which they intend to offer or sell securities and may be required to comply with state notice filing requirements. The failure to file, or pay filing fees in connection with, any such materials may cause state securities regulators to suspend the offer or sale of securities within their jurisdiction.

#### 4. Analysis of Regulation Crowdfunding in the Exempt Market

Table 11 summarizes amounts sought and reported raised in offerings under Regulation Crowdfunding.

<sup>458</sup> See 17 CFR 227.203(a)(3)(iii).

<sup>459</sup> See 17 CFR 227.202(a); 17 CFR 227.203(b).

<sup>460</sup> See *id.*

<sup>461</sup> See 17 CFR 227.202(b).

<sup>462</sup> See 17 CFR 227.203(b)(3).

<sup>463</sup> See 15 U.S.C. 77r(b)(4)(C). See also Section II.B.2.b.

TABLE 11—OFFERING AMOUNTS AND REPORTED PROCEEDS, MAY 16, 2016–DECEMBER 31, 2018

	Number	Average	Median	Aggregate (million)
Target amount sought in initiated offerings .....	1,351	\$69,800	\$25,000	\$94.3
Maximum amount sought in initiated offerings <sup>464</sup> .....	1,351	602,200	500,000	775.9
Amounts reported as raised in completed offerings .....	519	208,400	107,367	108.2

In comparison, over the same period (from May 16, 2016 to December 31, 2018), approximately 12,700 issuers other than pooled investment funds each reported raising up to \$1.07 million in funds in reliance on Regulation D, totaling approximately \$4.5 billion, with average reported proceeds of approximately \$0.4 million per issuer.

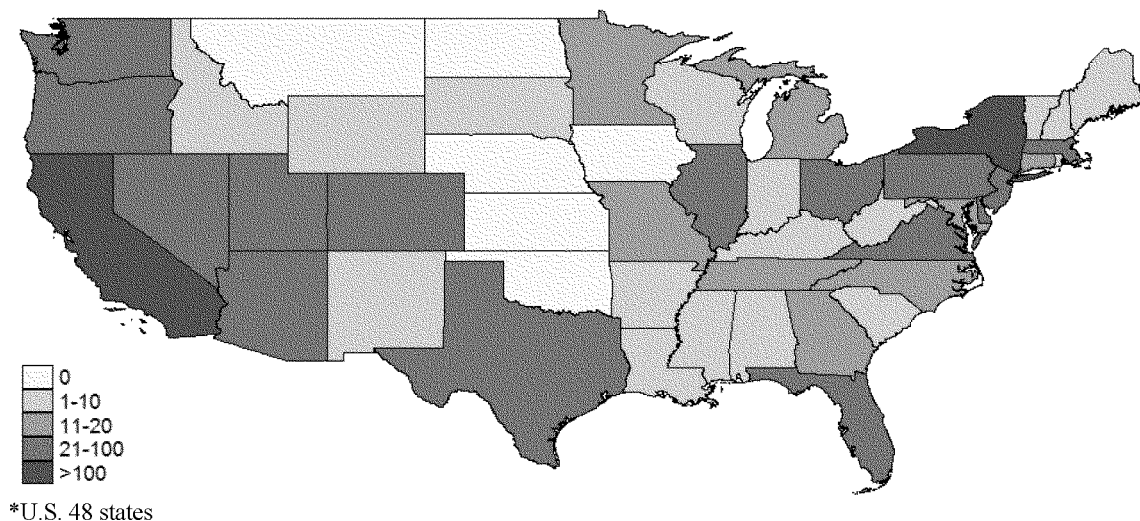
Given the offering limits, crowdfunding is used primarily by

relatively small issuers. Based on information in offering statement filings, the median crowdfunding offering was by an issuer that was incorporated approximately two years prior to the offering and employed about three people. The median issuer had total assets of approximately \$30,000 and no revenues (just over half of the offerings were by issuers with no revenues). Approximately 10% of offerings were by issuers that had attained profitability in

the most recent fiscal year prior to the offering.

Offerings were geographically concentrated, with just under a third of the offerings made by issuers located in California (approximately 32%), followed by New York (approximately 11%) and Texas (approximately 7%). Figure 10 reflects the geographic concentration of offerings based on the number of offering statement filings by issuer location.

Figure 10: Number of Regulation Crowdfunding offerings by issuer location



Unlike issuers conducting Regulation A offerings, a minority of Regulation Crowdfunding issuers have reported conducting an offering under Regulation D in the past—about 14% undertook a Regulation D offering prior to the Regulation Crowdfunding offering—suggesting that Regulation Crowdfunding, at least based on data as of December 31, 2018, tends to bring new issuers to the exempt offering market rather than encouraging current issuers to switch between offering exemptions. We estimate that only 188 Regulation Crowdfunding issuers had filed at least one Form D prior to undertaking their first crowdfunding offering; however, we are not able to

observe if these Regulation Crowdfunding issuers used other offering exemptions for which we do not have data, such as Section 4(a)(2), Rule 147, or Rule 147A.

5. Request for Comment

79. Do the requirements of Regulation Crowdfunding appropriately address capital formation and investor protection considerations? Do the costs associated with conducting a Regulation Crowdfunding offering dissuade issuers from relying on the exemption? If so, can we alleviate burdens in the rules or reduce costs for issuers while still providing adequate investor protection? For example, should we simplify any of

the disclosure requirements for issuers in small offerings under Regulation Crowdfunding? For example, as recommended by the 2017 and 2018 Small Business Forums, for offerings under \$250,000, should we limit the ongoing reporting obligations to actual investors (rather than the general public) and scale the disclosure requirements to reduce costs? Alternatively, as recommended by the 2016 Small Business Forum, should we allow issuers to provide reviewed rather than audited financial statements in subsequent offerings unless audited financial statements are available? How would such changes affect capital formation and investor protection? How

<sup>464</sup> This amount is capped at the offering limit for issuers undertaking multiple offerings in a 12-month period.

would changes to the requirements affect issuer interest in the exemption and investor demand for securities offered under Regulation Crowdfunding? Would legislative changes be necessary or beneficial to make such changes?

80. Should we retain Regulation Crowdfunding as it is?

81. Are there any data available that show fraudulent activity in connection with offerings under Regulation Crowdfunding? If so, what are the causes or explanations and what should we do to address them?

82. Should we increase the \$1.07 million offering limit? If so, what limit is appropriate? For example, should we, as recommended by the 2017 Small Business Forum and the 2017 Treasury Report, consider increasing the offering limit to \$5 million? What are the appropriate considerations for a maximum offering size? Should additional investor protections and/or disclosure requirements depend on the size of the offering? If the individual investment limits are preserved as they currently exist, will there be adequate investor demand to justify an increase in the offering limit, or would an increase in the individual investment limits also be required? Would legislative changes be necessary or beneficial to increase the offering limit?

83. If we were to increase the offering limit, would Regulation Crowdfunding overlap with Rule 504 of Regulation D or with Regulation A? If there is overlap, should we still retain the overlapping exemptions? How could we rationalize and streamline these offering exemptions?

84. Should we modify the eligibility requirements for issuers or securities offered under Regulation Crowdfunding? Should we extend the eligibility for Regulation Crowdfunding to Canadian issuers or all foreign issuers? Should the eligibility requirements for Regulation Crowdfunding mirror the Regulation A eligibility requirements? For example, should we exclude issuers subject to a Section 12(j) order? Should we amend the types of securities eligible under Regulation Crowdfunding? Should we extend the eligibility for Regulation Crowdfunding to issuers subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act? Are there other eligibility limitations we should consider? Would legislative changes be necessary or beneficial to make such changes?

85. Should we, as recommended by prior Small Business Forums, permit issuers to offer securities through SPVs under Regulation Crowdfunding? If so,

are there additional requirements that would be appropriate to ensure investor protection? Would legislative changes be necessary or beneficial to make such changes? Are there other ways we should modify our regulations to allow investors to invest in pooled crowdfunding vehicles that are advised by a registered investment adviser?

86. Should we revise the rules that require issuers to provide reviewed or audited financial statements? If so, how? At what level should issuers be required to provide reviewed or audited financial statements? For example, if we were to increase the offering limit, should reviewed financial statements only be required for offerings over \$1 million and audited financial statements only be required for offerings over another higher limit, such as the Regulation A Tier 1 limit? Would legislative changes be necessary or beneficial to make such changes?

87. As generally recommended by the 2015, 2017, and 2018 Small Business Forums and the 2017 Treasury Report,<sup>465</sup> should we eliminate, increase, or otherwise amend the individual investment limits? If we should change the investment limits, what limits are appropriate and why? Should we require verification of income or net worth for larger investments, such as \$25,000 and higher? Should certain investors be subject to higher limits or exempt from the limits altogether? For example, should accredited investors be exempt from the investment limits or should accredited investors be subject to higher limits? If accredited investors are subject to higher investment limits or exempt from investment limits, should we require verification of accredited investor status? Should we make changes to rationalize the investment limits for entities by entity type, not income? If investment limits are raised to allow an offering to be successful with fewer investors, would such a change have an effect on the use of the exemption? Would legislative changes be necessary or beneficial to make such changes?

88. As generally recommended by the 2016<sup>466</sup> and 2017 Small Business

<sup>465</sup> The 2017 Treasury Report and the 2015 Small Business Forum recommended basing investment limits on the greater of an investor's annual income or net worth rather than the lesser, to increase the amount that individual investors are permitted to invest. See 2017 Treasury Report; 2015 Forum Report.

<sup>466</sup> The 2016 Forum Report recommended that we harmonize the Regulation Crowdfunding advertising rules to avoid difficulties where an issuer advertises or engages in a general solicitation in a Regulation A or Rule 506(c) offering and then

Forums, should we allow issuers to test the waters or engage in general solicitation and advertising prior to filing a Form C? If so, should we impose any limitations on such communications to ensure adequate investor protection? Would legislative changes be necessary or beneficial to make such changes?

89. As recommended by the 2018 Small Business Forum, should we allow for more communication about the offering outside of the funding portal's platform channels? If so, what would be the benefits of allowing more communications? Would there be investor protection concerns? Are there limitations we should impose on those communications?

90. Should the Section 12(g) exemption for securities issued in reliance on Regulation Crowdfunding be modified? For example, should it be revised to follow the Section 12(g) exemption for Regulation A Tier 2 securities?

91. Do the costs associated with facilitating offerings under Regulation Crowdfunding or operating as a Crowdfunding intermediary dissuade intermediaries from facilitating offerings under the exemption? If so, should we modify the requirements to alleviate burdens or reduce costs for crowdfunding intermediaries while still providing adequate investor protection? If so, which ones and how? Should we modify any of the requirements regarding crowdfunding intermediaries to better meet the needs of issuers and investors? If so, which ones and how? For example, as recommended by the 2017 and 2018 Small Business Forums, should we allow intermediaries:

- To receive as compensation securities of the issuer having different terms than the securities of the issuer received by investors in the offering; or
- To co-invest in the offerings they facilitate?

In addition, as recommended by the 2018 Small Business Forum, should we clarify the ability of funding portals to participate in Regulation A and Rule 506 offerings? Would legislative changes be necessary or beneficial to make such changes?

92. To the extent not already addressed in the questions above, would legislative changes be necessary or beneficial to address any recommended changes to Regulation Crowdfunding? Alternatively, should we consider using our exemptive authority under Section

wishes to convert to a Regulation Crowdfunding offering.

28<sup>467</sup> of the Securities Act to adopt an alternative exemption for crowdfunding offerings to complement Section 4(a)(6)? If so, how should we structure the exemption to facilitate capital formation while still ensuring adequate investor protection? Is there anything else we should do to reduce the accounting, legal, and other inelastic costs associated with Regulation Crowdfunding?

### G. Potential Gaps in the Current Exempt Offering Framework

As discussed in this release, Congress and the SEC have taken a number of steps to expand the options that small businesses have to raise capital. While the options to raise capital in exempt offerings have grown significantly since the JOBS Act, concerns persist that smaller issuers continue to face difficulties accessing capital.

#### 1. Micro-Offerings

One area where staff has heard concerns about accessing capital is with respect to issuers that may be too small, or may be seeking too small an amount of capital, to realistically or cost-effectively conduct an exempt offering under the existing exemptions. For example, according to the U.S. Small Business Administration, 25% of startups report having no startup capital and 20% of startups cite insufficient capital access as a primary constraint to their business health and growth.<sup>468</sup> According to a recent study based on a 2014 survey of entrepreneurs, approximately 64% of startup firms used personal or family savings of the owner, with business loans from a bank or a financial institution being the next most common source of startup capital (18% of all firms).<sup>469</sup> For reference, based on data available to us on exempt offerings, in 2018, approximately 3,080 issuers each reported raising \$250,000 or less in reliance on Regulation D, totaling approximately \$330 million (averaging approximately \$100,000 per offering). Since the effective date of the 2015 Regulation A amendments, fewer than 10% of Regulation A issuers reporting proceeds reported proceeds of \$250,000 or less. In contrast, approximately 75% of Regulation

Crowdfunding issuers reporting proceeds reported proceeds of \$250,000 or less, consistent with a lower offering limit under Regulation Crowdfunding. Most of these were non-debt offerings. Alongside securities offerings of this size, various marketplace lending alternatives have gained traction.<sup>470</sup>

Some market participants have called for a “micro-offering” or “micro-loan” exemption to assist small businesses that have insufficient capital access. For example, the 2012 Small Business Forum recommended that the Commission consider adopting a “micro-offering” exemption for non-reporting companies with only minimal conditions. For example, it recommended an exemption for offerings only to “friends and family” well below the \$1 million crowdfunding offering limit.<sup>471</sup> In addition, as discussed above, the 2017 and 2018 Small Business Forums recommended that the Commission rationalize Regulation Crowdfunding requirements for debt offerings and small offerings under \$250,000. For example, they recommended limiting the ongoing reporting obligations to actual investors (rather than the general public) and scaling Regulation Crowdfunding to reduce accounting, legal, and other costs that currently are relatively inelastic, regardless of the size of the offering.<sup>472</sup>

#### 2. Request for Comment

93. Should we add a micro-offering or micro-loan exemption? If so, please describe the parameters of such a potential exemption. In suggesting parameters, consider how the small offering size should affect the potential requirements.

94. Should there be limits on the types of securities that may be offered under such an exemption? For example, should the exemption be limited to debt securities? Are there inherent differences in debt offerings, such as the general liquidation preference of debt holders, which would protect investors in these types of offerings? Does the inclusion of equity or other types of securities in this type of offering raise concerns for investors or does it expand

investor options in a way that would benefit them?

