Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090
File No. S7-02-20

Re: Securities and Exchange Commission Proposed Rules Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets; File No. S7-05-20

Dear Ms. Countryman:

The Shareholder Advocacy Forum ("SAF") is a nonprofit, nonpartisan organization dedicated to preserving the long-term interests of all shareholders. We are affiliated with Americans for Tax Reform, also a nonprofit, nonpartisan organization focused on lower taxes and limited government. We appreciate the opportunity to comment on pending SEC proposals.

On March 4, 2020 the SEC proposed amendments[1] intended to simplify, harmonize, and improve the current framework for private offerings under the Securities Act of 1933. The set of amendments represent an effort by the Securities and Exchange Commission to further its three-part mission to protect investors; maintain fair, orderly, and efficient markets, and facilitate capital formation.

We commend the SEC for its efforts to observe and respond to the changing landscape of the private markets. The proposed amendments represent a collaborative undertaking between the SEC's commissioners, directors, commenters, and participants in the private market. However, we do take concern with certain aspects of the proposal, for which we offer these comments for the Commissioners to consider. We appreciate the opportunity to regularly provide comments, and we urge the SEC to contemplate necessary adjustments before adopting the proposal.

Introductory Comments on Current Exemption Framework

The exemption framework allows certain offerings to avoid registration with the SEC, as is required for reporting companies issuing and trading securities on public exchanges. The private market stands as the counterpart to the public market in terms of how securities are marketed, issued, and traded. The private market contains various exemptions to public company registration requirements that facilitate capital raising in the niche market.

1 See *Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets*, https://www sec gov/rules/proposed/2020/33-10763 pdf

Currently available exemptions are not absolute. There are always conditions that must be met before the exemption can be relied on. There are generally more investor protective conditions to satisfy when non-accredited investors or those who are considered "less sophisticated" are permitted to participate in the offering. Additionally, the burden is on the issuer seeking to rely on the exemption to prove that it is available and applicable to the current offering.[2] The SEC allows exemptions when an offering has characteristics that provide an inherent safeguard for investors. This may be the type of investors who are targeted (accredited investors), the scope of the offering, or the methods by which information about the offering is disseminated.

The Proposal Would Harmonize Patchwork Regulations

SEC Chairman Jay Clayton correctly points out that the private market has changed significantly in the past 35 years to become a much more present and utilized landscape next to the public market. Chairman Clayton also acknowledges that:

> *"Today's proposals are centered on small and medium-sized companies. These companies contribute substantially to our economy but are unlikely to become public companies due to their size, the nature of their capital needs, or other factors. For them, private offerings are a key source of capital to continue to grow and create jobs. However, they generally do not have the sophistication to effectively navigate complex rule sets."*[3]

Larger companies tend to begin in the private market to raise capital before transitioning to the public market. Small and medium companies have very valid reasons for choosing to stay private - and the SEC should allow the regulations to evolve to better facilitate private company's formation of capital and ensure investors are still protected.

A. Offering Limits Raised for Certain Exempt Offerings

The proposal raises the offering limits within a 12-month period in the follow scheme:

- Regulation A: Tier 2: $75 million (up from $50 million)
- Rule 504 of Regulation D: $10 million (up from $5 million)
- Regulation Crowdfunding: Section 4(a)(66): $5 million (up from $1.07 million)

[2] *See SEC v. Ralston Purina Co.*, 346 U.S. 119, 126 (1953) (stating that "[k]eeping 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.")

