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12 June 2020

Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

By Email: (rule-comments@sec.gov)

Re: File Number S7-05-20, *Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets*

Dear Ms. Countryman:

CFA Institute[1] appreciates the opportunity to respond to the US Securities and Exchange Commission (the "SEC" or the "Commission") on its rule proposal, *Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets* (the "Proposal").[2] CFA Institute speaks on behalf of its members and advocates for investor protection and market integrity before standard setters, regulatory authorities, and legislative bodies worldwide. We focus on issues affecting the profession of financial analysis and investment management, education and competencies for investment professionals, and on issues of fairness, transparency and accountability of global financial markets.

Executive Summary

The Proposal to amend the exemptive offering framework has two main goals. The first is to facilitate capital formation for companies that issue exemptive offerings, including smaller growth issuers that currently lack sufficient access to financing.[3] The second goal is to facilitate access to private-market investment opportunities for investors.

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[1] CFA Institute is a global, not-for-profit professional association of nearly 171,400 investment analysts, advisers, portfolio managers, and other investment professionals in 165 countries, of whom more than 164,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 154 member societies in 77 countries and territories.

[2] Sec. and Exch. Comm'n, *Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets,* Rel. Nos. 33-10763 and 34-88321 (March 4, 2020), *available at* https://www.sec.gov/rules/proposed/2020/33-10763.pdf.

[3] *See supra* note 1 at 10 and 171(saying, "Rather, we believe that the amendments might have the most significant effects on smaller growth issuers that presently lack sufficient access to financing that they require to develop their

We do not believe the Proposal makes the case that current rules impede capital formation through exemptive offerings. Moreover, most exempt offerings fall short of existing offering limits,[4] and we question whether there is significant pent-up investor demand that current rules hold back.

We are concerned that the combined effect of the proposed amendments would tip the balance in favor of private markets at the expense of public ones. We note that previous laws and regulations already have led to a significant expansion of private markets, to the point where they now dwarf public markets in size. Academics have made a compelling case that the expansion of exemptive offerings has played a significant role in driving the decline in the number of IPOs and number of companies listed on public markets. We are concerned that the Proposal would further this trend.

We also believe the proposed amendments would weaken investor protections. These concerns fall into two main categories. First, the proposal would encourage more investors – including non-accredited and unsophisticated investors – to increase their exposure to exemptive markets, which have fewer investor protections than do public markets. Second, some of the proposed amendments would weaken investor protections in exemptive markets. We are especially concerned about adverse selection and the proposed rollback of an audit requirement.

These concerns notwithstanding, we applaud the Proposal for strengthening investor protections in two ways. The first would be to limit the types of securities eligible under Regulation Crowdfunding, thereby excluding non-traditional securities, such as Simple Agreements for Future Equity (SAFE) securities. Despite their name, SAFE securities may be decidedly unsafe for unsophisticated investors who do not understand them. The second improvement would fill a gap in reporting requirements for Exchange Act companies seeking to conduct Regulation A offerings.

Regardless of its eventual determination, we urge the Commission to delay the rulemaking process. Before proceeding with this Proposal, the Commission should first determine whether to adopt its proposed amendments to the accredited investor definition. If the Commission adopts that rulemaking, it would allow time to observe the effects on investors, issuers and exemptive markets before introducing further changes with this Proposal.

In addition, and independently of the first argument, we urge delay in light of the extraordinary conditions prevailing as a result of the coronavirus and its economic fallout. In our view, now is not the time to make regulatory changes that could engender further investor confusion and exacerbate already heightened risks facing investors.

We conclude by touching on questions of legitimacy and fairness in our economy and capital markets.

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business model and gain scale).” *See* also Sec. and Exch. Comm’n, *News Release: SEC Proposes Rule Changes to Harmonize, Simplify and Improve the Exempt Offering,* available at https://www.sec.gov/news/press-release/2020-55.

[4] *See infra* at 5.