95. What would be the appropriate aggregate offering limit for such an exemption? For example, would \$250,000 or \$500,000 in a 12-month period be appropriate? Would another limit be appropriate? What are the appropriate considerations for the offering limit?

96. What type of investor protections should be required? For example, should investors be limited on how much they can invest in any one offering? If so, what should the limit be? Are there other protections we should consider? Should there be investor requirements, such as a financial sophistication requirement?

97. Should the issuer be prohibited from engaging in general solicitation or advertising to market the securities?

98. Should there be disclosure requirements or notice filing requirements?

99. Should we require the offering to take place through a registered intermediary, such as broker-dealer or funding portal?

100. Should the securities issued under the exemption contain resale restrictions? If so, what resale restrictions are appropriate? Should the securities be deemed “restricted securities” under Rule 144(a)(3) (similar to securities acquired from the issuer that are subject to the resale limitations of Rule 502(d)) or have a 12-month resale restriction (similar to Regulation Crowdfunding)?

101. Should the securities sold in the transaction be considered a “covered security” such that the issuer would not be required to register or qualify the offering with state securities regulators?

102. Should there be issuer eligibility requirements, such as bad actor disqualification provisions or exclusion of investment companies or non-U.S. issuers?

103. Are there other perceived gaps in the current exempt offering framework that we should address? If so, why are the existing exemptions from registration inadequate? For example, are the existing exemptions unavailable due to the nature of the securities being offered or characteristics of the issuer? Or are the existing exemptions not feasible or attractive to issuers due to compliance costs or similar concerns? Are regulatory changes needed in light of the geographic concentration of certain types of offerings?

### III. Integration

The integration doctrine provides an analytical framework for determining whether multiple securities transactions

<sup>467</sup> See text accompanying notes 16 and 17 for a discussion of our exemptive authority under Section 28.

<sup>468</sup> Michelle Schimpp, U.S. Small Business Administration, discussion at SEC–NYU Dialogue on Securities Crowdfunding, February 28, 2017, at <https://www.sec.gov/files/Highlights%20from%20the%20SEC-NYU%20Dialogue%20on%20Securities-Based%20Crowdfunding.pdf>.

<sup>469</sup> See Alicia Robb (2018) Financing Patterns and Credit Market Experiences: A Comparison by Race and Ethnicity for U.S. Employer Firms.

<sup>470</sup> See, e.g., David W. Perkins (2018) Marketplace Lending: Fintech in Consumer and Small-Business Lending, *Congressional Research Service*; Adair Morse (2015) Peer-to-Peer Crowdfunding: Information and the Potential for Disruption in Consumer Lending, *Annual Review of Finance and Economics* 7: 463–482; Rajkamal Iyer, Asim Khwaja, Erzo Luttmer, and Kelly Shue (2015) Screening Peers Softly: Inferring the Quality of Small Borrowers, *Management Science* 62: 1554–1577.

<sup>471</sup> See 2012 Forum Report.

<sup>472</sup> See 2017 Forum Report; 2018 Forum Report.



should be considered part of the same offering. This analysis helps to determine whether registration under Section 5 of the Securities Act is required or an exemption is available for the entire offering. In other words, the integration doctrine seeks to prevent an issuer from improperly avoiding Securities Act registration by artificially dividing a single offering into separate offerings such that exemptions would apply to the separate offerings that would not be available for the combined offering. The integration analysis generally is dependent on considering the facts and circumstances of each offering. In order to simplify the analysis in particular cases, however, the Commission has created a number of safe harbors from integration.

#### A. Facts and Circumstances Analysis

The integration concept was first articulated in 1933 and was further developed in two interpretive releases issued in the 1960s.<sup>473</sup> The interpretive releases stated that determining whether a particular securities offering should be integrated with another offering requires an analysis of the specific facts and circumstances of the offerings. The Commission identified five factors to consider in making the determination of whether the offerings should be integrated.<sup>474</sup> The five factors are whether: (1) The different offerings are part of a single plan of financing, (2) the offerings involve issuance of the same class of security, (3) the offerings are made at or about the same time, (4) the same type of consideration is to be received, and (5) the offerings are made for the same general purpose.<sup>475</sup>

More recently, the Commission has provided additional guidance to help issuers evaluate whether two offerings should be integrated. In 2007, the Commission set forth a framework for analyzing how an issuer can conduct simultaneous registered and private offerings.<sup>476</sup> The Commission noted that the determination as to whether the filing of a registration statement should be considered to be a general solicitation or general advertising that would affect the availability of the Section 4(a)(2) exemption for a concurrent private placement should be

based on a consideration of whether the investors in the private placement were solicited by the registration statement or through some other means that would not foreclose the availability of the Section 4(a)(2) exemption.<sup>477</sup> Issuers should analyze whether the offering is exempt under Section 4(a)(2) on its own, including whether securities were offered and sold to the private placement investors through the means of a general solicitation in the form of the registration statement.<sup>478</sup> The Commission also noted that this guidance did not affect the ability of issuers to continue to rely on the views expressed by the staff of the Division of Corporation Finance in interpretive letters that, under specified circumstances, issuers may continue to conduct concurrent private placements without those offerings necessarily being integrated with the ongoing registered offering.<sup>479</sup>

In 2015 and 2016, the Commission further modernized and expanded the facts and circumstances analysis in the context of concurrent exempt offerings involving Regulation A, Regulation Crowdfunding, Rule 147, or Rule 147A, including situations where one offering permits general solicitation and the other does not.<sup>480</sup> Essentially, whether concurrent or subsequent offers and

sales of securities will be integrated with any offering conducted under Regulation A, Regulation Crowdfunding, Rule 147, or Rule 147A will depend on the particular facts and circumstances, including whether each offering complies with the requirements of the exemption that is being relied on for the particular offering.<sup>481</sup> For example, an issuer conducting a concurrent exempt offering for which general solicitation is not permitted will need to be satisfied that purchasers in that offering were not solicited by means of an offering made in reliance on Regulation A, Regulation Crowdfunding, Rule 147, or Rule 147A.<sup>482</sup> Alternatively, an issuer conducting a concurrent exempt offering for which general solicitation is permitted, for example, under Rule 506(c), could not include in any such general solicitation an advertisement of the terms of a Regulation A, Regulation Crowdfunding, or Rule 147A offering, unless that advertisement also included the necessary legends for, and otherwise complied with, the respective exemption, as well as any additional restrictions on the general solicitation required by the other exemption concurrently being relied on by the issuer.<sup>483</sup>

Market participants have requested that the Commission clarify the relationship between exempt offerings in which general solicitation is not permitted—such as Section 4(a)(2) and Rule 506(b) offerings—and exempt offerings in which general solicitation is permitted—such as Rule 506(c) offerings. The 2016, 2017, and 2018 Small Business Forums each recommended that the Commission clarify that the facts and circumstances integration analysis the Commission

<sup>477</sup> *Id.*

<sup>478</sup> *Id.* The Commission provided the following examples: If an issuer files a registration statement and then seeks to offer and sell securities without registration to an investor who became interested in the purportedly private placement offering by means of the registration statement, then the Section 4(a)(2) exemption would not be available for that offering. If the prospective private placement investor became interested in the concurrent private placement through some means other than the registration statement that was consistent with Section 4(a)(2), such as through a substantive, pre-existing relationship with the issuer or direct contact by the issuer or its agents outside of the public offering effort, then the filing of the registration statement generally would not impact the potential availability of the Section 4(a)(2) exemption for that private placement and the private placement could be conducted while the registration statement for the public offering was on file with the Commission. Similarly, if the issuer is able to solicit interest in a concurrent private placement by contacting prospective investors who (1) were not identified or contacted through the marketing of the public offering and (2) did not independently contact the issuer as a result of the general solicitation by means of the registration statement, then the private placement could be conducted in accordance with Section 4(a)(2) while the registration statement for a separate public offering was pending.

<sup>479</sup> See 2007 Regulation D Proposing Release citing as examples Division of Corporation Finance no-action letters to Black Box Incorporated (June 26, 1990) and Squadron Ellenoff, Pleasant & Lehrer (Feb. 28, 1992).

<sup>480</sup> See 2015 Regulation A Release at Section II.B.5, Regulation Crowdfunding Adopting Release at Section II.A.1.c and Intrastate and Regional Offerings Release at Section II.B.5.

<sup>481</sup> See *id.*

<sup>482</sup> For a concurrent offering under Rule 506(b), purchasers in the Rule 506(b) offering could not be solicited by means of a general solicitation under Regulation A (including any “testing the waters” communications), Regulation Crowdfunding, or Rule 147 or 147A. The issuer would need an alternative means of establishing how purchasers in the Rule 506(b) offering were solicited. For example, the issuer may have had a preexisting substantive relationship with such purchasers. Otherwise, the solicitation conducted in connection with the Regulation A (including any “testing the waters” communications), Regulation Crowdfunding, or Rule 147 or 147A offering would very likely preclude reliance on Rule 506(b). See 2015 Regulation A Release at Section II.B.5, Regulation Crowdfunding Adopting Release at Section II.A.1.c and Intrastate and Regional Offerings Release at Section II.B.5. See also 2007 Regulation D Proposing Release.

<sup>483</sup> For example, the limitations imposed on advertising the terms of the offering pursuant to Rule 204 of Regulation Crowdfunding would limit the issuer’s general solicitation in a concurrent offering made pursuant to Regulation A, Rule 506(c), or Rule 147A.

<sup>473</sup> See SEC Release No. 33–97 (Dec. 28, 1933); Section 3(a)(11) Release; Non-Public Offering Exemption Release.

<sup>474</sup> See Non-Public Offering Exemption Release. See also 17 CFR 230.502(a).

<sup>475</sup> See Non-Public Offering Exemption Release; 17 CFR 230.502(a). See also Section 3(a)(11) Release. See also note 497.

<sup>476</sup> See Revisions of Limited Offering Exemptions in Regulation D, Release No. 33–8828 (Aug. 3, 2007) [72 FR 45116 (Aug. 10, 2007)] (“2007 Regulation D Proposing Release”).

applies to the integration of concurrent private and registered offerings<sup>484</sup> would also apply to concurrent exempt offerings where one prohibits general solicitation and the other permits it.<sup>485</sup> Specifically, the Small Business Forums sought clarification that an issuer could avoid integration of concurrent offerings under Rule 506(b) and Rule 506(c) if it could show that the investors in the Rule 506(b) offering were not solicited by means of the general solicitation used in connection with the Rule 506(c) offering, regardless of whether the Rule 506(c) offering was completed, abandoned, or ongoing.<sup>486</sup>

### B. Safe Harbors

Commission rules contain several integration safe harbors that provide objective standards on which an issuer can rely so that two or more offerings will not be integrated into one combined offering. For transactions that fall within the scope of the respective safe harbor, issuers do not have to conduct any further integration analysis to determine whether the two offerings would be treated as one for purposes of qualifying for either exemption. The issuer will, however, need to comply with the requirements of each exemption on which it is relying.<sup>487</sup>

#### 1. Regulation D

Rule 502(a) of Regulation D provides for a safe harbor from integration for all offers and sales that take place at least six months before the start of, or six months after the termination of, the Regulation D offering, so long as there are no offers and sales of the same securities<sup>488</sup> within either of these six-month periods.

Over the years, market participants have expressed concern that such a long delay could inhibit issuers, particularly smaller issuers, from meeting their

capital needs.<sup>489</sup> In 2006, the Advisory Committee on Smaller Public Companies advised that the six-month safe harbor period provided in Rule 502(a) of Regulation D “represents an unnecessary restriction on companies that may very well be subject to changing financial circumstances, and weighs too heavily in favor of investor protection, at the expense of capital formation.”<sup>490</sup> The Committee supported “clearer guidance concerning the circumstances under which two or more apparently separate offerings will or will not be integrated.”<sup>491</sup> The Advisory Committee acknowledged the difficulty, however, of modifying the five-factor test contained in Rule 502(a) and concluded that the issue could be addressed more readily by shortening the six-month period. Based on its analysis of the issue, the Advisory Committee recommended that the Commission shorten the integration safe harbor from six months to 30 days.<sup>492</sup>

In 2007, the Commission proposed, but ultimately never adopted, amendments to shorten the integration safe harbor in Rule 502(a) from six months to 90 days.<sup>493</sup> In proposing 90 days, the Commission stated that it believed 90 days was appropriate, as it would provide additional flexibility to issuers, permitting an issuer to rely on the safe harbor once every fiscal quarter, while still requiring issuers to wait a sufficient period of time before initiating a substantially similar offering in reliance on the safe harbor.<sup>494</sup>

#### 2. Rule 152

In 1935, the Commission adopted 17 CFR 230.152 (“Rule 152”),<sup>495</sup> which provides a safe harbor from integration

when an issuer conducts a private placement offering pursuant to Securities Act Section 4(a)(2) and, following the completion of that offering, makes a public offering and/or files a registration statement. Rule 152 states that Section 4(a)(2) shall be deemed to apply to transactions that did not involve any public offering at the time of the private placement offering<sup>496</sup> even though the issuer decides subsequently to make a public offering<sup>497</sup> and/or file a registration statement.<sup>498</sup> In 2007, the Commission clarified that an issuer’s contemplation of filing a Securities Act registration statement at the same time that it is conducting an exempt private placement under Section 4(a)(2) would not cause the Section 4(a)(2) exemption to be unavailable for that private placement.<sup>499</sup> So long as all of the applicable requirements of the private placement exemption were met for offers and sales that occurred prior to the general solicitation, those offers and sales would be exempt from registration. Once the public offering is commenced or the registration statement is filed, the issuer must satisfy all of the applicable requirements for that subsequent offering.

As noted above, market participants have requested that the Commission provide additional clarity about the integration of exempt offerings in which general solicitation is permitted—such as Rule 506(c) offerings. The 2016, 2017, and 2018 Small Business Forums recommended that the Commission clarify that Rule 152 applies to a Rule 506(c) offering so that an issuer using Rule 506(c) may subsequently engage in a registered public offering without adversely affecting the Rule 506(c)

<sup>496</sup> The private placement offering can include convertible securities or warrants, so long as the offering of those securities is completed before the filing of the public offering or registration statement. See 1998 Proposing Release.