[3] Chairman Jay Clayton; *Harmonizing, Simplifying and Improving the Exempt Offering Framework* (March 4, 2020), https://www sec gov/news/public-statement/statement-clayton-harmonization-2020-03-04

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Commissioner Elad Roisman defended the decision to raise limits by pointing out that the goal is not to necessarily expand the exempt market, but to facilitate private companies to raise capital more efficiently so that they may transition to the public companies:

> *"Encouraging and enabling issuers to raise capital in our private markets earlier may result in them raising money in our public markets at an earlier growth stage than we presently see. This, in turn, could allow Main Street investors to invest in public companies that have more growth potential."* [4]

Additionally, Commissioner Roisman's recognition that some private companies choose to remain private is appreciated. These companies still contribute to our markets and the customers they serve and deserve rules and regulations that are not only streamlined to avoid compliance issues, but designed with private market goals in mind. The Shareholder Advocacy Forum is pleased to see the Commission attempting to raise offering limits, and we support this effort.

B. <u>"Test-the-Waters" and "Demo Day" Communications</u>

The SEC proposed three amendments relating to communications:[5]

- A proposed rule allowing an issuer to solicit interest materials to test the waters for an exempt offering before determining which exemption it will use for the impending sale
- A proposed rule amendment permitting issuers within Regulation Crowdfunding to test the waters prior to filing an offering document with the SEC - similar to the current Regulation A framework
- A proposed new rule that would exempt certain "demo day" communications from falling within the general solicitation or advertising scope

General solicitation within the private market is extremely limited and entirely banned for some exempt offerings. The rationale is that the public market registration and disclosure requirements safeguard market participants. Where those requirements are largely absent in the private market, investors may be left vulnerable.

1. *Solicited Interest Materials*

Securities Act Rule 163B, adopted in September 2019, extended the "test the waters" accommodation to all issuers, previously available only to emerging growth companies (EGCs).[6]

[4] Commissioner Elad Roisman; *Statement on the Harmonization Proposal* (March 4, 2020), https://www.sec.gov/news/public-statement/statement-roisman-harmonization-2020-03-04
[5] Press Release; *SEC Proposes Rule Changes to Harmonize, Simplify and Improve the Exempt Offering Framework* (March 4, 2020), https://www.sec.gov/news/press-release/2020-55
[6] 17 CFR § 230.163

Regulation A also extends this accommodation to issuers soliciting interest from the general public when accompanied by a legend and a preliminary offering circular.[7] To protect investors, both accredited and non-accredited, solicitation of interest materials is considered an *offering* for the purposes of attaching anti-fraud liability.

These methods of solicitation allow issuers to gauge market interest before committing to the costs of an offering. Anti-fraud liability ensures that issuers cannot manipulate or deceive the public when soliciting interest but still allows them to judge if they should move forward towards an offering. Private companies relying on an exemption will benefit from the same opportunity to test the waters. Investor opinions and preferences play a vital role in the private market, especially the small and medium companies for which Chairman Clayton has directed this rule proposal. The issuer will use the information obtained during solicitation to determine which exemption to rely on, and will then be bound to comply with the rules of that exemption.

2. *Regulation Crowdfunding Issuers*

Issuers relying on Regulation Crowdfunding cannot make offers or sales prior to filing Form C with the Commission. However, there is currently no availability for these issuers to test the waters. Preparing a Form C and subsequent offer typically costs upwards of $10,000 - with issuers being excluded from the opportunity to gauge market interest. The proposed rule allowing Regulation Crowdfunding Issuers to solicit interest would be aligned with the above allowance and for the same reasons that issuers would benefit from the opportunity to test the waters. Anti-fraud provisions would, and absolutely should, attach to such solicitations as offerings to protect investors from deceptive and manipulative devices that undermine the allowance.

Previous commenters have suggested that such solicitations should be conditioned on the way in which communications were provided, content of the communications and the method of inclusion in public filings. For example: test the waters materials should be included in a filed Form C. The SEC listened to this suggestion and rightly included it in the proposal. Requiring a company to provide the solicitation materials in a Form C that will be subsequently published will promote accountability for the issuer gaining the benefit of an exemption and accommodation.