Introduction

We see merit in a comprehensive review of regulations for exemptive offerings, with the goal of establishing a systematic framework rather than a patchwork of rules. We particularly commend the staff for its extensive work and clear exposition of the exemptive framework, as depicted in the Proposal, the preceding concept release,[5] and supporting explanatory material.[6]

We also recognize the importance of entrepreneurs to our economy and appreciate how daunting it can be to navigate the exemptive offering process. Where regulatory frictions can be reduced without harming investor protections, they should be. A certain level of complexity is inevitable, however, in a system of 10 separate exemptions or safe harbors, each with disparate requirements. The regulations reflect the complexities of markets and their participants, which differ widely in terms of types of issuers, size of offerings, and the sophistication, resources, and the risk tolerances, goals, and needs of investors.

CFA Institute has published research on the evolving role of public and private markets in capital formation.[7] We recognize that private markets play a critical role in facilitating capital formation for entrepreneurs and companies that are not ready for public markets. At the same time, we recognize that public markets play a unique role in our capital markets. They provide transparency and a level playing field for investors, issuers, and intermediaries, alike, and they are subject to regulatory oversight designed to ensure market integrity. Regulations should not intentionally or inadvertently tilt the balance by favoring private markets over public ones.

The Proposal

Capital Formation

A key goal of the proposal, as reflected in its title, is to facilitate capital formation by small issuers.[8] The proposals would supplement exemptions already adopted in recent decades that have greatly expanded access to private markets.[9] As a consequence of these changes, the size of private markets has come to dwarf the public market, with private offerings in 2019 raising

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[5] Sec. and Exch. Comm'n, *Concept Release on Harmonization of Securities Offering Exemptions,* Rel. No. 33-10649, (June 18, 2019), *available at* https://www.sec.gov/rules/concept/2019/33-10649.pdf.

[6] We found the tabular overview provided by the Office of the Advocate for Small Business Capital Formation to be particularly helpful. *See Capital Formation Proposal: Overview of the Current and Proposed Capital-Raising Exemptions.*

[7] *See* Sviatoslav Rosov, CFA Institute, *Capital Formation: The Evolving Role of Public and Private Markets* (November 29, 2018), available at https://www.cfainstitute.org/en/advocacy/policy-positions/capital-formation, and Sviatoslav Rosov, CFA Institute, *Capital Formation 2: Investing Pension Contributions in Private Markets Responsibly* (2020), available at https://www.cfainstitute.org/en/advocacy/policy-positions/capital-formation-investing-pension-contributions-in-private-markets.

[8] The proposal is titled, "Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets." The proposing release begins, "The Securities and Exchange Commission is proposing amendments to facilitate capital formation and increase opportunities for investors by expanding access to capital for entrepreneurs across the United States." *See supra* note 1 at 1.

[9] For a review of key expansions, *see, e.g.,* Elisabeth De Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, Hastings Law Journal (April 11, 2017) at 445–502), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2951158.

approximately $2.7 trillion, or 69.2 percent, of all new capital raised, compared with $1.2 trillion, or 30.8 percent for registered offerings.[10] Based on these statistics, it appears private markets are an effective means of raising capital and not in need of more rules to enhance their competitiveness vis-à-vis public markets.

Despite the impact of these changes, the Proposal is based on the premise that the exemptive offering framework is in need of further improvements. Perhaps the clearest statement of this perspective came from Chairman Clayton in his Senate testimony in December 2019, when he stated, "…the private offering framework often does not function well for small and medium-sized companies seeking to grow beyond the start-up stage, particularly those that do not have established relationships with professional investors."[11]

Likewise, the Release speaks of "smaller growth issuers that presently lack sufficient access to financing that they require to develop their business models and gain scale. Such issuers may face significant financing constraints and lack an established network of angel investors or venture capital backing and may be too early in their lifecycle to be a candidate for a public offering."[12]

The question is whether this is evidence of a regulatory failure, in which excessive regulations are impeding the ability of smaller issuers to raise capital, or evidence of markets functioning properly to screen investment opportunities and allocate capital efficiently. Alternatively, is capital formation in private markets restrained, not by overregulation, but by the limits of investor demand?