<sup>497</sup> A securities transaction that at the time involves a private offering will not lose that status even if the issuer subsequently decides to make a public offering. Therefore, offers and sales of securities made in reliance on Rule 506(b) prior to a general solicitation would not be integrated with subsequent offers and sales of securities pursuant to Rule 506(c). So long as all of the applicable requirements of Rule 506(b) were met for offers and sales that occurred prior to the general solicitation, those offers and sales would be exempt from registration and the issuer would be able to make offers and sales pursuant to Rule 506(c). However, the issuer would have to satisfy all of the applicable requirements of Rule 506(c) for the subsequent offers and sales, including that it take reasonable steps to verify the accredited investor status of all subsequent purchasers.

<sup>498</sup> 17 CFR 230.152.

<sup>499</sup> See 2007 Regulation D Proposing Release.

<sup>484</sup> See 2007 Regulation D Proposing Release.

<sup>485</sup> 2016 Forum Report; 2017 Forum Report; and 2018 Forum Report.

<sup>486</sup> 2016 Forum Report; 2017 Forum Report; and 2018 Forum Report.

<sup>487</sup> For example, an offering made pursuant to Rule 506(b) will not be integrated with a subsequent offering pursuant to Regulation A (see Section III.B.4), but the issuer will need to comply with the requirements of each rule, including the limitation on general solicitation for offers made pursuant to Rule 506(b).

<sup>488</sup> Rule 502(a) specifically excludes offers or sales of securities under an employee benefit plan as defined in Rule 405. In addition, generally, transactions otherwise meeting the requirements of an exemption will not be integrated with simultaneous offers and sales of securities being made outside the United States in compliance with Regulation S. 17 CFR 230.901 *et seq.* See 17 CFR 230.500(g) (“Rule 500(g)”) and Note to 17 CFR 230.502(a); see also Section III.B.5 for a discussion of the Regulation S integration safe harbor.

<sup>489</sup> See 2007 Regulation D Proposing Release; Final Report of the Advisory Committee on Smaller Public Companies to the United States Securities and Exchange Commission (April 23, 2006) (“2006 Advisory Committee Report”), available at <http://www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf>.

<sup>490</sup> 2006 Advisory Committee Report at 96. See also 2007 Regulation D Proposing Release, at text accompanying n. 116.

<sup>491</sup> 2006 Advisory Committee Report at 95.

<sup>492</sup> See *id.* at 94.

<sup>493</sup> See 2007 Regulation D Proposing Release. In that release, the Commission declined to propose a period shorter than the 90 days because “an inappropriately short time frame could allow issuers to undertake serial Rule 506-exempt offerings each month to up to 35 non-accredited investors in reliance on the safe harbor, resulting in unregistered sales to hundreds of non-accredited investors in a year.” *Id.* But cf. 2006 Advisory Committee Report (recommending shortening the integration safe harbor to 30 days).

<sup>494</sup> See 2007 Regulation D Proposing Release (“For issuers that provide quarterly reports, the 90-day requirement would provide time and transparency for investors and the market to take into account the offering and its results.”).

<sup>495</sup> See SEC Release No. 33–305 (Mar. 2, 1935).

offering exemption.<sup>500</sup> Because the current language of Rule 152 does not provide an integration safe harbor for an issuer that conducts a Rule 506(c) offering and then subsequently engages in a registered offering, the Commission would need to amend Rule 152 to provide the recommended integration safe harbor.

### 3. Abandoned Offerings: Rule 155

In 2001, the Commission adopted 17 CFR 230.155 (“Rule 155”) to provide a non-exclusive integration safe harbor for abandoned offerings—that is, a registered offering following an abandoned private offering<sup>501</sup> or a private offering following an abandoned registered offering<sup>502</sup>—without integrating the registered and private offerings in either case.<sup>503</sup> Rule 155 was intended to enhance an issuer’s ability to switch from a private offering to a registered offering, or vice-versa, in response to changing market conditions.<sup>504</sup> “Private offerings” for purposes of Rule 155 is defined as offerings exempt under Section 4(a)(2) or 4(a)(5), or Rule 506.<sup>505</sup> A preliminary note to the rule provides that the safe harbors are not available if they are used as part of a plan or scheme to evade registration.<sup>506</sup> In addition, in adopting Rule 155, the Commission specifically noted that the safe harbors address only registration requirements under the Securities Act and are not intended to affect antifraud provisions.<sup>507</sup>

Rule 155(b) states that a private offering of securities will not be considered part of an offering for which the issuer later files a registration statement if: (1) No securities were sold in the private offering; (2) the issuer and any person acting on its behalf terminate all offering activity in the private offering before the issuer files the registration statement; (3) the preliminary and final prospectuses used

<sup>500</sup> 2016 Forum Report; 2017 Forum Report; and 2018 Forum Report.

<sup>501</sup> See 17 CFR 230.155(b).

<sup>502</sup> See 17 CFR 230.155(c).

<sup>503</sup> See Integration of Abandoned Offerings, Release No. 33–7943 (Jan. 26, 2001) [66 FR 8887 (Feb. 5, 2001)] (“Rule 155 Adopting Release”).

<sup>504</sup> *Id.*

<sup>505</sup> See 17 CFR 230.155(a).

<sup>506</sup> See Preliminary Note to Rule 155. See also Rule 155 Adopting Release at text accompanying note 55 (“At the time the private offering is made, in order to establish the availability of a private offering exemption, the issuer or any person acting on its behalf must be able to demonstrate that the private offering does not involve a general solicitation or advertising. Use of the registered offering to generate publicity for the purpose of soliciting purchasers for the private offering would be considered a plan or scheme to evade the registration requirements of the Securities Act.”).

<sup>507</sup> See Rule 155 Adopting Release at note 12.

in the registered offering disclose specified information about the abandoned private offering;<sup>508</sup> and (4) the issuer does not file the registration statement until at least 30 calendar days after termination of all offering activity in the private offering, unless the issuer and any person acting on its behalf offered securities in the private offering only to persons who were (or who the issuer reasonably believes were) sophisticated or accredited investors.

Rule 155(c) states that an offering for which the issuer filed a registration statement will not be considered part of a later commenced private offering if: (1) No securities were sold in the registered offering; (2) the issuer withdraws the registration statement under 17 CFR 230.477 (“Rule 477”); (3) neither the issuer nor any person acting on the issuer’s behalf commences the private offering earlier than 30 calendar days after the effective date of withdrawal of the registration statement under Rule 477; (4) the issuer provides specified information about the private offering to each offeree in the private offering;<sup>509</sup> and (5) any disclosure document used in the private offering discloses any changes in the issuer’s business or financial condition that occurred after the issuer filed the registration statement that are material to the investment decision in the private offering.

### 4. Regulation A, Rules 147 and 147A, and Regulation Crowdfunding

In recent rulemakings, the Commission’s approach to integration has evolved to articulate further the principles underlying the integration doctrine in light of current offering practices and developments in information and communication technology.<sup>510</sup> This new approach to integration for offerings under Regulation A, Rules 147 and 147A, and Regulation Crowdfunding provides issuers with greater certainty as to the

<sup>508</sup> This information includes: The size and nature of the private offering; the date on which the issuer abandoned the private offering; that any offers to buy or indications of interest given in the private offering were rejected or otherwise not accepted; and that the prospectus delivered in the registered offering supersedes any offering materials used in the private offering.

<sup>509</sup> This information includes: The fact that the offering is not registered under the Securities Act; the securities will be “restricted securities” and may not be resold unless they are registered under the Securities Act or an exemption from registration is available; purchasers in the private offering do not have the protection of Securities Act Section 11 [15 U.S.C. 77k]; and a registration statement for the abandoned offering was filed and withdrawn, specifying the effective date of the withdrawal.

<sup>510</sup> See 2015 Regulation A Release, Intrastate and Regional Offerings Release and Regulation Crowdfunding Adopting Release.

availability of an exemption for a given offering and increased consistency in the application of the integration doctrine among the exempt offering rules available to smaller issuers, while preserving important investor protections provided in each exemption.<sup>511</sup>

This new integration approach provides that for offerings conducted under Regulation A or Rules 147 and 147A, the offering will not be integrated with:

- Prior offers or sales of securities; or
- Subsequent offers or sales of securities that are:
  - Registered under the Securities Act, except as provided in Rule 255(c);
  - Made pursuant to Rule 701 under the Securities Act;<sup>512</sup>
  - Made pursuant to an employee benefit plan;
  - Made pursuant to Regulation S;<sup>513</sup>
  - Made pursuant to Regulation Crowdfunding;
  - Made pursuant to Regulation A;
  - Made pursuant to Rules 147 or 147A; or
  - Made more than six months after completion of the respective offering.<sup>514</sup>

As discussed above, for transactions that fall within the scope of the safe harbor, issuers will not have to conduct

<sup>511</sup> See Intrastate and Regional Offerings Release. See also 17 CFR 230.251(c); 17 CFR 230.701; and Regulation Crowdfunding Adopting Release. Each exemption is designed based on a particular type of offer and investor, with corresponding requirements that must be satisfied.

<sup>512</sup> Rule 701 exempts from Securities Act registration requirements certain sales of securities made to compensate employees, consultants, and advisors. This exemption is not available to issuers that already are required to file reports under Exchange Act Section 13(a) or 15(d). An issuer can sell at least \$1 million of securities under this exemption, regardless of its size. An issuer can sell a higher amount if it satisfies certain formulas based on its assets or on the number of its outstanding securities. If an issuer sells more than \$10 million in securities in a 12-month period, it is required to provide certain financial and other disclosure to the persons that received securities in that period. Securities issued under Rule 701 are “restricted securities.” Compensatory Benefit Plans and Contracts, Release No. 33–6768 (Apr. 14, 1988) [53 FR 12918 (Apr. 20, 1988)] (“Rule 701 Adopting Release”). See also Concept Release on Compensatory Securities Offerings and Sales, Release No. 33–10521 (Jul. 18, 2018) [83 FR 34958 (Jul. 24, 2018)] (soliciting comment on possible ways to modernize rules related to compensatory arrangements in light of the significant evolution in both the types of compensatory offerings and the composition of the workforce since the Commission last substantively amended these rules in 1999).

<sup>513</sup> 17 CFR 230.901 *et seq.* Regulation S provides a safe harbor for offers and sales of securities outside the United States so long as the securities are sold in an offshore transaction and there are no “directed selling efforts” in the United States. See Offshore Offers and Sales, Release No. 33–6863 (Apr. 24, 1990) [55 FR 18306 (May 2, 1990)] (“Regulation S Adopting Release”).

<sup>514</sup> See 17 CFR 230.251(c); 17 CFR 230.147(g); 17 CFR 230.147A(g).

any further integration analysis to determine whether the two offerings would be treated as one for purposes of qualifying for either exemption.<sup>515</sup>

Unlike Regulation A and Rules 147 and 147A, Regulation Crowdfunding does not include the same enumerated list. However, Securities Act Section 4A(g) provides that “[n]othing in the exemption shall be construed as preventing an issuer from raising capital through means other than [S]ection 4[(a)](6).” Given this statutory language, the Commission provided guidance in the Regulation Crowdfunding Adopting Release that an offering made in reliance on Section 4(a)(6) is not required to be integrated with another exempt offering made by the issuer to the extent that each offering complies with the requirements of the applicable exemption that is being relied on for that particular offering.<sup>516</sup> We believe Section 4A(g) and this guidance is generally consistent with, but broader than, the approach to integration in Regulation A and Rule 147 and 147A.

#### 5. Other Integration Provisions

Other Commission rules provide clarity with respect to integration in specific types of transactions. For example, offshore transactions made in compliance with Regulation S will not be integrated with registered domestic offerings or domestic offerings that satisfy the requirements for an exemption from registration under the Securities Act.<sup>517</sup> In 2013, the Commission clarified that concurrent offshore offerings that are conducted in compliance with Regulation S will not be integrated with domestic unregistered offerings that are conducted in compliance with Rule 506(c) or Rule 144A,<sup>518</sup> consistent with the historical treatment of concurrent Regulation S and Rule 144A/Rule 506

<sup>515</sup> The issuer will, however, need to comply with the requirements of each exemption on which it is relying. For example, an offering made pursuant to Rule 506(b) will not be integrated with a subsequent offering pursuant to Rule 147A, but the issuer will need to comply with the requirements of each rule, including the limitation on general solicitation for offers made pursuant to Rule 506(b).

<sup>516</sup> See Regulation Crowdfunding Adopting Release at text accompanying notes 1343–1344.

<sup>517</sup> 17 CFR 230.901 *et seq.* See Regulation S Adopting Release. See also Note to Rule 502(a) (“Generally, transactions otherwise meeting the requirements of an exemption will not be integrated with simultaneous offerings being made outside the United States in compliance with Regulation S.”). See also Rule 500(g) (“Regulation S may be relied upon for such offers and sales even if coincident offers and sales are made in accordance with Regulation D inside the United States.”).

<sup>518</sup> See Section V.A.2 for a discussion of Rule 144A.

offerings.<sup>519</sup> Similarly, offers and sales of securities that comply with the Rule 144A non-exclusive safe harbor exemption will not affect the availability of any exemption or safe harbor relating to any previous or subsequent offer or sale of such securities by the issuer or any prior or subsequent holder of the securities.<sup>520</sup> When the Commission adopted Rule 144A, it specifically noted that each transaction will be assessed under Rule 144A individually and that the availability of the non-exclusive safe harbor exemption for an offer and sale complying with Rule 144A will be unaffected by transactions by other sellers.<sup>521</sup>

In addition, Rule 701, which provides a limited exemption from registration for certain compensatory securities transactions,<sup>522</sup> specifically provides that offers and sales that are exempt under Rule 701 are deemed to be a part of a single, discrete offering and are not subject to integration with any other offers or sales, whether registered under the Securities Act or otherwise exempt from the registration requirements of the Securities Act.<sup>523</sup>

#### C. Request for Comment

104. Should we articulate one integration doctrine that would apply to all exempt offerings? If so, what should that integration doctrine be? For example, should we articulate that two or more exemptions, or an exemption and a registered offering, will not be deemed to be part of the same offering if the issuer is able to satisfy the requirements of the exemption(s) at the time of sale? If so, should we still aggregate the total number of non-accredited investors for purposes of multiple Rule 506(b) offerings that occur less than six months apart? Would one consistent integration doctrine make it easier for issuers to transition from one exemption to another and, ultimately, to a registered offering? Would there be any investor protection concerns if we were to articulate one integration doctrine for all exempt offerings?

<sup>519</sup> Rule 506(c) Adopting Release. An issuer, however, seeking to conduct concurrent offerings using general solicitation under Rule 506(c) to U.S. investors and under Regulation S to offshore investors could not solicit both U.S. and offshore investors with the same offering materials, as the Regulation S materials would then include activity undertaken for the purpose of conditioning the market in the U.S.

