

September 20, 2013

Via Electronic Mail at rule-comments@sec.gov

Ms. Elizabeth M. Murphy
Secretary, Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Comments on Proposed Rule: Amendments to Regulation D, Form D and Rule 156 under the Securities Act of 1933; Release Nos. 33-9416, 34-69960, IC-30595; File No. S7-06-13

Dear Ms. Murphy:

Thank you for the opportunity to provide comments to the Securities and Exchange Commission (the "Commission") on its proposed amendments to Regulation D, Form D, and Rule 156 under the Securities Act of 1933 (the "Proposals").

The Milken Institute is a nonpartisan, nonprofit, public charity with a mission of improving lives around the world by advancing innovative economic and policy solutions that create jobs, widen access to capital and enhance health. At our Center for Financial Markets, we believe that well functioning financial markets, accessible to all, can expand opportunities to develop human and social capital, magnify productive investment, and dramatically improve global prosperity. The following guiding principles and recommendations are intended to aid the Commission in responsibly implementing Title II of the Jumpstart Our Business Startups Act (the "JOBS Act"), ensuring investor and entrepreneur access to sound educational information, expanding access to capital for American companies, and ensuring investor protection.¹ This letter will focus on how the Proposals might impact private companies and their investors, as opposed to pooled investment funds.

I. Guiding Principles

What follows are guiding principles that we believe are useful in undertaking an analysis of the Proposals. The following suggestions take into account: (i) the nature of private capital markets; (ii) the critical need to provide regulatory clarity for a new generation of entrepreneurs; and (iii) the importance of market education and understanding for entrepreneurs and investors.

- ***In furtherance of its investor protection mandate, the Commission should clarify and explain to issuers the existing private securities law framework.*** Since 2009, non-financial issuers (many being startups and small businesses) have raised \$354 billion in private capital markets.² Largely pursuant to what would now be Rule 506(b) offerings, angel investors in 2012 were responsible for \$22.9 billion in total investments into

¹ The following principles and recommendations were discussed at a recent Milken Institute Center for Financial Markets roundtable convened in partnership with the Georgetown University Law Center. We thank our diverse group of participants for providing valuable feedback and suggestions, and for contributing to many of the ideas presented here. A number of our participants are noted as additional signatories at the conclusion of this letter.

² Vladimir Ivanov and Scott Bauguess, *Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D Exemption, 2009-2012*, U.S. Securities and Exchange Commission (July 2013), available at: <http://www.sec.gov/divisions/riskfin/whitepapers/dera-unregistered-offerings-reg-d.pdf>.

approximately 67,000 mostly early-stage or younger companies.³ Meanwhile, venture capital investments totaled \$26.5 billion and helped fund nearly 3,700 companies.⁴ These significant investments into startup companies and small businesses take place within an existing and well-developed framework of federal and state securities laws. However, as more entrepreneurs and small business owners resort to private finance, potentially much earlier in their companies' lives, many will not be familiar with how laws related to, for example, integration (e.g. with Reg S or Reg A), forward looking statements, and material misstatements and omissions apply in the context of private securities offerings. To prevent issuer missteps, the Commission does not necessarily need new rules that may unintentionally impede the current success of private markets; instead, the Commission should focus on clarifying and explaining to a new generation of entrepreneurs the parameters of existing securities laws.

- *The Commission should: (i) make clear to market participants by way of easy-to-understand guidance that existing securities laws intended to protect investors continue to apply to Rule 506(c) offerings; and (ii) not unduly burden the private market by increasing the regulatory requirements when the benefits of such action do not clearly outweigh the costs.*
- ***The Commission should acknowledge, permit, and embrace the development and centrality of the Internet in today's financial markets.*** The development of a Rule 506(c) Internet industry presents new challenges for regulators due to the speed of change, but also new opportunities for harnessing data and providing accessible information to market participants. This requires a specific government strategy with respect to how to engage with this industry. Perhaps informative to today's market, the Clinton Administration pragmatically opted to pursue a permissive regulatory approach, educated law enforcement regarding new risks, and promoted industry self-regulation in the late 1990s when faced with the rise of new Internet companies like Yahoo!, eBay, and E*Trade. Noting the rapid pace of innovation and technological transformation, then senior policy adviser Ira Magaziner stated in 1997 that given "the breakneck speed of change in [] technology . . . [g]overnment attempts to regulate [the Internet] are likely to be outmoded by the time they are finally enacted."⁵ Applying these principles to today, government would be better suited allowing this new Internet industry to develop, enabling the data analytics and educational opportunities made possible by the Internet, while maintaining the flexibility to act quickly, if necessary, to developments that threaten market integrity.
 - *The Commission should allow this new Internet marketplace to develop, promote and leverage the data analytics and educational opportunities made possible by web platforms, and where necessary utilize tools such as no action letters, FAQs, and interpretative guidance to react quickly to market developments.*
- ***The Commission should clarify the meaning of 'general solicitation,' and consider carving out certain types of communications that should not trigger application of Rule 506(c).*** The definition of 'general solicitation' remains ambiguous, especially when applied to modern forms of communication, including social media and websites, and when applied to practices that have become commonplace, particularly in entrepreneurial