We do not believe that the Proposing Release has made an evidence-based case to demonstrate that excessive regulation is the source of the problem.

Investor Access

A second goal of the Proposal is to enhance investor access to private market offerings. Many of the proposed changes would expand access by non-accredited investors, who are ineligible to participate in most Regulation D private placements. To address this matter, the Proposal seeks to attract more issuers to those exemptions—under Regulation A, Regulation Crowdfunding, and Rule 504—that are fully accessible to non-accredited investors.[13] One way to do so would be to

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[10] *See supra* note 1 at 8.

[11] *See* Jay Clayton, *Testimony on "Oversight of the Securities and Exchange Commission" Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs*, (Dec. 2019), (stating, "However, the private market regulatory framework—one that is heavily reliant on our wealth-based definition of "accredited investor"—is rooted in the markets, technology and employment and professional relationships that existed thirty or more years ago. As a result, access to potentially attractive investment opportunities for Main Street investors who do not meet those wealth standards is limited and, where it is available, costly. Additionally, the private offering framework often does not function well for small and medium-sized companies seeking to grow beyond the start-up stage, particularly those that do not have established relationships with professional investors.").

[12] *See supra* note 1at 171.

[13] *See id.* at 234 (stating, "Amendments that increase the offering limits of Regulation A Tier 2, Regulation Crowdfunding, and Rule 504 also might improve the composition of the pool of issuers relying on these exemptions. The amended exemptions could draw a larger and more diversified set of issuers with high growth potential that may require financing in excess of the existing limits. Today such startups might forgo an exemption with an offering limit in favor of a Rule 506 offering, which does not cap the offer amount. A broader and more diversified

induce some issuers to switch from Rule 506 offerings to other exemptive offerings that are open to non-accredited investors. (Unlike Regulations A and CF, Rule 506(b) of Regulation D tightly limits the number of non-accredited investors who can participate, while Rule 506(c) offerings are accessible only to accredited investors.)

As a general principle, it is appropriate to place appropriate limits on the access of non-accredited investors to exemptive offerings, in large part because such offerings come with significantly reduced investor protections, not to mention illiquid investments and limited secondary trading. We do not believe that the Proposal has demonstrated that the current limits are inappropriate or unduly restrictive for non-accredited investors (or for accredited investors, who already enjoy unrestricted access to Regulation D offerings).

In our comment letter on the concept release on harmonization, we stated:

> Before changing the current exemption rules we caution the Commission to make sure there is sufficient demand from individual and smaller investors to justify changing the current exemption rules.[14]

The evidence provided in the Proposal or in the market fails to demonstrate pent-up investor demand that would call for expanding the framework of exemptive offers. On the contrary, most exemptive offerings have fallen far short both of the regulatory limits and of issuers' own targets for their offerings.

For example, as the Proposal acknowledges, few issuers have met the 12-month offering limit of \$1.07 million for crowdfunding offers. It is unclear, therefore, how the proposed increase in the limit to \$5 million would assist issuers in raising more capital.

Likewise, most issuers of Regulation A offerings have reported proceeds that fell significantly below the amounts sought and the twelve-month offering limits. Only 183 issuers reported receiving proceeds from a Regulation A offering, from 2015, when the two tiers of Regulation A offerings were established, to December 2019. The reported proceeds represented approximately 27 percent (\$2.446 billion) of the aggregate qualified amounts sought (\$9.095 billion) over that period.[15]

Even more tellingly, only an estimated 10 percent of issuers in Tier 2 offerings have reached the \$50 million offering limit over the same four-year span.[16] Nevertheless, the Proposal seeks to raise that limit to \$75 million. It is unclear, based on these factors, how an increased offering limit would overcome the muted demand under the current limit.

There are a number of reasons to explain the muted investor demand, which the Proposal observed:

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range of investment opportunities might benefit investors in these market segments, particularly non-accredited investors that seek exposure to private companies but are constrained from participation in private placements.").