<sup>520</sup> See Resale of Restricted Securities; Rule 144A Adopting Release. See also Section V.A.2 for a discussion of Rule 144A.

<sup>521</sup> See *id.*

<sup>522</sup> See note 512.

<sup>523</sup> 17 CFR 230.701(f).

105. Throughout the Securities Act rules, where a safe harbor does not apply, should we replace the five-factor test with the new analysis articulated in connection with Regulation A and Rules 147 and 147A (*i.e.*, whether each offering complies with the requirements of the exemption that is being relied on for the particular offering), consistent with the 2016, 2017, and 2018 Small Business Forum recommendations? Are there other integration analyses that we should consider? Should we consider whether other categories of transactions clearly do not need to be integrated into other offerings, similar to the treatment of offerings conducted in accordance with Regulation S, Rule 144A, and Rule 701?

106. Should we shorten the six-month integration safe harbor in Rule 502(a) of Regulation D? If so, what time period is appropriate? 90 days? 30 days? What are the appropriate considerations for an alternate time period?

107. Consistent with Regulation A and Rules 147 and 147A, for issuers relying on an exemption that permits general solicitation and advertising, such as the exemption under Rule 506(c), should we provide an integration safe harbor for offers and sales of securities prior to the commencement of that offering?

108. Should we specifically revise Rule 152 to clarify that offers and sales that do not involve any form of general solicitation or advertising prior to the completion of those transactions would not be integrated with subsequent offers and sales of securities that involve general solicitation or advertising? Consistent with the 2016, 2017, and 2018 Small Business Forum recommendations, should we revise Rule 152 to provide an integration safe harbor for an issuer that conducts a Rule 506(c) offering and then subsequently engages in a registered public offering?

109. Should we revise Rule 155? For example, should we define a private offering as an exempt offering that does not involve any form of general solicitation or advertising? In addition, should we expand Rule 155(c) to include an abandoned offering that involved general solicitation followed by a private offering?

110. Should we consider other integration safe harbors? If so, please describe the parameters of such potential safe harbors. For example, as recommended by the 2015 Small Business Forum, should we provide additional guidance about concurrent offerings under Regulation Crowdfunding and Rule 506(c)? If so, should we provide guidance regarding issues that may arise when an

intermediary seeks to host concurrent offerings? Conversely, should we eliminate any of the existing integration safe harbors? How would such changes affect capital formation and investor protection?

#### IV. Pooled Investment Funds

##### A. Background

For issuers, particularly issuers seeking to raise growth-stage capital, pooled investment funds can serve as an important source of funding. For purposes of this discussion, pooled investment funds include investment companies, such as a mutual fund or exchange-traded fund (“ETF”), registered under the Investment Company Act, a BDC, or a private fund that operates pursuant to an exemption or exclusion from the Investment Company Act. For retail investors seeking exposure to growth-stage issuers, there are potential advantages to investing through a pooled investment fund, including the ability to have an interest in a diversified portfolio that can reduce risk relative to the risk of holding a security of a single issuer.<sup>524</sup> Retail investors who seek a broadly diversified investment portfolio could benefit from the exposure to issuers making exempt offerings, as these securities may have returns that are less correlated to the public markets. In addition, investing through a pooled investment vehicle would be consistent with retail investor trends over the past several decades, which have seen an increasing number of investors investing through mutual funds and ETFs.<sup>525</sup>

While retail investors can obtain some exposure to exempt offerings indirectly through investment companies registered under the Investment Company Act and BDCs,<sup>526</sup> we

<sup>524</sup> See, e.g., Harry Markowitz, *Portfolio Selection*, 7 J. of Finance 77 (1952).

<sup>525</sup> Investment Company Institute, 2019 Investment Company Fact Book (April 2019), at 142 (“ICI Fact Book”) (showing that the percentage of U.S. households owning mutual funds increased to 43.9% in 2017 from 14.7% in 1985).

<sup>526</sup> BDCs are a category of closed-end investment companies that do not register under the Investment Company Act, but rather elect to be subject to the provisions of sections 55 through 65 of that act. See 15 U.S.C. 80a-2(a)(48). Congress established BDCs for the purpose of making capital more readily available to small, developing and financially troubled companies that do not have ready access to the public capital markets or other forms of conventional financing. See H.R. Rep. No. 1341, 96th Cong., 2d Sess 21 (1980). The Commission recently proposed rules that would, among other things, extend to closed-end funds and BDCs offering reforms currently available to operating company issuers by expanding the definition of “well-known seasoned issuer” to allow these funds and BDCs to qualify, streamlining the registration process for these funds and BDCs, including the process for shelf registration, permitting these funds

understand that those opportunities may be limited. Open-end funds, which provide investors with the ability to redeem their interests in the fund on a daily basis, have liquidity restrictions and valuation requirements that present challenges to holding significant amounts of securities issued in exempt offerings.<sup>527</sup> The potential limited effects on overall return<sup>528</sup> may also constrain larger registered funds from investing in exempt offerings by smaller issuers.<sup>529</sup> Some types of registered investment companies, such as closed-end funds, are better suited to holding less liquid securities obtained in exempt offerings because they are not redeemable and therefore are not subject to the same rules on liquidity risk management as open-end funds.

##### 1. Interval Funds and Tender Offer Funds

An interval fund is a type of registered closed-end fund that makes periodic repurchase offers pursuant to 17 CFR 270.23c-3 (“Rule 23c-3”) under the Investment Company Act.<sup>530</sup> Unlike many traditional registered closed-end funds, interval funds generally have not chosen to list their shares on an exchange.<sup>531</sup> Instead, the shares are subject to periodic repurchase offers by

and BDCs to satisfy their final prospectus delivery requirements by filing the prospectus with the Commission, and permitting additional communications by and about these funds and BDCs during a registered public offering. See Securities Offering Reform for Closed-End Investment Companies, Release No. 33-10619 (Mar. 20, 2019) [84 FR 14448 (Apr. 10, 2019)] (“Closed-End and BDC Securities Offering Reform Release”).

<sup>527</sup> See, e.g., 17 CFR 270.22e-4 (liquidity risk management programs); 15 U.S.C. 80a-2(a)(41) (defining “value”).

<sup>528</sup> See, e.g., Robert P. Bartlett III, Paul Rose, and Steven Davidoff Solomon, *The Small IPO and the Investing Preferences of Mutual Funds*, 47 J. of Finance 151 (2017) (providing an example that if a \$1 billion fund, which in 2014 represented the median fund in the fourth size quartile, purchased 10% of a \$50 million offering, or \$5 million, the investment would have to triple in value in order to produce a 1% gross return); Jeffrey M. Solomon, *Presentation to the SEC Investor Advisory Committee* (June 22, 2017), available at <https://www.sec.gov/spotlight/investor-advisory-committee-2012/jeffrey-solomon-presentation.pdf>. Although both are in the context of smaller initial public offerings, the impact on overall fund performance for a comparably-sized exempt offerings would be similar.

<sup>529</sup> See Katie Rushkewicz, Morningstar, *Unicorn Hunting: Large-Cap Funds That Dabble in Private Companies* (June 4, 2018) (finding that “while fund managers have greater inclination in investing in private firm equity over the past few years, the impact for most fund investors is minimal”).

<sup>530</sup> 17 CFR 270.23c-3. Although BDCs may also use Rule 23c-3, in this release our references to interval funds generally refer to registered closed-end funds. We are not aware of any BDCs that are currently making periodic repurchase offers under Rule 23c-3.

<sup>531</sup> Only one interval fund is currently exchange-traded.

the interval fund at a price based on net asset value. An interval fund is permitted to offer its shares continuously at a price based on the fund’s net asset value.<sup>532</sup> An interval fund will make periodic repurchase offers to its shareholders, generally every three, six, or twelve months, as disclosed in its prospectus and annual report.<sup>533</sup> The repurchase offer amount cannot be less than 5% or more than 25% of the common stock outstanding on a repurchase request deadline. An interval fund must maintain liquid assets equal to at least 100% of the amount of the mandatory repurchase offer.<sup>534</sup> An interval fund also may make a discretionary repurchase offer not more than once every two years.<sup>535</sup> Commission rules require that certain aspects of the interval fund’s repurchases, including the periodic interval between repurchase request deadlines, are fundamental policies that can be changed only by a majority vote of the outstanding voting securities.<sup>536</sup>

As compared to open-end funds, interval funds can employ strategies that involve less liquid assets, such as securities obtained in exempt offerings, or strategies where the predictability of potential inflows and outflows to the fund is more important. An interval fund differs from traditional closed-end funds in that it has a fundamental policy to provide investors with some degree of liquidity at net asset value on a periodic basis through the repurchase offer. While investors in traditional closed-end funds may be able to obtain liquidity for their shares through trading on an exchange, such transactions may occur at prices that are at a discount to net asset value. Unlike private funds,

<sup>532</sup> Interval funds are generally required under the Securities Act to pay a registration fee to the Commission at the time of filing a registration statement. See 15 U.S.C. 77f(b)(1). This means that they pay registration fees at the time they register the securities, regardless of when or if they sell them. In March 2019, the Commission proposed amendments to its rules that would permit interval funds to pay their registration fees to the Commission in the same manner as open-end funds (by computing registration fees due on an annual net basis) as they routinely repurchase shares at net asset value and are required to periodically offer to repurchase their shares. See Closed-End and BDC Securities Offering Reform Release. Specifically, open-end funds pay fees on a net basis, based upon the sales price for securities sold during the fiscal year and reduced based on the price of shares redeemed or repurchased that year. See 15 U.S.C. 80a-24(f)(2).

<sup>533</sup> The Commission also has issued exemptive orders to interval funds that permit them to conduct repurchase offers on a monthly basis, subject to conditions. See, e.g., In the Matter of Weiss Strategic Interval Fund, Release No. IC-33124 (June 18, 2018).

<sup>534</sup> 17 CFR 270.23c-3(b)(10).

<sup>535</sup> 17 CFR 270.23c-3(c).

<sup>536</sup> 17 CFR 270.23c-3(b)(2)(i).

interval funds are registered investment companies, may be open to non-accredited investors,<sup>537</sup> are not subject to the “plan assets” rule under ERISA,<sup>538</sup> and are eligible for tax treatment under Subchapter M of the Internal Revenue Code of 1986, as amended (“Internal Revenue Code”) if the conditions of that regulation are satisfied.<sup>539</sup>

Based on a review of filings with the Commission, the number of new interval funds that have been introduced over the past several years has increased, from nine in 2016 to 19 in 2018, and over half of all active interval funds are less than five years old. However, interval funds remain a relatively small component of all registered investment companies, consisting of 57 interval funds with about \$29.7 billion in assets under management as of December 31, 2018.<sup>540</sup> Current interval funds employ a wide variety of investment strategies, including insurance-linked securities, real estate and real estate debt, credit, and derivatives. The 2017 Treasury Report recommended that the Commission review its rules regarding interval funds to determine whether more flexible provisions might encourage the creation of registered closed-end funds that invest in offerings of smaller public companies and private companies whose shares have limited or no liquidity.<sup>541</sup>

Some registered closed-end funds operate as tender offer funds. Tender offer funds repurchase securities under Section 23(c)(2) of the Investment Company Act,<sup>542</sup> which permits the fund to repurchase tendered shares after providing a reasonable opportunity to all shareholders to submit tenders. As a

<sup>537</sup> Some interval funds limit their distribution to high net worth clients, institutional investors, or qualified clients under the Advisers Act. Other interval funds may sell to retail investors, but may require a minimum investment amount.

<sup>538</sup> See 29 CFR 2510.3–101. When a plan subject to ERISA invests in an equity interest of an entity that is neither a publicly-offered security nor a security issued by a registered investment company, the ERISA plan’s assets include both the equity interest and an undivided interest in each of the underlying assets of the entity unless the entity is an operating company or equity participation in the entity by benefit plan investors is “not significant.” Thus, private funds sometimes limit the amount of interests purchased by investors subject to ERISA in order to prevent the private fund itself from being deemed to be a “plan asset” subject to ERISA.

<sup>539</sup> See 26 U.S.C. 851 *et seq.* Under Subchapter M, a qualifying fund may avoid corporate-level taxation on dividends and capital gains passed through to fund investors.

<sup>540</sup> By comparison, at the end of 2018, total net assets were \$250 billion for closed-end funds, \$17.7 trillion for mutual funds, and \$3.4 trillion for exchange traded funds. See ICI Fact Book, at 32.

<sup>541</sup> See 2017 Treasury Report, at 37.

<sup>542</sup> 15 U.S.C. 80a–23(c)(2).

result, tender offer funds have greater flexibility with respect to the amount and timing of the repurchase offers, relative to interval funds, as there is no requirement for a tender offer fund to conduct such offers at specific intervals or any minimum or maximum repurchase amount. However, tender offers must comply with the tender offer rules under the Exchange Act, including 17 CFR 240.13e–4 (“Rule 13e–4”).<sup>543</sup>

## 2. Private Funds

Private funds, such as venture capital funds, private equity funds, and angel funds,<sup>544</sup> are pooled investment funds that must comply with the terms of an appropriate exemption from the registration requirements of the Securities Act as well as an exemption or exclusion from registration under the Investment Company Act. When a private fund makes an offering, it typically relies on Section 4(a)(2) and Rule 506 under the Securities Act to offer and sell its interests without registration under the Securities Act.<sup>545</sup> Private funds generally rely on one of two exclusions from the definition of “investment company” under the Investment Company Act—Section 3(c)(1) or Section 3(c)(7)<sup>546</sup>—which exclude them from substantially all regulatory provisions of that act.<sup>547</sup>

Both Sections 3(c)(1) and 3(c)(7) have conditions that the fund does not make a public offering of its securities. Notwithstanding these conditions, the Commission has previously concluded that Section 201(b) of the JOBS Act permits private funds to engage in

<sup>543</sup> Rule 13e–4 imposes filing, disclosure, and dissemination requirements on the issuer, or an affiliate of the issuer, that is making a tender offer, including the filing of Schedule TO [17 CFR 240.14d–100] with the Commission. Rule 13e–4 also imposes certain requirements on the manner of making a tender offer. Rule 13e–4 does not apply to repurchase offers by interval funds conducted under Rule 23c–3. Repurchase offers conducted under Rule 23c–3 may be less costly than under the Commission’s tender offer rules.