3. *Demo Day (and Similar Events) Communications*

A "demo day" is an event organized by a group or entity that invite issuers to present the most captivating opportunities in their business plan to an auditorium full of potential investors – both individual and angel – with the goal of securing investments. Currently, determination of whether an issuer violates federal laws by offering unregistered securities at a demo day hinges on characteristics of the participant crowd that are outside the issuers control. The proposal represents

[7] 17 CFR § 230.251

a narrow and tailored approach to ease the compliance confusion and allow private issuers the opportunity to present demo day communications without violating federal securities laws. The proposal offers a multilevel approach to regulating demo days:

- The sponsor of the event is not permitted to make investment recommendations, give investment advice, or engage in negotiations between issuers and investors
- The sponsor cannot receive compensation such that broker-dealer or investment adviser registration is triggered, nor can they charge attendees fees other than those reasonable for administration
- Advertising for the event may not reference any specific offering of securities by the issuer
- The information conveyed by the issuer is limited to: notification that the issuer is in the process of offering or planning to offer securities; the type and amount of securities being offered; and the intended use of the proceeds of the offering

These rules allow issuers with historically low capital start-up to reach a broader base of potential investors without violating any ban on general solicitation. The Shareholder Advocacy Forum is delighted to see such a detailed approach proposed that enables issuers to communicate pertinent information to investors without astronomical compliance costs, while also preventing this information from misleading investors.

Commissioner Peirce's Additional Questions

In her public statement on the Proposal, Commissioner Peirce posed additional questions for consideration outside of the release itself. Her questions were probative and insightful and warrant discussion.

1. *Why not simply deregulate offerings?*

A complete deregulation of offerings will not aid the SEC in upholding its three-tenant mission. While removing certain regulations does facilitate capital formation - hence our support for the current proposal - eliminating all regulation will chip away at investor protections and leave retail investors especially vulnerable during the early stages of an offering.

Eliminating registration and focusing regulation on the "time of sale" would be a mistake, and the result would be costly for investors who have been stripped of a safeguard that has existed since the 1933 Act. Main Street investors do not make buy/sell decisions on a whim - their broker or themselves review relevant research, consult possible opportunities and determine which strategy is best based on the information available during that deliberation. Although private offers have less disclosure requirements, there should never be a scenario where an investor's protective measures are sacrificed by playing semantics.

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A "time of sale" approach would make enforcing anti-fraud laws more difficult. The first level of manipulative or deceptive devices are shown through registration statements. Preventing an offering from moving forward to approval and listing on the exchanges if it misleads investors is crucial to the SECs mission. Part of the SEC's job is to determine if an offering is accurate, informed, and not intended to fraudulently induce investments. If registration requirements are eliminated, investors capital will only be safeguarded after the money changes hands - at which point the chance of recovery of that investment severely decreases. *Exemptions* from registrations requirements are allowed only after conditions are met to assure the SEC that investors are not at risk of losing the protection the market has promised them.

Consider an extreme example of a Ponzi scheme masquerading as an offering with private and public market implications. Perhaps the SEC would detect discrepancies in the registration statement and prevent the offering from going forward. Alternatively, absent registration requirements, investors must exchange money before the SEC can explore any anti-fraud protections. It would then be the responsibility of the investors and/or the SEC to bring suits against the issuer for recovery. History has repeatedly shown that a wronged investor's chance of recovery once money has been exchanged it is nearly impossible to recover, or recovery occurs at a slow, onerous process at best, with little guarantee the investor is able to recoup their investment in full. To say that "an investor who merely hears an offer suffers no harm aside from the mild annoyance that might come with any request for money"[8] downplays the present and potential dangers that retail investors could suffer.

2. *How can we unlock the potential of crowdfunding?*

Equity crowdfunding presents a unique opportunity for retail individuals to function effectively as mini-venture capitalists by participating in private offerings that were formerly reserved only for accredited investors.