[14] See James Allen and Matt Orsagh, *CFA Institute Comment Letter on Harmonization of Securities Offering Exemptions* (Sept. 24, 2019).

[15] Sec. and Exch. Comm'n, *Staff Report to the Commission: Regulation A Lookback Study and Offering Limit Review Analysis* (March 4, 2020), at 8-9.

[16] *See id.* at 13.

> Non-accredited investors might choose not to participate in exempt offerings (*e.g.*, due to illiquidity, high transaction costs, search costs, high information asymmetries and due diligence costs, high investment minimums that preclude the desired level of diversification for small investors, agency problems due to minority stakes, etc.).[17]

These same disincentives equally could deter individual accredited investors from investing, as well, particularly those with more modest resources and lower risk tolerances.

Nonetheless, the Proposal suggests that higher offering limits could attract new issuers who are deterred by the current limits and their presence, in turn, could attract greater investor interest. We are unaware of any reason to believe this possibility is likely. The Proposal's Economic Analysis acknowledges:

> We lack data or a methodology that would allow us to predict how many new issuers that would not have otherwise undertaken any securities offering would be drawn to Regulation Crowdfunding, Regulation A, and Rule 504 under the proposed offering limits.[18]

Finally, we note the outsized role played by a single industry –real estate – in Regulation A markets. The relatively few Regulation A offerings that have exhausted the offering limits have been almost exclusively those from real estate issuers.[19] In addition, real estate offerings have represented the largest share of reported proceeds.[20]

We question the need to amend existing rules for all issuers and industries based on the historical record of a single industry. Moreover, that specific industry is one marked by significant historical – and current –volatility and risk. The Federal Reserve, for instance, has singled out the commercial real estate market as being particularly vulnerable to potential steep declines in asset prices if the coronavirus pandemic deepens.[21] That could make exemptive offers from real estate issuers particularly risky for investors, especially those who are non-accredited or unsophisticated.

Tipping the Balance in Favor of Private Markets

We are concerned that the Proposal would tip the competitive balance in favor of private markets and at the expense of public markets. Previous regulatory actions to expand exemptive offerings have been significant factors driving the decline of public markets. Such actions undermine the traditional trade-off between the burdens of public disclosure and the benefits of the right to raise capital from the general public.[22]

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[17] *See supra* note 1 at 172.
[18] *See id* at 233.
[19] *See id* note 247 at 119.
[20] *See supra* note 15 at 35.
[21] Board of Governors of the Federal Reserve System, *Financial Stability Report* (May 2020), at 19, available at https://www.federalreserve.gov/publications/files/financial-stability-report-20200515.pdf.
[22] *See, e.g., supra* note 9.

While the Proposal's Economic Analysis expresses doubt that the proposed rule changes would deter a "significant proportion"[23] of mature issues from seeking a public offering, it nevertheless acknowledges the potential to further that trend:

> As discussed above, these amendments might enable some issuers to delay or forgo a registered offering, thereby avoiding the associated costs of Exchange Act registration and being a public reporting company.[24]

Investor Protection Concerns

Our investor protection concerns fall into two main categories. First, the proposal would permit more investors – including non-accredited and unsophisticated investors – to increase exposure to exemptive markets. Second, some of the proposed amendments will weaken investor protections in exemptive markets. Adverse selection is already a key challenge to investors in exemptive markets, and we believe the proposed amendments will exacerbate this problem. The proposed reduction in audit requirements also will harm investors by depriving them of critical information. Finally, we are concerned that a combination of other proposed amendments regarding communication and integration will produce investor confusion and lead to less-informed investment decisions.