<sup>544</sup> Angel investors are usually accredited investors who invest their own money in early-stage companies with high growth potential. According to the Angel Capital Association, in 2013, the median angel round size was \$600,000 in funding. See Presentation to the SEC Advisory Committee on Small and Emerging Companies, Dec. 17, 2014, available at <https://www.sec.gov/spotlight/acsec/sec-small-biz-committee-aca-12-17-14-final.pdf>. Some angel funds are structured as pooled investment vehicles, while other angel investors may form an “angel group” that collectively conducts due diligence on a potential investment but allows each angel investor to make an individual decision to participate in an exempt offering.

<sup>545</sup> See Section II.B for a discussion of these exemptions. See also Rule 506(c) Adopting Release at Section II.E.

<sup>546</sup> 15 U.S.C. 80a–3(c)(1) and (c)(7).

<sup>547</sup> See Rule 506(c) Adopting Release at Section II.E.

general solicitation in compliance with Rule 506(c) of Regulation D without losing either of the exclusions under the Investment Company Act.<sup>548</sup> Therefore, a private fund may offer its securities under Rule 506(c) of Regulation D without violating the conditions of Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act.

### a. Qualifying Venture Capital Funds Under the Investment Company Act

Section 3(c)(1) excludes any fund that is beneficially owned by not more than 100 persons and that is not making and does not presently propose to make a public offering of its securities. Section 504 of the Economic Growth Act amended Section 3(c)(1) to increase the limit to 250 persons in the case of a “qualifying venture capital fund,” which is defined as a venture capital fund<sup>549</sup> with not more than \$10 million in aggregate capital contributions and uncalled committed capital.<sup>550</sup> Under the Advisers Act,<sup>551</sup> a “venture capital fund” includes any private fund that:

- Represents that it pursues a venture capital strategy;
- Holds no more than 20% of the fund’s aggregate capital contributions and uncalled committed capital in assets (other than short-term holdings) that are not qualifying investments;<sup>552</sup>
- Does not borrow, issue debt obligations, provide guarantees, or otherwise incur leverage, in excess of 15% of the private fund’s aggregate capital contributions and uncalled committed capital;
- Only issues securities the terms of which do not provide a holder with any right, except in extraordinary circumstances, to withdraw, redeem, or

<sup>548</sup> See *id.*

<sup>549</sup> The provision references the definition of “venture capital fund” in 17 CFR 275.203(l)–1.

<sup>550</sup> The \$10 million amount is required to be indexed for inflation once every five years by the Commission, rounded to the nearest million. 15 U.S.C. 80a–3(c)(1).

<sup>551</sup> 15 U.S.C. 80b–1 *et seq.*

<sup>552</sup> A “qualifying investment” generally means an equity security issued by a qualifying portfolio company that has been acquired directly by the private fund from the qualifying portfolio company. See 17 CFR 275.203(l)–1(c)(3). A “qualifying portfolio company” means any company that: (i) At the time of any investment by the private fund, is not reporting or foreign traded and does not control, is not controlled by or under common control with another company, directly or indirectly, that is reporting or foreign traded; (ii) does not borrow or issue debt obligations in connection with the private fund’s investment in such company and distribute to the private fund the proceeds of such borrowing or issuance in exchange for the private fund’s investment; and (iii) is not an investment company, a private fund, an issuer that would be an investment company but for the exemption provided by 17 CFR 270.3a–7 (“Rule 3a–7”) under the Investment Company Act, or a commodity pool. See 17 CFR 275.203(l)–1(c)(4).

require the repurchase of such securities but may entitle holders to receive distributions made to all holders pro rata; and

- Is not a registered investment company or a BDC.<sup>553</sup>

A venture capital fund also includes SBICs licensed by the U.S. Small Business Administration<sup>554</sup> and rural business investment companies.<sup>555</sup>

#### b. Qualified Purchasers Under the Investment Company Act

Section 3(c)(7) excepts from the definition of investment company any fund the outstanding securities of which are owned exclusively by persons who, at the time of acquisition of such securities, are “qualified purchasers,” and which is not making and does not at that time propose to make a public offering of its securities. The following are qualified purchasers:

- Natural persons who own not less than \$5 million in investments;<sup>556</sup>
- Family-owned companies that own not less than \$5 million in investments;
- Certain trusts; and
- Persons, acting for their own accounts or the accounts of other qualified purchasers, who in the aggregate own and invest on a discretionary basis, not less than \$25 million in investments (e.g., institutional investors).<sup>557</sup>

#### c. Qualified Client Under the Advisers Act

Subject to certain exemptions, Section 205(a) of the Advisers Act<sup>558</sup> prohibits

investment advisers registered or required to be registered with the Commission from charging performance fees to clients, which are commonly used by investment advisers to private equity and venture capital funds. Rule 205-3 under the Advisers Act<sup>559</sup> provides an exemption from the prohibition when a client meets the definition of “qualified client.” A “qualified client” is a natural person who, or a company that:<sup>560</sup>

- Has at least \$1 million in assets under management with the adviser immediately after entering into an investment advisory contract with the adviser;
- The adviser reasonably believes has a net worth (together with assets held jointly with a spouse) of more than \$2.1 million exclusive of the value of a person’s primary residence immediately prior to entering into an advisory contract;
- The adviser reasonably believes is a “qualified purchaser” as defined in Section 2(a)(51)(A) of the Investment Company Act at the time an advisory contract is entered into;
- Is an executive officer, director, trustee, general partner, or person serving in a similar capacity, of the adviser; or
- Is an employee of the adviser who participates in the investment activities of the adviser, and has performed investment activities for at least 12 months.

A Section 3(c)(1) fund, a registered investment company, or a BDC, may only charge performance fees if each equity owner of such entity is a qualified client.<sup>561</sup> A separate statutory provision provides an exemption from Section 205(a) for performance fees charged to Section 3(c)(7) funds<sup>562</sup> and, subject to certain conditions, for contracts involving BDCs.<sup>563</sup>

Section 203(l) of the Advisers Act<sup>564</sup> provides that an investment adviser that solely advises “venture capital funds” is

exempt from registration under the Advisers Act.<sup>565</sup> Section 203(m) of the Advisers Act<sup>566</sup> and 17 CFR 275.203(m)-1 (“Rule 203(m)-1”)<sup>567</sup> thereunder provide an exemption from registration for any investment adviser that solely advises private funds if the adviser has assets under management in the United States of less than \$150 million. The Commission has previously referred to investment advisers relying on either exemption as “exempt reporting advisers” because Sections 203(l) and 203(m) provide that the Commission shall require such advisers to maintain such records and to submit such reports as the Commission determines necessary or appropriate in the public interest or for the protection of investors. Because exempt reporting advisers are not registered with the Commission, the prohibition on performance fees contained in Section 205(a) of the Advisers Act does not apply.

#### B. Pooled Investment Funds as Accredited Investors

Certain pooled investment funds are deemed to be accredited investors without being subject to holding a minimum amount of assets or other qualifications.<sup>568</sup> These include registered investment companies, BDCs, and SBICs.<sup>569</sup>

Private funds otherwise are not accredited investors unless they qualify under another provision of Rule 501(a). A private fund could qualify as an accredited investor if it holds total assets in excess of \$5 million and is a corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered.<sup>570</sup> A private fund may also be able to qualify as a trust, with total assets in excess of \$5 million, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person.<sup>571</sup> Alternatively, a private fund could be an accredited investor if all of the fund’s equity owners are accredited investors.<sup>572</sup> Small private funds with assets of \$5 million or less may not qualify as

<sup>553</sup> 17 CFR 275.203(l)-1.

<sup>554</sup> 17 CFR 230.501(a)(1) and (2). An SBIC is any company that is licensed as a small business investment company under the Small Business Investment Act of 1958 or that has received the preliminary approval of the U.S. Small Business Administration and has been notified by the Administration that it may submit a license application. See General Instruction A to Form N-5 [17 CFR 239.24; 17 CFR 274.5].

<sup>555</sup> See Public Law 115-417 (2019). A “rural business investment company” is defined in Section 384A of the Consolidated Farm and Rural Development Act [7 U.S.C. 2009cc] as a company that is approved by the Secretary of Agriculture and that has entered into a participation agreement with the Secretary. To be eligible to participate as an RBIC, the company must be a newly formed for-profit entity or a newly formed for-profit subsidiary of such an entity, have a management team with experience in community development financing or relevant venture capital financing, and invest in enterprises that will create wealth and job opportunities in rural areas, with an emphasis on smaller enterprises. See 7 U.S.C. 2009cc-3(a).

<sup>556</sup> For purposes of the qualified purchaser definition, the Commission defined “investments” to include interests held for investment purposes, physical commodities held for investment purposes, financial contracts entered into for investment purposes, and cash and cash equivalents held for investment purposes. 17 CFR 270.2a51-1(b).

<sup>557</sup> 15 U.S.C. 80a-2(a)(51)(A).

<sup>558</sup> 15 U.S.C. 80b-5(a).

<sup>559</sup> 17 CFR 275.205-3.

<sup>560</sup> The amounts below reflect the most recent inflation adjustments to the assets under management and net worth tests. See Order Approving Adjustment for Inflation of the Dollar Amount Tests in Rule 205-3 under the Investment Advisers Act of 1940, Release No. IA-4421 (June 14, 2016) [81 FR 39985 (June 20, 2016)].

<sup>561</sup> See 17 CFR 275.205-3(b). For registered investment companies, the Advisers Act provides an exemption from Section 205(a) for fulcrum fees. A fulcrum fee generally involves averaging the adviser’s fee over a specified period and increasing or decreasing the fee proportionately with the investment performance of the company or fund in relation to the investment record of an appropriate index of securities prices. See 15 U.S.C. 80b-5(b)(2).

<sup>562</sup> 15 U.S.C. 80b-5(b)(4).

<sup>563</sup> 15 U.S.C. 80b-5(b)(3).

<sup>564</sup> 15 U.S.C. 80b-3(l).

<sup>565</sup> See note 553 and accompanying text.

<sup>566</sup> 15 U.S.C. 80b-3(m).

<sup>567</sup> 17 CFR 275.203(m)-1.

<sup>568</sup> See Section II.A for a discussion of the definition of accredited investor.

<sup>569</sup> 17 CFR 230.501(a)(1) and (2).

<sup>570</sup> 17 CFR 230.501(a)(3). Other entities, such as limited liability companies, that have assets in excess of \$5 million may qualify as accredited investors. See note 70.

<sup>571</sup> 17 CFR 230.501(a)(7). “Sophisticated purchaser” is a person described in Rule 506(b)(2)(ii).

<sup>572</sup> 17 CFR 230.501(a)(8).

accredited investors and could be excluded from participating in certain exempt offerings under Rule 506 unless each equity owner of the fund is an accredited investor. If a “knowledgeable employee”<sup>573</sup> of the private fund or the fund’s general partner does not otherwise satisfy the accredited investor standard, then the private fund will not qualify as an accredited investor under Rule 501(a)(8), which requires all equity owners of the investor to be accredited investors.

### C. Retail Investor Access to Pooled Investment Funds That Invest in Exempt Offerings

For retail investors who are not currently accredited investors, the ability to obtain exposure to exempt offerings through a pooled investment fund is limited to exposure through registered investment companies and BDCs. Registered investment companies and BDCs are subject to extensive disclosure requirements under the Securities Act, the Exchange Act, and the Investment Company Act; registered investment companies are also subject to substantive regulation under the Investment Company Act and BDCs are subject to selected provisions of the Investment Company Act. Retail investors can also invest through a SBIC<sup>574</sup> that is publicly offered, but there are currently no SBICs with a public offering. However, it may be difficult for retail investors in practice to obtain exposure to exempt offerings through these vehicles. Liquidity and daily valuation requirements for mutual funds and ETFs present challenges to their ability to invest in a significant number of exempt offerings.<sup>575</sup> The need for economies of scale regarding portfolio investments by registered investment companies may make it impractical for these funds to invest in relatively smaller exempt offerings.<sup>576</sup>

We recognize that certain types of registered investment companies primarily intended for persons saving for retirement may be designed for investors to hold for a long period of time. For example, target date retirement funds are designed to make it easier for investors to save for retirement and hold a diversified portfolio of securities that is rebalanced automatically among asset classes over time without the need for each investor to rebalance his or her portfolio

repeatedly.<sup>577</sup> For funds with target dates significantly far into the future, the intended holding period may be better aligned with the limited liquidity of securities from exempt offerings relative to other types of open-end funds where the intended investor holding period may be shorter. However, nearly all target date retirement funds are registered as open-end funds, which give investors the ability to redeem their interests in the fund. As a result, target date retirement funds generally invest in other open-end funds, including ETFs, to obtain exposures to different types of asset classes while retaining appropriate liquidity. By investing only in other open-end funds, target date retirement funds may forgo exposure to issuers making exempt offerings.

We also recognize that, in recent years, investment advisory services have become more broadly available to retirement investors. Such services include digital investment advisory programs, or “robo-advisers,” which provide automated services through algorithmic-based programs. Based on information obtained about the client, such as an expected retirement date and life expectancy, these advisory services provide a recommended portfolio for the client and subsequently manage the client’s account. In recent years, these advisory services have been offered to retail investors with minimal account balances and can be appealing to younger persons who have recently entered the workforce,<sup>578</sup> as starting retirement savings early can increase the long-term probability of accumulating sufficient financial resources to fund retirement. Many of the asset allocation exposures recommended by the advisory services are achieved through low-cost funds such as ETFs. These solutions may be able to provide a more customized retirement solution for investors.<sup>579</sup> However, the current ability to allocate a small portion of a portfolio to investments in exempt offerings through an advisory service would be subject to the same purchaser eligibility requirements, such as

accredited investor status and, if applicable, qualified purchaser status.

Closed-end funds, including BDCs, do not have the liquidity and valuation-related constraints on their ability to invest in exempt offerings that open-end funds have. However, there can be challenges for investors in closed-end funds and BDCs to convert any profits from successful growth-stage exempt issuers held in a fund or BDC’s portfolio. Unlike private venture capital funds that return contributed capital and profits directly to fund investors upon a liquidity event of a portfolio company, closed-end funds and BDCs generally retain such proceeds, which would be reflected in the net asset value of the fund. While investors in a closed-end fund or BDC could convert their interests in the fund to cash by selling on the secondary market, to the extent one exists, such sales could occur at prices that are at a discount to net asset value.<sup>580</sup>

Interval funds and tender offer funds are types of closed-end funds that can provide investors with an ability to participate directly in returns based on an increase in the value of their investments. Unlike exchange-listed closed-end funds, both of these funds have mechanisms that allow them to repurchase fund interests from investors from time to time, but we do not believe these funds currently are used extensively as a means to provide capital to smaller issuers in exempt offerings based on staff review of filings with the Commission.