The United Kingdom boasts a strong equity crowdfunding regime weighted towards the crowdfunding platforms bearing most of the responsibility to screen companies, rather than looking to agencies to pass heave-handed regulations. Additionally, the U.K offers a pair of tax incentives to retail investors that the Commission should research and consider. The Seed Enterprise Investment Scheme (for seed-stage companies) and Enterprise Investment Scheme (for established companies) allow investors to offset a portion of their investment in qualifying companies against their existing tax liability.[9] Main Street investors especially would benefit from such a tax credit while being encouraged to participate in crowdfunding campaigns. Growing

[8] Commissioner Hester Peirce*; Statement on Proposed Amendments for Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets* (March 4, 2020), https://www sec gov/news/public-statement/statement-peirce-2020-03-04

[9] See, Kristen Voinovich; *How the UK Uses Tax Relief to Boost Entrepreneurs* (June 20, 2013), https://www crowdfundinsider com/2013/06/16641-how-the-uk-uses-tax-relief-to-boost-entrepreneurs/

businesses would see an influx in investment as a direct result of tax incentives. The SEC should research and consider the effects – culminating in a staff study report – of whether a variation of this can be implemented in the United States.

New Zealand has also emerged as a leader in equity crowdfunding, modeling its legislation after the JOBS Act. In its first year alone New Zealand saw a 78% success rate in campaigns, compared to only 53% in the United States.[10] In its first three years the average amount per investor in all campaigns was reported as NZ$43,000, NZ$96,000, and NZ$61,000. Given the relative size of the country and its economy, these figures are impressive.[11]

Commissioner Peirce cites an inciteful comment letter[12] from a Colorado Law professor, Andrew Schwartz, which the Commission should look to for potential proposed amendments. Schwartz described a two-pronged approach of *syndication* and *gatekeeping* that achieve both goals of investor protection and promoting capital formation. Syndication functions because New Zealand has higher limits on single investments than the United States. There, individuals invest alongside a larger "lead" investor who has performed due diligence.[13] Gatekeeping mimics the U.K. model where the online platforms have a responsibility to ensure that legitimate and trustworthy companies are raising capital on the platform.[14] This presumably shifts costs away from the issuers and investors, while also enabling the SEC to relax the regulatory regime. Anti-fraud laws should still impose liability on issuers to the same degree currently contained in Regulation Crowdfunding.

3. *Should we holistically streamline the offering framework?*

Commissioner Pierce questions if efforts to amend and streamline the regulatory framework has made the situation more confusing and burdensome, rather than fixing the problem. Would the better alternative be to scrap the current system entirely and start anew? Simply put: no. The bright-eyed prospect of crafting a new offering landscape appeals greatly to those on either side of the political aisle. Regardless of the reasons for frustration with how the private markets function, it is easy to give in to the allure of endless possibilities when rebuilding the system. However, private companies and investors have relied on the general framework of the current system for decades. If the issue is compliance burdens and costs, both will surely skyrocket if we implement an entirely new framework. The best option is exactly what the SEC has been doing - identifying problematic

10 See Lloyd Kavanaugh, *New Zealand: The Equity Crowdfunding Revolution* (October 11, 2017) https://minterellison co nz/our-view/new-zealand-the-equity-crowdfunding-revolution
11 Additional statistics can be found here.
12 Letter from Andrew Schwartz, Professor, Colorado Law, to File No. S7-08-19 (Sept. 24, 2019), https://www.sec.gov/comments/s7-08-19/s70819-6193349-192506.pdf
13 *Ibid*.
14 *Ibid*.

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regulations, proposing rules or amendments to existing regulations, seeking comments, and making informed decisions based on the market's reaction.

<u>Conclusion</u>

We applaud the SEC for its work to protect investors and promote market efficiency, and we thank the Commission for the opportunity to provide feedback on proposed rulemaking measures. The Shareholder Advocacy Forum strongly urges the SEC to adopt the proposed amendments.

If you should have any questions or comments, please contact James Setterlund by phone at [redacted], or email at [redacted] or [redacted].

Sincerely,

C. M.

Christina Mitsopoulos, *Securities Regulation Advisor*
Shareholder Advocacy Forum