General Investor Protections

The Proposal introduces the proposed amendments by stating that they would facilitate capital formation "while preserving or enhancing important investor protections."[25] Farther into the Release, on page 189, the Economic Analysis offers a more limited claim: "the proposed amendments would not have significant adverse effects on investor protection." Elsewhere, the Proposal acknowledges that reduced disclosure requirements in all exemptive markets "may in some cases lead to a weakening of investor protections."[26]

Nonetheless, the Proposal argues that the exemptive framework is sufficient to protect investors, because investor protection provisions would remain in place under each of the exemptions. For example:

> At the same time, we believe raising the offering limit would be consistent with investor protection because existing Regulation Crowdfunding requirements, including the intermediary requirements and the eligibility, disclosure, and ongoing reporting requirements for issuers would continue to provide appropriate investor protections at this higher offering limit.[27]

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[23] *See supra* note 1 at 171, (saying, "Importantly, we do not expect the proposed amendments to deter a significant proportion of the issuers that are large and mature enough to be on the cusp of going public from pursuing a public offering.").
[24] *See id.* at 236.
[25] *See id.* at 1.
[26] *See id.* at 184 (saying, "The disclosure requirements of all of these exemptions are less extensive than the requirements associated with a registered offering, which may in some cases lead to a weakening of investor protections.").
[27] *See id.* at 132.

CFA Institute strongly supports such protections. Yet doubts about compliance with these rules surfaced at a recent meeting of the SEC Small Business Advisory Council, an entity that generally supports expansion of exemptive markets. At its May 8, 2020, meeting, one council member observed:

> …one of the things that we see with Regulation CF is noncompliance with firms' investor protection rules across the board… in the proposing release, one of the statements is, well, we can [raise the offering limit] because investor protection is included by the fact that there is ongoing reporting. Most companies with ongoing reporting obligations are not meeting those obligations.[28]

Adverse selection concerns

Adverse selection is already a major issue for investors in exemptive markets, and we believe the proposed amendments would further exacerbate the challenges. In today's private markets, adverse selection takes numerous forms. The best deals can be expected to go to well-connected, experienced, and deep-pocketed investors or investment funds, such as established private equity and venture capital firms, leaving less attractive offers for smaller, less-connected investors. Likewise, significant asymmetries of information in such deals may place smaller investors at considerable disadvantage. Small-dollar investors may be exposed to future dilution, while professional firms may have the savvy and clout to protect themselves from such dilution through negotiations with offerors. Compounding these existing challenges, the proposed amendments will give greater flexibility to companies wishing to avoid scrutiny to issue offerings under exemptions with lower levels of disclosure requirements.

In our comment letter on the concept release, we cautioned:

> We are concerned that issuers would only approach these investors for financing when they could not secure financing from traditional sources. Lowering the standards for disclosure to this group of investors (small and individual investors) has the potential to create large problems for the investors, for securities issuers, and even for the Commission.[29]

Several passages in the Proposal spell out the various types of adverse selection risks that smaller investors will face. Issuers with worse prospects, unable to attract capital from large investors, may seek out non-accredited investors instead.[30] Issuers with high information risks may seek to

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[28] The speaker, Sara Hanks, recommended that the SEC accompany any increase in the limit with greater efforts to address noncompliance. Meeting of the Securities and Exchange Commission Small Business Capital Formation Advisory Committee (Friday, May 8, 2020), available at https://www.sec.gov/sbcfac/meetingmaterials and https://www.sec.gov/info/smallbus/acsec/sbcfac-transcript-050820.pdf.

[29] *See supra* note 14 at 3.

[30] *See supra* note 1 at 172 (saying, "Issuers with worse prospects that are unable to attract capital from large investors, which undertake more monitoring and screening, might be overrepresented among exempt offerings focused on non-accredited investors.").

avoid audit requirements.[31] Increases in offering limits may attract other high-risk issuers.[32] In addition, non-accredited investors may face risks of lower payoffs and higher dilution, while larger investors protect themselves from those risks through private negotiations with issuers.[33]

Repealing an Audit Requirement

We strongly oppose the proposal to repeal audit requirements for Rule 506(b) offerings of up to $20 million involving non-accredited investors.[34]