For retail investors, the ability to participate directly in private fund offerings from a regulatory perspective<sup>581</sup> will largely depend on the investor’s status as an accredited investor, qualified purchaser, and qualified client. Retail investors who are accredited investors, but not qualified purchasers or qualified clients, can participate in private funds offered pursuant to Section 3(c)(1) of the Investment Company Act. Such a fund would be limited to 100 beneficial owners, or 250 beneficial owners for a qualifying venture capital fund.

Closed-end funds, including BDCs, would be considered qualified purchasers for purposes of investment in private funds, including hedge funds and private equity funds, offered pursuant to Section 3(c)(7) of the

<sup>577</sup> See Investment Company Advertising: Target Date Retirement Fund Names and Marketing, Release No. IC-29301 (June 16, 2010) [75 FR 35919 (June 23, 2010)].

<sup>578</sup> See, e.g., Michael Blanding, Harvard Business School, Why Millennials Flock to Fintech for Personal Investing (Dec. 7, 2016), available at <https://hbswk.hbs.edu/item/why-millennials-flock-to-fintech-firms-for-personal-investing?cid=wk-sm-fb-sf51284263&sf51284263=1>.

<sup>579</sup> But see Office of Investor Education and Advocacy, Investor Bulletin: Robo-Advisers (Feb. 23, 2017), available at [https://www.sec.gov/oiea/investor-alerts-bulletins/ib\\_robo-advisers.html](https://www.sec.gov/oiea/investor-alerts-bulletins/ib_robo-advisers.html) (discussing considerations for investors in determining whether to use a robo-adviser).

<sup>580</sup> See Section V for a discussion of other potential limitations on the secondary market for securities issued in exempt offerings.

<sup>581</sup> In addition, a private fund may have contractual provisions and other conditions, such as a minimum investment level, that effectively preclude the ability of a typical retail investor from investing in the private fund.

<sup>573</sup> See note 141.

<sup>574</sup> Interests in SBICs may also be offered and sold in exempt offerings.

<sup>575</sup> See note 528 and accompanying text.

<sup>576</sup> See note 529 and accompanying text.



Investment Company Act. However, the possibility of offering closed-end funds that make significant investments in private funds to retail investors has historically raised staff concerns under the Investment Company Act, insofar as these investors could not invest directly in private funds.<sup>582</sup> Currently, our understanding is that all closed-end funds that invest primarily in private funds are offered only to investors who meet certain wealth requirements (e.g., the tests for accredited investor), and require significant minimum initial investments.

#### D. Request for Comment

For general questions related to the accredited investor definition and exempt transactions under Section 4(a)(2) or Rule 506, see Sections II.A.5 and II.B.3 for additional requests for comment.

111. To what extent do issuers view pooled investment funds as an important source of capital for exempt offerings? Do certain types of pooled investment funds facilitate capital formation more efficiently than others? For example, do private equity and venture capital funds provide more capital to issuers than registered investment companies and BDCs? From an issuer's perspective, are there benefits to raising capital from a pooled investment fund rather than from individual investors?

112. For small issuers, particularly those that seek to raise capital in micro-offerings, to what extent are angel funds an important source of capital?

113. How have recent market trends affected retail investor access to growth-stage issuers that do not seek to raise capital in the public markets? To the extent that issuers are more likely to seek capital through exempt offerings, do existing regulations make investor access to this market through a pooled investment vehicle difficult?

114. Are there any regulatory provisions or practices, including those promulgated or engaged in by the Commission, that discourage or have the effect of discouraging participation by registered investment companies and BDCs in exempt offerings? For closed-end funds and BDCs, are there any existing regulatory provisions or practices that discourage the introduction of investment products that focus on issuers seeking capital at key stages of their growth cycle? If so,

how do these regulatory provisions or practices create barriers?

115. What restrictions should there be, if any, on the ability of closed-end funds, including BDCs, to invest in private funds, including private equity funds and hedge funds, and to offer their shares to retail investors? For example, should there be a maximum percentage of assets that closed-end funds and BDCs can invest in private funds? Should such closed-end funds be required to diversify their investments across a minimum number of private funds, if they are not restricting their offerings to accredited investors?

116. Should we consider making any changes to our rules regarding interval funds? If so, what types of changes? Should we modify the periodic intervals from the current three, six, or twelve months? Should a fund have flexibility to determine the length of its periodic interval? If so, should there be a maximum permitted periodic interval? Should we create a mechanism for investors to vote to determine the periodic interval? Should we amend or eliminate the minimum and/or maximum repurchase offer amount?

117. Should we shorten the minimum time at which an interval fund and other eligible funds can make a discretionary repurchase offer from the current period of two years after its last discretionary repurchase offer?<sup>583</sup> Should we amend the conditions under which a majority of the interval fund's directors, including a majority of the fund's directors who are not interested persons of the fund, can suspend or postpone a repurchase offer?<sup>584</sup> Should we allow interval funds to have more flexibility before a repurchase offer must commence, such as a five-year investment period with periodic repurchase offers thereafter?<sup>585</sup>

<sup>583</sup> See 17 CFR 270.23c-3(c).

<sup>584</sup> See 17 CFR 270.23c-3(b)(3). Existing conditions include if the suspension or postponement would result in the loss of status as a regulated investment company under Subchapter M of the Internal Revenue Code, if the suspension or postponement would result in the delisting of the fund from a national securities exchange, any period during which its principal securities market is closed (other than customary week-end and holiday closings) or trading on which is suspended, any period during which an emergency exists as a result of which disposal by the fund of securities owned by it is not reasonably practicable or during which it is not reasonably practicable for the fund fairly to determine the value of its net assets, or by order of the Commission for the protection of security holders of the fund.

<sup>585</sup> 17 CFR 270.23c-3(a)(7) allows an interval fund to delay its first repurchase request deadline up to an additional interval after the effective date of its registration statement (e.g., if its periodic interval is six months, it may schedule its first repurchase request deadline up to 12 months after the effective date).

118. Should we make any modifications as to which elements of an interval fund's repurchase policy should be fundamental and changeable only by a majority vote of the outstanding voting securities?<sup>586</sup> What elements of a repurchase policy should be determined by a majority of the board or a majority of the non-interested directors? If the periods between repurchase offers become longer or less predictable, what measures, if any, should we take to facilitate sales of interval funds shares on the secondary market for investors who may need liquidity? If we were to permit interval funds to engage in repurchase offers less frequently and/or with less predictability than under our current rule, should we limit the purchase of such interval funds to sophisticated investors such as accredited investors or qualified purchasers?

119. Are there other measures that can be taken to decrease the compliance costs associated with the interval fund structure? Are there any changes that we should make to our rules to increase the efficiency of the repurchase offer notification and tender process, such as facilitating electronic or other notification? Should we have rules that permit interval funds to have multiple share classes?<sup>587</sup> Should we have rules that permit interval funds to utilize the series and trust structure used by open-end funds to set up new interval funds? Would a series and trust structure make it easier to establish follow-on funds for new investments, rather than for the original fund to remain in a continuous offering?

120. Should we provide a transitory exemption from the diversification requirements in Section 5(b)(1) of the Investment Company Act during the initial stages of an interval fund so that the advisor has sufficient time to identify and invest in appropriate portfolio companies?<sup>588</sup> If so, would two years be a sufficient duration?

<sup>586</sup> See 17 CFR 270.23c-3(b)(2)(i).

<sup>587</sup> We have issued exemptive orders to interval funds that permit them to have multiple share classes, subject to conditions. See, e.g., In the Matter of SharesPost 100 Fund, Release No. IC-32799 (Aug. 28, 2017).

<sup>588</sup> Section 5(b)(1) of the Investment Company Act [15 U.S.C. 80a-5(b)(1)] provides that a "diversified company" holds at least 75% of the value of its total assets in cash and cash items, Government securities, securities of other investment companies, and other securities limited in respect of any one issuer to an amount not greater in value than 5% of the value of its total assets and to not more than 10% of the outstanding voting securities of such issuer. Our staff has engaged in outreach efforts with existing sponsors of interval funds, who have indicated that these diversification requirements can pose challenges to making investments in the start-up phase of the fund.

<sup>582</sup> See Staff Report to the United States Securities and Exchange Commission, *Implications of the Growth of Hedge Funds* (Sept. 2003), at 80-83 (discussing concerns about the "retailization" of private funds), available at <https://www.sec.gov/news/studies/hedgefunds0903.pdf>.

Would similar changes need to be implemented to the diversification requirements under subchapter M of the Internal Revenue Code in order to make any changes under the Investment Company Act meaningful? To the extent an interval fund pursues a private equity or venture capital strategy that may result in the control of a portfolio company, what types of relief under the Investment Company Act, if any, should be provided for affiliated transactions and subject to what conditions? Would an interval fund need other types of relief and, if so, what conditions should apply?

121. Should we consider making any changes to our rules regarding tender offer funds? If so, what type of changes? To what extent would any changes to the interval fund rule lessen the need for tender offer funds? Should we permit tender offer funds to use the conditions described in Rule 23c3–3(c)<sup>589</sup> in place of the Exchange Act tender offer rules, if investors in those tender offer funds are limited to accredited investors or qualified purchasers?

122. If a target date retirement fund were to seek a limited amount of exposure to exempt offerings in its portfolio, what measures, if any, should we consider taking to enable this? Similarly, if investment advisory services, including robo-advisers, that are focused on retirement savings seek to include a limited amount of exposure to securities from exempt offerings as part of a diversified retirement portfolio that they recommend to retail investors, should we consider making any changes to our rules to enable this? If so, what types of changes?

123. How do the restrictions on performance fees under the Advisers Act affect the offering of venture strategies by registered investment companies and BDCs? Should we make changes to the restrictions on performance fees?

124. What changes, if any, should be made to the regulatory regime with respect to SBICs and/or RBICs?

125. Certain pooled investment funds, such as registered investment companies, BDCs, and SBICs, specifically qualify as accredited investors without satisfying any quantitative criteria such as a total assets or investments threshold. Should

<sup>589</sup> Paragraph (c) of the interval fund rule permits any registered closed-end fund or a BDC to repurchase common stock of which it is the issuer pursuant to a repurchase offer that is not made pursuant to a fundamental policy and that is made to all holders of the stock if a similar offer has not been made in the prior two years. See 17 CFR 270.23c–3(c).

other types of pooled investment funds be similarly treated? For example, should we include Section 3(c)(7) funds? Should we include any venture capital fund as defined by Rule 203(l)–1 under the Advisers Act? Should we include any qualifying venture capital fund, as recently added by the Economic Growth Act? Should we include RBICs?

126. The definition of “qualified client” under the Advisers Act specifically includes a “qualified purchaser” as defined by the Investment Company Act. Should we similarly define an “accredited investor” under Regulation D to specifically include a “qualified purchaser”? Would that be a less costly approach for regulating offerings of Section 3(c)(7) funds?

127. The rules implementing the accredited investor and qualified client definitions have provisions for periodic reassessment of the quantitative thresholds, but the qualified purchaser definition does not. Should we consider a similar periodic reassessment for the qualified purchaser definition? If so, should the periodic reassessment for the three definitions occur at the same time?

128. Does the issue of secondary market liquidity have a significant effect on investors’ decision-making with respect to whether to invest in pooled investment vehicles, particularly with respect to closed-end funds and BDCs?

129. Should we consider any changes to our rules to encourage the establishment or improvement of secondary trading opportunities for closed-end funds or BDCs? If so, what changes should we consider?

## V. Secondary Trading of Certain Securities

The expansion of our exempt offering framework through the implementation of the JOBS Act and other recent Commission initiatives has sought to provide additional avenues for small- and medium-sized businesses to raise capital.<sup>590</sup> Section II of this release has focused on the framework of exemptions available for primary offerings by an issuer. Secondary market liquidity for investors in these issuers is integral to capital formation in the primary offering market.<sup>591</sup> While restricted and otherwise illiquid securities can yield a more stable shareholder base with less investor turnover, small businesses report struggling to attract capital in their

<sup>590</sup> See, e.g., Public Law 112–106, 126 Stat. 306 (2012); Crowdfunding Adopting Release; Rule 147 Adopting Release.

<sup>591</sup> See, e.g., 2017 Treasury Report (“Robust secondary markets are critical to supporting capital formation, and in turn, economic growth.”).

primary offerings because potential investors are reluctant to invest unless they are confident there will be an exit opportunity.<sup>592</sup> Those issuers that are able to attract investors may incur a higher cost of capital or bear an illiquidity discount if the securities lack secondary market liquidity.<sup>593</sup> In addition, limited secondary market liquidity and a lack of an active trading market may impair investors’ ability to diversify their portfolios over time because their capital may be locked up longer than they would like.<sup>594</sup> In turn, an investor’s inability to divest prior investments due to illiquidity may prevent the investor from reallocating capital to the next investment opportunity, thereby limiting the capital available to the next business.<sup>595</sup>

While factors affecting secondary market liquidity for securities are numerous and complex,<sup>596</sup> we are soliciting comment on possible ways to revise our rules governing exemptions for resales of securities to facilitate capital formation and to promote investor protection by improving secondary market liquidity.

### A. Resale Exemptions

As discussed above, several offering exemptions result in the issuance of restricted securities or securities that are otherwise subject to resale limitations. Even without resale restrictions, an investor who wishes to sell securities must either register (or have the issuer register) the transaction or have an exemption for the transaction. Several exemptions, including the exemptions under Section 4(a)(2) and Regulation D, are available only for offers and sales by an issuer of securities to initial purchasers and are not available to an affiliate of the issuer or to another person for resales of the securities.<sup>597</sup>

<sup>592</sup> See ACSEC Secondary Market Liquidity Recommendation.

<sup>593</sup> See *id.*

<sup>594</sup> See *id.*

<sup>595</sup> See *id.*

<sup>596</sup> See, e.g., Report to Congress: Access to Capital and Market Liquidity (Aug. 2017) available at <https://www.sec.gov/files/access-to-capital-and-market-liquidity-study-dera-2017.pdf>.

<sup>597</sup> For additional information pertinent to secondary market sales and restricted securities, see also the discussion of Commission regulation of transfer agents and the removal of restrictive legends in Advanced Notice of Proposed Rulemaking, Concept Release and Request for Comment on Transfer Agent Regulations, Release No. 34–76743 at 127–135 (Dec. 22, 2015) [80 FR 81947 (Dec. 31, 2015)], available at <https://www.sec.gov/rules/concept/2015/34-76743.pdf> and Transcript of Equity Market Structure Roundtable, Roundtable on Combating Retail Investor Fraud at 142–172 (Sept. 26, 2018), available at <https://www.sec.gov/spotlight/equity-market-structure-roundtables/retail-fraud-round-table-092618-transcript.pdf>.