³ Jeffrey Sohl, *Moderate Recovery Continues in 2012 for U.S. Angel Investor Market*, UNH Center for Venture Research (Apr. 25, 2013), available at <http://www.unh.edu/news/releases/2013/apr/lw25cvr.cfm>.

⁴ Press Release, PricewaterhouseCoopers/National Venture Capital Association MoneyTree™ (Jan. 18, 2013), available at: <http://www.pwc.com/us/en/press-releases/2013/annual-venture-investment-dollars.jhtml>. See also See Scott Shane, *Fool's Gold: The Truth Behind Angel Investing in America* New York, Oxford University Press (2009), at *41 (estimating that 'friends and family' investors make \$139 billion of investment annually into startups and small businesses).

⁵ Steve Lohr, *Ideas & Trends; Policing the Internet: Anyone But Government*," The New York Times (Feb. 20, 2000), available at: <http://www.nytimes.com/2000/02/20/weekinreview/ideas-trends-policing-the-internet-anyone-but-government.html?pagewanted=print&src=pm>.

circles, such as pitch contests, accelerator competitions, and “demo days.” It is unlikely that entrepreneurs will recognize that certain communications approach the line of a general solicitation, and it is even less likely that most will be able to afford competent legal counsel to provide clarification. One can consider the hypothetical of a startup boasting in a ‘tweet’ that it is “new in town and hopes to triple in size by year end!” while it is simultaneously seeking to raise capital in a Rule 506(b) offering. Is this a general solicitation,⁶ and if so, will entrepreneurs understand it as such?

The Commission should provide clear examples of what it deems to be a general solicitation, and consider adopting for private markets the same advertising safe harbors that apply to companies pursuing a public offering.⁷ The Commission should also consider the types of solicitation that invoke the greatest concern over investor protection, and consider carve-outs where those concerns are not implicated. This would help to underscore a distinction between communicating with parties with whom an issuer has a prior relationship and a truly “public” offering. For example, given the spirit of the law, the Commission should review whether communications at entrepreneur accelerator, University pitch contests, demo days, or even confidential communications aimed at a discrete – but more broad – set of accredited investors or qualified institutions should by themselves trigger Rule 506(c). Finally, the Commission should consider expanding Rule 508 (or applying the same standard to a Rule 507 ‘waiver’) to provide relief for good faith, accidental violations of rules related to tripping general solicitation.

- *The Commission should consider the likelihood of confusion and noncompliance if it does not provide clear guidance on the meaning of ‘general solicitation,’ and it should consider carving out practices that do not invoke the same investor protection concerns as public mass marketing activities. The Commission should also consider providing relief for good faith, accidental violations of rules related to tripping general solicitation.*
- ***The Commission should promote more effective disclosure strategies that prioritize investor – and issuer – education over standard boilerplate language requirements.*** The ultimate utility and effectiveness of boilerplate disclosure requirements are questionable.⁸ The Internet provides significant opportunities to improve the quality and utilization of information for both investors and issuers. This opportunity is made possible by the Internet through the concept of the ‘user experience,’ which refers to the careful consideration of how a user engages and interacts with information on a website. To date, the Commission has done a commendable job in maintaining the Investor.gov website, and should likewise provide investors and issuers with questions they should ask and considerations and data they should contemplate before engaging in a private offering. But more can be done. The Commission should accordingly highlight quality websites and distill key information for market participants, while encouraging experimentation with the ‘user experience’ to improve how investors and issuers utilize and engage with educational information.⁹

⁶ At the Center for Financial Markets’ recently hosted roundtable on the Commission’s proposed Title II rules, a diverse group of participants discussed at length the meaning and application of ‘general solicitation’ in today’s market. Notably, the group struggled to agree as to whether certain communications and practices would or should be deemed a general solicitation in the context of private capital markets and use of social media.

⁷ See, e.g., Nilene R. Evans, *Frequently Asked Questions About Communications Issues for Issuers and Financial Intermediaries*, Morrison & Foerster LLP (2013), available at: http://www.mofo.com/files/Uploads/Images/FAQ_Communications.pdf.