We have heard from members that they recognize the burden audit requirements may impose on such companies. At the same time, however, members also have routinely and repeatedly expressed the trust and importance they place on audited financial statements. We further note that the current rule governing audit requirements for 506(b) offerings is already substantially limited. It applies only to offerings that are sold to non-accredited investors and, even then, the rule requires only that the balance sheet be audited in all cases (except if the issuer is a limited partnership).[35]

Audited financial statements are the bedrock of our capital markets. Independent audits foster investor confidence in the accuracy and reliability of financial statements. Audited financial statements are needed to provide essential information that enables investors to value companies, determine securities prices, and make investment decisions.[36]

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[31] *See id.* at 214 (saying, "Further, the proposed elimination of audit requirements for disclosures to non-accredited investors in Rule 506(b) offerings of up to $20 million might encourage some issuers with relatively higher information risk to sell securities to non-accredited investors given the absence of investment limits in such offerings.").

[32] *See id.* at 235, (saying, "Amendments that increase the offering limits of Regulation A Tier 2, Regulation Crowdfunding, and Rule 504 could make the exemptions more attractive to issuers that are unable to meet more restrictive requirements applicable to larger offerings today, resulting in higher-risk issuers potentially being overrepresented among the issuers relying on the amended exemptions.").

[33] *See id.* at 174 (saying "…non-accredited investors that tend to hold minority stakes might need to perform additional due diligence, given potential differences in the payoffs obtained by accredited versus non-accredited investors."). A footnote further explains: "Such differences might be due to differences in terms of securities. For instance, downside protection and anti-dilution options may be negotiated by large investors with greater bargaining power."

[34] *See id.* at 218. While the Proposal's stated objective is to simplify the exemptive rules, this provision would do the opposite: it would take a single audit rule for all 506(b) offerings and split it into two, depending on the size of the offering.

[35] For a table specifying financial statement and audit requirements under Current Rule 502(b), *See id.* at 96.

[36] *See, e.g.*, SEC Chief Accountant Sagar Teotia, *Statement in Connection with the 2019 AICPA Conference on Current SEC and PCAOB Developments*, (Dec. 9, 2019), available at https://www.sec.gov/news/speech/teotia-speech-2019-aicpa-conference, (saying, "As Chairman Clayton has emphasized, audited financial statements are the bedrock of our financial reporting system. High-quality financial statements, prepared in accordance with a framework developed by independent standard setters, provide relevant and reliable information to investors. Audits of financial statements performed by independent accountants increase the credibility of the financial statements.)". [Note omitted.] *See also* SEC Chairman Jay Clayton, SEC Chief Accountant Wes Bricker, and PCAOB Chairman William D. Duhnke III, *Statement on the Vital Role of Audit Quality and Regulatory Access to Audit and Other Information Internationally—Discussion of Current Information Access Challenges with Respect to U.S.-listed Companies with Significant Operations in China,* (Dec. 7, 2018), available at

The Proposal's Economic Analysis reiterates the importance of audited financial statements:

> For instance, to the extent that audited financial statements are valuable for informed investment decisions, scaled disclosures in offerings of up to $20 million might cause some non-accredited investors to incorrectly value the offered securities and to make less well-informed investment decisions.

We agree that the omission of audited financials will negatively affect investors' ability to accurately value investment options. The Economic Analysis makes this point even more clearly in its discussion of an alternative[37] proposal to eliminate audit requirements in an even wider set of offerings:

> However, the loss of information to non-accredited investors could significantly reduce their ability to allocate capital in an informed manner, particularly because a lack of a secondary trading market in many cases precludes effective price discovery through other sources.[38]

This same argument applies with equal force to the proposed elimination of audited financials.

The proposed removal of the audit requirement in certain for 506(b) offerings would align them with offerings under Regulation A Tier 1, which are also limited to no more than $20 million and do not require audits of financial statements. Yet there are fundamental differences between the two regulations. Among other differences, Rule 506(b) lacks investor protections that Regulation A Tier 1 (and Regulation Crowdfunding) provide to non-accredited investors.[39] The differences amplify the need for the current audit requirement in certain 506(b) offerings.