## 1. Section 4(a)(1) and Rule 144

Investors seeking to resell their securities frequently rely on the exemption provided by Section 4(a)(1) of the Securities Act, which is available to any person other than an issuer, underwriter, or dealer. A dealer is any person who engages, directly or indirectly, in the business of offering, buying, selling or otherwise dealing or trading in securities issued by another person and includes a person acting for his or her own account (*i.e.*, a dealer or principal) or for the accounts of others (*i.e.*, a broker or agent).<sup>598</sup>

The term “underwriter” is defined broadly in Section 2(a)(11) of the Securities Act to mean “any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates, or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking.”<sup>599</sup> The interpretation of this definition traditionally has focused on whether the purchaser “purchased from an issuer with a view to . . . distribution.”<sup>600</sup> While an investment banking firm arranging an issuer’s public sale of securities is clearly an underwriter, individual investors who are not securities professionals also may be underwriters if they “act as links in a chain of transactions through which securities move from an issuer to the public.”<sup>601</sup>

Rule 144 is a non-exclusive safe harbor from the Section 2(a)(11) definition of underwriter that establishes specific criteria for determining whether a person is engaged in a distribution. A person satisfying the applicable conditions of Rule 144 is deemed not to be engaged in a distribution of the securities and therefore not an underwriter when determining whether a sale is eligible for the Section 4(a)(1) exemption. In addition, the purchaser in the transaction will receive securities that are not restricted securities.<sup>602</sup>

Rule 144 provides a safe harbor for the resale of restricted securities if a number of conditions are met, including holding the securities for six months or one year, depending on whether the issuer has been filing reports under the Exchange Act.<sup>603</sup> Specified current

information concerning the issuer must be publicly available.<sup>604</sup> A reporting company satisfies this information requirement if it has been subject to the reporting requirements of Section 13 or Section 15(d) of the Exchange Act for at least 90 days and has filed all reports required during the 12 months prior to the sale.<sup>605</sup> A non-reporting company satisfies the information requirement by making publicly available certain information, similar to the information required to be included in an annual report to shareholders.<sup>606</sup> In addition, if a selling security holder is an affiliate of the issuer,<sup>607</sup> additional conditions in Rule 144 apply.<sup>608</sup>

The 2016 Small Business Forum and several of its predecessors have recommended that the Commission reduce the holding periods for reporting companies under Rule 144(d)(1)(i) from six months to three months and for non-reporting companies under Rule 144(d)(1)(ii) from one year to six months.<sup>609</sup>

The Advisory Committee on Small and Emerging Companies stated that there are situations under which certain security holders may not be able to meet the conditions of Rule 144, and that these security holders incur transaction expenses to sell outside of the Rule 144 safe harbor that can be significant.<sup>610</sup> To address these concerns, the Advisory Committee recommended that the Commission adopt an additional exemption “to mimic existing . . . practice for resales of privately-issued securities by shareholders who are not able to rely on Securities Act Rule 144.”<sup>611</sup> The 2013, 2014, and 2015 Small Business Forums recommended that the Commission “propose a new federal exemption governing the private resale of restricted securities under Section 4(a)(1)” based on common market practices.<sup>612</sup>

<sup>604</sup> See 17 CFR 230.144(c).

<sup>605</sup> See 17 CFR 230.144(c)(1).

<sup>606</sup> See 17 CFR 230.144(c)(2).

<sup>607</sup> An affiliate of an issuer is a person who, directly, or indirectly through one or more intermediaries controls, or is controlled by, or is under common control with, the issuer. 17 CFR 230.144(a)(1).

<sup>608</sup> See 17 CFR 230.144(b)(2).

<sup>609</sup> See 2016 Forum Report. See also, *e.g.*, 2014 Forum Report and 2012 Forum Report.

<sup>610</sup> See Advisory Committee on Small and Emerging Companies: Recommendations Regarding the “4(1½) Exemption” (June 11, 2015) available at <https://www.sec.gov/info/smallbus/acsec/acsec-4a-one-and-a-half-recommendation.pdf>.

<sup>611</sup> *Id.*

<sup>612</sup> 2013 Forum Report (stating that based on changes resulting from the JOBS Act, private companies have much more flexibility to remain private longer, and that, as a result, the need for a specific federal exemption for private secondary transactions for shareholders who cannot satisfy

## 2. Rule 144A

Rule 144A provides a non-exclusive safe harbor for unregistered resales of certain restricted securities<sup>613</sup> to QIBs.<sup>614</sup> When the Commission adopted Rule 144A, it viewed it as a step toward achieving a more liquid and efficient institutional resale market for unregistered securities.<sup>615</sup>

The term “qualified institutional buyer” is defined in Rule 144A(a)(1) to include specified institutions that, in the aggregate, own and invest on a discretionary basis at least \$100 million in securities of issuers that are not affiliated with such institution. Banks and other specified financial institutions must also have a net worth of at least \$25 million. A registered broker-dealer qualifies as a QIB if it, in the aggregate, owns and invests on a discretionary basis at least \$10 million in securities of issuers that are not affiliated with the broker-dealer.

In the case of persons other than an issuer or a dealer, any person who offers and sells securities in accordance with Rule 144A will be deemed not to be engaged in a distribution and therefore not to be an underwriter within the meaning of Section 2(a)(11) of the Securities Act. Such person therefore may rely on the exemption from registration provided by Section 4(a)(1).<sup>616</sup>

In 2013, the Commission amended Rule 144A to permit the use of general solicitation under Rule 144A, as long as the purchasers are limited to QIBs or to purchasers that the seller and any person acting on behalf of the seller reasonably believe are QIBs.<sup>617</sup> As discussed in Section III.B.5, a selling security holder can conduct a Rule 144A offering using general solicitation after purchasing the securities in a private placement or other exempt

Rule 144 has become critical); 2014 Forum Report; and 2015 Forum Report.

<sup>613</sup> When issued, the restricted securities cannot be of the same class as securities listed on a national securities exchange registered under Section 6 of the Exchange Act or quoted in an automated inter-dealer quotation system. See 17 CFR 230.144A(d)(3)(i).

<sup>614</sup> See Rule 144A Adopting Release.

<sup>615</sup> See *id.*

<sup>616</sup> As discussed in Section V.A.3, dealers have the benefit of an exemption from registration under Section 4(a)(3) of the Securities Act [15 U.S.C. 77d(a)(3)], except when they are participants in a distribution or within a specified period after the securities have been offered to the public. If the conditions of Rule 144A are met, a dealer will be deemed not to be a participant in a distribution of securities within the meaning of Section 4(a)(3)(C) or an underwriter of such securities within the meaning of Section 2(a)(11), and the securities will be deemed not to have been offered to the public within the meaning of Section 4(a)(3)(A). *Id.*

<sup>617</sup> 17 CFR 230.144A(d). See Rule 506(c) Adopting Release.

<sup>598</sup> 15 U.S.C. 77b(a)(12).

<sup>599</sup> 15 U.S.C. 77b(a)(11). See also Preliminary Note 2 to 17 CFR 230.144.

<sup>600</sup> Preliminary Note 2 to 17 CFR 230.144.

<sup>601</sup> *Id.*

<sup>602</sup> See *id.*

<sup>603</sup> See 17 CFR 230.144(d).

offering. As a result, while Rule 144A is available solely for resale transactions, market participants use it to facilitate capital-raising by issuers by means of a two-step process, in which the first step is a primary offering on an exempt basis, often in reliance on Section 4(a)(2), to one or more financial intermediaries, and the second step is a resale to QIBs pursuant to Rule 144A.<sup>618</sup>

### 3. Section 4(a)(3)

While Section 4(a)(1) specifically excludes offerings by dealers, Section 4(a)(3) of Securities Act generally exempts transactions by dealers not acting as underwriters. Section 4(a)(3) is not available to a dealer to the extent it is acting as an underwriter, including any person who purchased the securities from the issuer with a view to distributing them.<sup>619</sup> Section 4(a)(3) also is not available for resales of restricted securities or “control securities,” which are securities held by an affiliate of the issuer.<sup>620</sup>

The 2014 Small Business Forum recommended that the Commission preempt state registration requirements for offers and sales pursuant to Section 4(a)(1) or (3) through a registered broker-dealer.<sup>621</sup>

### 4. Section 4(a)(4)

Section 4(a)(4) provides a limited exemption for certain transactions not covered by Section 4(a)(3). Specifically, Section 4(a)(4) exempts brokers’ transactions executed on unsolicited customers’ orders on any exchange or in the over-the-counter market. Section 4(a)(4) only exempts the broker’s part of a broker’s transaction. It does not extend to the customer selling the securities, who must rely on his or her own exemption or register the transaction.<sup>622</sup> If the customer can comply with the Rule 144 safe harbor requirements for its resale, Rule 144(g) provides additional guidance on what constitutes a broker’s

<sup>618</sup> See Rule 506(c) Adopting Release (“By its terms, Rule 144A is available solely for resale transactions; however, since its adoption by the Commission in 1990, market participants have used Rule 144A to facilitate capital-raising by issuers.”).

<sup>619</sup> 15 U.S.C. 77b(a)(11). In addition, Section 4(a)(3) specifically excludes offers and sales of securities within the 40 days following the first date the securities were offered to the public by an underwriter (or 90 days from such date in the event of an initial public offering). See Section V.A.2. for a discussion of the safe harbor available for dealers under Rule 144A.

<sup>620</sup> See Revisions to Rules 144 and 145, Release No. 33–8869 (Dec. 6, 2007) [72 FR 71546 (Dec. 17, 2007)] (“Although it is not a term defined in Rule 144, ‘control securities’ is used commonly to refer to securities held by an affiliate of the issuer, regardless of how the affiliate acquired the securities.”).

<sup>621</sup> See 2014 Forum Report.

<sup>622</sup> See SEC Release No. 131 (March 13, 1934).

transaction under Section 4(a)(4), including that in any such transaction, the broker-dealer must:

- Function as an agent;
- Receive no more than the usual and customary commission for services;
- Not solicit customers’ orders; and
- Not have any reason to believe that the customer is engaged in an unlawful distribution of the securities.

### 5. Section 4(a)(7)

In 2015, the FAST Act introduced a new registration exemption for private resales of securities by adding new Section 4(a)(7) to the Securities Act. A sale of securities by other than the issuer or its subsidiary is exempt under Section 4(a)(7) if the following conditions are met:

- The purchaser is an “accredited investor;”
- Neither the seller, nor any person acting on its behalf, uses any form of general solicitation or advertising;
- Neither the seller nor any person who has been or will be paid for its participation in the transaction is a “bad actor” under Rule 506(d);
- The issuer is engaged in business, not in the organizational stage or in bankruptcy or receivership, and is not a blank check, blind pool, or shell company that has no specific business plan or purpose and has not indicated that its primary business plan is to engage in a merger with an unidentified person;
- The transaction does not relate to an unsold allotment to, or a subscription or participation by, a broker or dealer as an underwriter of the securities;
- The securities have been authorized and outstanding for at least 90 days; and
- If the issuer of the securities is not subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act, a variety of specified information must be provided to prospective purchasers, including the issuer’s most recent balance sheet and statement of profit and loss and similar financial statements for the two preceding fiscal years, prepared in accordance with U.S. GAAP or, in the case of a foreign private issuer, International Financial Reporting Standards (“IFRS”).

Securities acquired under Section 4(a)(7) are “restricted securities” and cannot be further transferred except pursuant to registration or another exemption from registration.<sup>623</sup>

<sup>623</sup> See Section II.B.1.b for a discussion of restricted securities.

## B. Relationship With State Law

### 1. Section 18: Federal Preemption for Secondary Offerings

In addition to having an exemption from federal registration requirements, an investor seeking to resell securities must also consider whether state securities registration or other requirements apply. Federal securities laws currently preempt state securities law registration and qualification requirements for secondary offers or sales of securities:

- Pursuant to Sections 4(a)(1) and 4(a)(3), if the issuer files reports with the Commission pursuant to Exchange Act Section 13 or 15(d);<sup>624</sup>
- Pursuant to Section 4(a)(4)<sup>625</sup> or Section 4(a)(7);<sup>626</sup> and
- If such security is listed, or authorized for listing, on a national securities exchange.<sup>627</sup>

For all other resale transactions, a selling security holder would be required either to register the transaction with the state securities regulator in each state where an offer or sale occurs or to rely on an exemption to state registration requirements under the relevant state law in each state in which its offers or sells the securities. For example, an investor seeking to sell to a non-accredited investor securities that such investor purchased in a Regulation A offering by a non-reporting issuer whose securities are not listed on a national securities exchange must either have the issuer register the resale transaction under the Securities Act and with the state securities regulator in each state in which it offers or sells the securities, or rely on a Securities Act exemption and an exemption from state registration requirements under the relevant state law in each state in which it offers or sells the securities. Similarly, an investor seeking to sell to a non-accredited investor restricted securities under Rule 144 that it purchased from a non-reporting company still would have to register the resale with the state securities regulator or rely on an exemption from state registration requirements under the relevant state law in each state in which it offers or sells those securities.

The 2017 and 2018 Small Business Forums recommended that the Commission provide blue sky preemption for secondary trading of securities issued under Tier 2 of Regulation A.<sup>628</sup> The 2016 Small

<sup>624</sup> See 15 U.S.C. 77r(b)(4)(A).

<sup>625</sup> See 15 U.S.C. 77r(b)(4)(B).

<sup>626</sup> See 15 U.S.C. 77r(b)(4)(G).

<sup>627</sup> See 15 U.S.C. 77r(b)(1).

<sup>628</sup> See 2016 Forum Report; 2018 Forum Report.