We see harmonization as unwarranted when, as is the case here, the regulations are designed for different purposes and types of issuers. Moreover, we consider Regulation A as particularly inappropriate as a model for harmonization given the widely publicized problems with Regulation A issuers that graduated onto exchanges.[40]

Two Amendments Will Strengthen Investor Protection

Notwithstanding our aforementioned concerns with other provisions of the Proposal, we applaud the inclusion of two amendments that we believe would strengthen investor protections. The first would limit the types of eligible securities under Regulation Crowdfunding, thereby excluding

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https://www.sec.gov/news/public-statement/statement-vital-role-audit-quality-and-regulatory-access-audit-and-other, (emphasizing the importance of "complete, accurate financial statements and credible audits.").

[37] Rather than proposing to remove the audit requirement in Rule 506(b) offerings by non-reporting issuers of up to $20 million with sales to non-accredited investors, the alternative would have waived the requirements for disclosures to non-accredited investors altogether. *See supra* note 1 at 219.

[38] *See id.* at 219.

[39] These include Commission qualification and state registration of Regulation A Tier 1 offerings, offering statement disclosure requirements in Regulation A, and additional investor protections provided in Regulation Crowdfunding offerings. *See id.* at 214. Moreover, unlike Rule 506(b), Regulation A (along with Regulation Crowdfunding and Rule 504) has offering caps and was developed with smaller issuers in mind compared to public companies – and, we would add, compared to 506(b) issuers. *See id.* at 114.

[40] *See, e.g.,* Alexander Osipovich, *Exchanges Shy Away From Mini-IPOs After Fraud Concerns*, Wall Street Journal, June 10, 2019, available at https://www.wsj.com/articles/exchanges-shy-away-from-mini-ipos-after-fraud-concerns-11560177205.

non-traditional securities such as Simple Agreements for Future Equity (SAFEs).[41] While SAFEs can confer legitimate benefits for issuers in the right circumstances, they also can create problems for unsophisticated investors who may not understand how the securities differ from traditional common stock. [42] The proposed amendment would be particularly useful in crowdfunding offerings, where SAFEs have accounted for 21 percent of the number of offerings and 24 percent of the aggregate target amount sought.[43]

The second proposed amendment would apply to Exchange Act reporting companies that seek to conduct Regulation A offerings. The proposed amendment would fill a gap in the current Regulation A, which does not expressly require public companies to have filed their Exchange Act reports in order to rely on Regulation A. The proposal would make these registrants ineligible to conduct a Regulation A offering if they did not file all required Exchange Act reports in the two-year period preceding the filing of an offering statement.

The required reports are material information for investors considering investments in either a company's registered securities or its Regulation A offerings. We agree with the Proposal that, by ensuring more timely availability of information in periodic reports to prospective Regulation A investors, the proposed amendments will facilitate better informed investment decisions.[44]

Timing of Rulemaking

Regardless of the final rule, we urge the Commission to delay taking action for two independent sets of reasons.

The first concerns the interplay between this Proposal and a concurrent proposal to amend the accredited investor definition. This latter matter would substantially expand the pools of retail and institutional accredited investors.

We urge the Commission to take a deliberative, orderly and coordinated approach by proceeding with that rulemaking first and, if it is adopted, wait to observe its impact before proceeding with this Proposal. As the Proposal observes, an expanded pool of accredited investors could intensify the effect of the proposed expansions of exemptive offerings.[45] Proceeding with both

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[41] *See supra* note 1 at 156-157.
[42] *See* Sec. and Exch. Comm'n Office of the Investor Advocate, *Report on Activities for Fiscal Year 2016,* at 20-21, available at https://www.sec.gov/advocate/reportspubs/annual-reports/sec-investor-advocate-report-on-activities-2016.pdf; and Sec. and Exch. Comm'n Office of Investor Education and Advocacy, *Investor Bulletin: Be Cautious of SAFEs in Crowdfunding* (May 9, 2017), available at https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_safes.
[43] These figures cover the period from the inception of Regulation Crowdfunding in May 2016 through December 2019. *See supra* note 1 at 261-262.
[44] *See id.* at 266.
[45] *See id.* at 176 (saying, "In particular, some of the effects of the changes to the exempt offerings proposed here that are intended to facilitate exempt offering financing under Regulation D (*e.g.*, expanded integration provisions) or under other exemptions (*e.g.*, exempting accredited investors from the investment limits under Regulation Crowdfunding) might have relatively greater economic effects if issuers can offer securities to an expanded pool of accredited investors as contemplated by the proposed accredited investor definition amendments.").

rulemakings at once could have unexpected consequences for private markets and participants in them.

For example, an expanded accredited investor definition could exacerbate existing challenges with adverse selection in crowdfunding offerings.[46] Moreover, adoption and implementation of both rulemakings around the same time would make it exceedingly difficult to disentangle the effects of each. That would impede the Commission's ability to review the rulemakings retrospectively and identify ways to improve them.

Independently of that argument, we recommend that the Commission delay consideration of the Proposal in light of the extraordinary conditions prevailing as a result of the coronavirus and its economic fallout. These have led to unprecedented, turbulent, and perplexing market conditions, which in turn has sparked investor confusion. Such confusion is natural at a time of great turbulence in capital markets. In this context, we do not believe the timing is right to introduce further uncertainty and investor confusion by making major changes to the framework of exemptive markets.

We also believe the combined Covid and economic crises have heightened investor risks that are exacerbated in private markets.[47]

Conclusion

We have sought to make four basic arguments. First, the Proposal does not make the case that the proposed changes are needed as neither capital formation nor investor access appear impeded by current regulatory framework for exemptive offerings. Second, the Commission should not tip the balance in favor of private markets and at the expense of public ones. Third, the proposed amendments raise significant investor protection concerns, particularly those involving adverse selection and a rollback of an audit requirement. Fourth, in the context of current crises, now is not the time proceed with this regulation.

In the context of perceived injustice arising from the coronavirus pandemic and its economic consequences, we are particularly concerned about any regulatory moves that reduce transparency and regulatory vigilance to protect investors and preserve market integrity. We believe the Proposal would have precisely those effects of reducing transparency and regulatory oversight.

In this time of vulnerability, it is worth noting that public markets – through their combination of transparency, level playing fields, and regulatory supervision –serve to foster the legitimacy of

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[46] *See, e.g.,* Sarah Hanks, Comment Letter on the Harmonization Concept Release, (Oct. 30, 2019) at 16 and 36, available at file:///C:/Users/sed1/OneDrive%20%20CFA%20Institute/Advocacy/Facilitating%20Cap%20Formation%20Proposal/Sarah%20Hanks%20Comment%20Letter%20on%20Harmonization%20Concept%20Release.pdf.

[47] *See* James C. Allen, CFA Institute Comment Letter on Amending the "Accredited Investor" Definition (May 4, 2020). *See* also Sec. and Exch. Comm'n Office of Investor Education and Advocacy, *Frauds Targeting Main Street Investors -- Investor Alert* (updated June 5, 2020), (saying, "Many legitimate companies use unregistered offerings to raise funds from investors. *Fraudsters, however, may also use unregistered offerings to conduct investment scams.*"), (italics in original), available at https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-alerts/frauds.

our capital markets. As Chairman Clayton has observed, retail investor participation in our capital markets "has been a democratizing force in our society." Private markets cannot claim these same attributes. A shift toward private markets will mean less transparency, regulatory oversight, and investor protections. We urge the Commission to consider the far-reaching impacts that its decisions will have on the legitimacy and fairness of the capital markets it regulates.

Should you have any question about our positions, please do not hesitate to contact Stephen Deane, CFA, at [redacted] or James C. Allen, CFA, at [redacted] or [redacted].

Sincerely,

/s/ James C. Allen

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