Business Forum recommended that Commission adopt rules that preempt state registration requirements for all primary and secondary trading of securities sold in offerings registered with the Commission.<sup>629</sup> The 2017 Treasury Report also recommended that state securities regulators update their regulations to exempt from state registration and qualification requirements secondary trading of securities issued under Tier 2 of Regulation A or, alternatively, that the Commission use its authority to preempt state registration requirements for such transactions.<sup>630</sup> The Commission's Advisory Committee on Small and Emerging Companies and the 2014, 2015, and 2017 Small Business Forums all recommended preemption for secondary trading of securities of Regulation A Tier 2 issuers that are current in their ongoing reports.<sup>631</sup> The 2015 and 2016 Small Business Forums further recommended that Commission adopt rules that preempt state registration requirements for all securities sold in offerings registered with the Commission.<sup>632</sup> The 2014 Small Business Forum also recommended that the Commission expand the definition of "qualified purchaser" under Section 18(b)(3) to include any purchaser of a security that has been offered and sold pursuant to Section 4(a)(1) or (3) through a registered broker-dealer.<sup>633</sup>

## 2. State Exemptions for Secondary Sales

State exemptions vary substantively. Many state exemptions are based on the Uniform Securities Act of 2002 or its pre-NSMIA predecessor, the Uniform Securities Act of 1956. However, notwithstanding states' adoption of one or more model exemptions under these acts, state laws are not uniform. Market participants report that this lack of uniformity inhibits the development of

a national secondary trading market.<sup>634</sup> We describe some state exemptions below that market participants have noted are generally applicable to secondary transactions.<sup>635</sup>

### a. Isolated Non-Issuer Transaction Exemption

Most states offer a narrow exemption from registration for isolated sales by a seller other than the issuer.<sup>636</sup> A form of the isolated non-issuer transaction exemption is contained in the Uniform Securities Acts for "any isolated non-issuer transaction, whether effected through a broker-dealer or not."<sup>637</sup> The model acts do not define the term isolated transaction, but the exemption generally is intended to cover occasional sales by a person and not multiple, successive, or frequent transactions of a similar character by a person or a group.<sup>638</sup> Specific requirements are left to the states to develop. Historically, there has been somewhat varied case law development of the term "isolated transaction," and states vary on, and frequently do not specify, how many such non-issuer offers and sales may be made and still considered isolated.<sup>639</sup> Market participants have indicated that this inconsistency creates confusion and makes it difficult to create an efficient interstate market for these transactions.<sup>640</sup>

### b. Institutional Investor Exemption

Most states provide an exemption for offers and sales to certain financial or other institutional investors and broker-dealers.<sup>641</sup> While many states' definitions of institutional investor<sup>642</sup>

are based on the 2002 Uniform Securities Act definition, which includes various categories based on the definition in Rule 501(a) of Regulation D, state requirements nonetheless differ. For example, some states adopt broader definitions or extend the exemption to sales to other sophisticated investors,<sup>643</sup> while others exclude certain categories of purchasers.<sup>644</sup>

### c. Manual Exemption

Another common type of state exemption for secondary offers and sales is the "manual exemption," which is currently available in 39 of the 54 U.S. jurisdictions.<sup>645</sup> These exemptions generally exempt secondary offers and sales by non-issuers if certain financial and other information about the issuer is published in a designated securities manual. Some states further restrict the exemption, for example, to sales through a broker-dealer or at a price reasonably related to the current market price.<sup>646</sup> The exemption is based on the public availability in a designated securities manual of current information about an issuer that enables parties on both sides of the trade to make an educated investment decision.<sup>647</sup> Historically, states typically recognized three manuals for purposes of the manual exemption: Standard & Poor's Corporation Records; Fitch Investors Service; and Mergent's Investor Service (formerly known as Moody's).<sup>648</sup> In 2016, however, Standard & Poor's discontinued the publication of its manual. Because many issuers quoted on the OTC Markets, Inc. ("OTC Markets") website had relied on their listing in the Standard & Poor's Corporation Records for purposes of the manual exemption, OTC Markets began seeking recognition of its website as a source of the requisite information for purposes of the manual exemption.<sup>649</sup> As of March 2019, 34 jurisdictions

<sup>634</sup> See, e.g., ACSEC Secondary Market Liquidity Recommendation.

<sup>635</sup> See, e.g., comments of Annemarie Tierney, Executive Vice President, Legal Affairs and General Counsel SecondMarket, at the 32nd Securities and Exchange Commission Government-Business Forum on Small Business Capital Formation, November 21, 2013, transcript available at <https://www.sec.gov/info/smallbus/sbforumtrans-112113.pdf> ("Tierney Comments"); see also "Secondary Trading Developments" slides as presented by Annemarie Tierney, contained as Attachment B to the Minutes of the March 4, 2015 ACSEC Meeting available at <https://www.sec.gov/info/smallbus/acsec/acsec-minutes-030415.pdf> ("Tierney Slides").

<sup>636</sup> 1 Blue Sky Regulation § 9.03.

<sup>637</sup> 1956 Uniform Securities Act § 402(b)(1); see also 2002 Uniform Securities Act § 202(1).

<sup>638</sup> See Official Comments, 2002 Uniform Securities Act Section 202(1) through (8).

<sup>639</sup> 1 Blue Sky Regulation § 9.03.

<sup>640</sup> See, e.g., Tierney Comments.

<sup>641</sup> See 1 Blue Sky Regulation § 9.03. Most of these state exemptions are modeled after the 2002 Uniform Securities Act § 202(13) or 1956 Uniform Securities Act § 402(b)(8), though some states have adopted a non-standard version.

<sup>642</sup> See, e.g., 6 Del. Code Ann. § 7309(b)(8); Wash. Rev. Code § 21–20.320(8).

<sup>643</sup> See, e.g., Wis. Dept. Fin. Inst. R. § 202(4).

<sup>644</sup> See, e.g., Tex. Rev. Civ. Stat. art. 581–5(H) (specifying that the exemption is applicable only if the broker-dealer is actively engaged in business).

<sup>645</sup> See ACSEC Secondary Market Liquidity Recommendation.

<sup>646</sup> See Notice of Request for Public Comments Regarding a Proposed Model Rule to Designate Nationally Recognized Securities Manuals for Purpose of the Manual Exemption and a Proposed Model Rule to Exempt Secondary Trading in Securities Issued by Regulation A – Tier 2 Issuers (Jul. 19, 2018) ("NASAA Proposal"), available at <http://www.nasaa.org/wp-content/uploads/2018/07/NASAA-Secondary-Trading-Proposal-Public-Comment-Request.pdf>, citing Uniform Securities Act of 1956, Draftsmen's Commentary to § 305(i), § 305(j) and Related Sections Referring to Non-Issuer Distributions.

<sup>647</sup> See ACSEC Secondary Market Liquidity Recommendation.

<sup>648</sup> See NASAA Proposal.

<sup>649</sup> See *id.*

<sup>629</sup> See 2016 Forum Report.

<sup>630</sup> See 2017 Treasury Report.

<sup>631</sup> See ACSEC Secondary Market Liquidity Recommendation; 2014 Forum Report (recommending that the Commission define "qualified purchaser" under Section 18(b)(3) to include any purchaser of a class of security that has been offered and sold pursuant to Section 4(a)(1) or (3), provided that, the issuer files reports pursuant to Rule 257(b) in order to preempt state blue sky regulation of after-market resale trading of securities issued pursuant to Tier 2 Regulation A offerings); 2015 Forum Report; 2017 Forum Report.

<sup>632</sup> See 2016 Forum Report; 2015 Forum Report (recommending that exemption from state law, rule, regulation, order, or other administrative action should be afforded to all primary and secondary registered public offerings of securities on Form S–1 (including rights offerings) by defining "qualified purchaser" to mean all original and subsequent purchasers of such security).

<sup>633</sup> See 2014 Forum Report.

recognized the OTCQX market for purposes of the manual exemption, while 31 jurisdictions recognized the OTCQB market for purposes of the manual exemption.<sup>650</sup> However, there remains no centralized information portal accepted by all jurisdictions where investors can find issuer information.<sup>651</sup> In addition, complying with the manual exemption can be costly for issuers because they must pay to disseminate their information in the various recognized manuals.<sup>652</sup>

In July 2018, the North American Securities Administrators Association, Inc. (“NASAA”) requested public comments on two proposed model rules that would facilitate secondary trading in securities of issuers where certain information about the issuer is publicly available.<sup>653</sup>

NASAA’s first proposed model rule would eliminate the outdated Standard & Poor’s Corporation Records manual and designate as nationally recognized securities manuals or their electronic equivalent for purposes of the manual exemption under state law: Fitch Investors Service, Mergent’s Investor Service, and the OTC Markets website with respect to securities that are included in the OTCQX and OTCQB markets.<sup>654</sup>

Not all states have adopted a manual exemption, and some states’ manual exemptions do not recognize EDGAR as a source of the required publicly available information. In those states, investors who want to trade securities of issuers that have sold securities under Tier 2 of Regulation A, even where those issuers remain current in their ongoing reporting requirements, may not have a readily available state exemption from registration to effect such trades.<sup>655</sup>

NASAA’s second proposed model rule is designed to facilitate secondary trading in certain securities issued under Tier 2 of Regulation A and would provide two alternative options for an exemption for secondary trading in securities of certain issuers subject to the ongoing reporting requirements of Regulation A. The first option would exempt from registration secondary sales of securities of issuers that at the time of the sale are current in their

ongoing reporting requirements under Tier 2 of Regulation A, provided that the transaction otherwise complies with the terms of the manual exemption. The second option is a narrowly tailored version of the manual exemption specifically for securities of issuers that are current in their ongoing reporting requirements. Comments on the proposed model rules were due by August 20, 2018.<sup>656</sup>

#### d. Broker-Dealer Exemptions

There are a number of types of state exemptions for transactions through a broker-dealer that are not within the scope of Securities Act Section 4(a)(4).<sup>657</sup> For example, market participants have indicated that most state laws include an exemption for offers and sales if the distribution is effected through a registered broker-dealer that does not solicit orders or offers to buy.<sup>658</sup> In an effort to ensure that the exemption is narrowly tailored only to unsolicited transactions, some states require purchasers to confirm that the order was unsolicited.<sup>659</sup>

#### C. Request for Comment

130. Do concerns about secondary market liquidity have a significant effect on issuers’ decision-making with respect to primary capital-raising options? Does secondary market liquidity affect the decision-making of individual investors? In considering which exemption may be best suited to a particular offering, do issuers take into account whether the securities issued in the transaction will be restricted securities and/or subject to other resale restrictions?

131. Issuers that are not currently subject to Exchange Act registration may prefer that their securities have restrictions on resale, due to concerns that trading in the securities could lead to a high number of record holders, which could trigger Section 12(g) registration. What effect would an exemption from Section 12(g) registration for certain exempt offerings, if introduced, extended, or made permanent, have on issuers’ access to capital or secondary market liquidity? For example, should we, as recommended by the 2014 Small Business Forum, exempt purchasers and

transferees of securities issued pursuant to Regulation A from the calculation of the number of registered holders under Section 12(g)? Would these types of changes provide benefits that could outweigh a decline in the rate at which issuers may become reporting companies?

132. Should we revise the Rule 144 non-exclusive safe harbor? If so, how should we revise Rule 144? For example, should we, as recommended by the 2012 and 2016 Small Business Forums, reduce the Rule 144 holding period for securities of issuers meeting the current public information requirement from six months to three months? Should we, as recommended by the 2012 Small Business Forum, reduce the Rule 144 holding period for securities of issuers not subject to the current information requirements from 12 months to six months?

133. Should we, as recommended by the Advisory Committee on Small and Emerging Companies and the 2013, 2014, and 2015 Small Business Forums, expand the safe harbors for secondary sales under Section 4(a)(1) for security holders that are not able to rely on Rule 144? If so, please describe the parameters of such potential safe harbors. How would the adoption of such additional safe harbors under Section 4(a)(1) affect capital formation, investor protection, and current market practices?

134. Investors who purchase in secondary transactions may not have access to current information about the issuer and its securities. Particularly if we expand the population of investors who may qualify as accredited investors, should we impose some type of issuer disclosure requirement in connection with resales? If so, should we consider a requirement similar to that required by Section 4(a)(7) or one similar to the manual exemption available in many states? What alternatives should we consider?

135. Are market participants using the Section 4(a)(7) resale exemption? We request data with respect to the use of the Section 4(a)(7) exemption.

136. In addition to Section 4(a)(7), secondary sales of securities may rely on other resale exemptions, such as those contained in Section 4(a)(1) and the related safe harbors under Rule 144 and Rule 144A, Section 4(a)(3), and Section 4(a)(4). Would additional resale exemptions or safe harbors be appropriate? If so, what other resale transactions should be exempt from the provisions of Section 5?

137. Should we extend federal preemption to additional offers and sales of securities, for example, by

<sup>650</sup> See <https://www.otcm Markets.com/corporate-services/products/blue-sky>.

<sup>651</sup> See ACSEC Secondary Market Liquidity Recommendation.

<sup>652</sup> See *id.*

<sup>653</sup> See NASAA Proposal.

<sup>654</sup> See *id.* The proposed model rule would not provide any relief with respect to securities of issuers included in the Pink Tier of the OTC Markets.

<sup>655</sup> See *id.*

<sup>656</sup> See *id.*

<sup>657</sup> As discussed in Section V.A.4, Section 18 of the Securities Act preempts state registration and qualification requirements for transactions under Section 4(a)(4) of the Securities Act [15 U.S.C. 77d(a)(4)].

<sup>658</sup> See Tierney Slides. See also 1 Blue Sky Regulation § 9.06.

<sup>659</sup> See 1 Blue Sky Regulation § 9.06; Tierney Slides.

expanding the definition of “qualified purchaser”? For example, should we preempt state securities registration or other requirements applicable to secondary sales of securities:

- Offered or sold pursuant to Section 4(a)(1) or 4(a)(3), if the issuer of such security is a Tier 2 Regulation A issuer and remains current in its ongoing reporting required under the rules, as recommended by the 2014 and 2015 Small Business Forums;

- Initially issued in a Tier 2 Regulation A offering, as recommended by the 2014–2018 Small Business Forums and the 2017 Treasury Report; or

- Initially issued in an offering registered under the Securities Act, as

recommended by the 2015 Small Business Forum?

138. What other steps should we consider to improve secondary trading liquidity of securities exempt from registration? For example, should we consider permitting securities that were exempt from registration to trade on venture exchanges? If so, how should we define a venture exchange and under what circumstances should we permit trading on the venture exchange? Will allowing such securities to trade on venture exchanges prior to being fully seasoned have an effect on companies issuing such securities through exempt offerings? If so, what effect?

## VI. Conclusion

We are interested in the public’s views regarding the matters discussed in this concept release. We encourage all interested parties to submit comments on these topics. In addition, we solicit comment on any other aspect of the exempt offering framework that commenters believe may be improved.

By the Commission.

Dated: June 18, 2019.

**Vanessa A. Countryman,**

*Acting Secretary.*

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