⁸ For an interesting discussion and review of recent studies regarding the questionable effectiveness of boilerplate disclosures, see Florencia Marotta-Wurgler, *Does Disclosure Matter?*, NYU Law and Econ. Research Paper No. 10-54 (Nov. 23, 2010), available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1713860.

⁹ The Commission may find useful investor information on other sites, including: NASAA, *Informed Investor Advisory: Private Placement Offerings* (Sept. 2013), available at: <http://www.nasaa.org/22284/informed-investor-alert-private-placement-offerings/>; Alberta Agriculture and Rural Development, *Private Venture Investing: “Questions an Investor Should Ask”* (Jan. 1998), available at: [http://www1.agric.gov.ab.ca/\\$department/deptdocs.nsf/all/bus2343](http://www1.agric.gov.ab.ca/$department/deptdocs.nsf/all/bus2343); FINRA, *Private Placements—Evaluate the Risks before Placing*

- *The Commission should publicize, and perhaps under appropriate circumstances require, links to investor and issuer educational information by leveraging Internet tools that promote better understanding of market risks and opportunities.*
- *The Commission should also encourage new interactive forms of disclosure on the part of issuers that could promote investor protection beyond often-ignored boilerplate. This approach would incorporate the concept of the ‘user experience.’*

II. Comments on Adopted and Proposed Rules

To the extent that the Commission is inclined to act on the rules as proposed, and guided by the above principles, please find below specific comment on the Commission’s adopted and proposed rules:

○ **Accredited Investor Verification Under Rule 506(c):**

The Commission has taken a pragmatic step of applying a principles-based, facts-and-circumstances standard to determining whether an issuer has taken reasonable steps to verify the accredited status of an investor. The inclusion of safe harbors for reliance on certain documentation is also helpful. The Commission should also consider:

- *Confirming through guidance that the method of verification suggested by the Angel Capital Association for members of an Established Angel Group (“EAG”) satisfies the facts and circumstances standard.¹⁰ This would ensure that the existing angel investor marketplace is not disrupted by new requirements that could otherwise chill professional angel investor participation.*
- *Promoting verification methods that rely on trusted advisers. The Commission prudently sought to incorporate trusted third-party advisers into the verification process, including CPAs, broker-dealers, and attorneys, who may reasonably be relied upon to verify the accredited status of an investor. Due to liability and scope of business concerns, however, it is likely that many of these third-parties will refrain from opining on an investor’s status or requesting certain documentation, such as credit reports. The Commission should accordingly consider methods that increase the likelihood of trusted adviser participation. One possibility would include providing guidance that the attestation of a third-party adviser that he or she has reviewed documentation maintained in the ordinary course of business -- and has no reason to believe the information provided therein is inaccurate -- stating that an investor has surpassed the threshold income level or holds investable assets above \$1 million is a reasonable verification methodology.¹¹*

Them in Your Portfolio, available at: <http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/PrivateOfferings/P339650>;
CircleUp, Frequently Asked Questions from Investors, available at: <https://circleup.com/investor-education/fag/>.

¹⁰ See *Angel Capital Association Guidance on Accredited Investor Verification: What Membership in an Established Angel Group Says About a Purchaser*, available at:

http://www.angelcapitalassociation.org/data/Documents/Public%20Policy/GuidanceonEAG09_03_13.pdf.

¹¹ See Capgemini and RBC Wealth Management, *World Wealth Report 2013*, at *6 (noting that only 1.1% of the U.S. population qualifies as a ‘High Net Worth Individual’ – defined as “as those having investable assets of US\$1 million or more, excluding primary residence, collectibles, consumables, and consumer durables.”), available at: http://www.capgemini.com/sites/default/files/resource/pdf/wwr_2013_0.pdf.

- *Creating a new safe harbor that applies to investors who certify their accredited status under penalty of perjury, possibly subject to investment caps if such self-certification is the sole basis for verification.* This approach considers the reality that in order to verify under the income test or net-wealth test, the issuer or a third-party verification provider may already have to rely on a certification that the individual reasonably anticipates earning above the income bar in the current year or that the individual has truthfully disclosed all assets and liabilities. Allowing self-certification under penalty of perjury would be similar to the current requirement that tax filings be made to the IRS under penalty of perjury – a requirement that the IRS deems useful in ensuring compliance and that the Commission clearly supports as demonstrated by its inclusion of tax returns in the list of safe harbor documentation that can be used to prove income. Finally, the inclusion of an investment cap limits the downside risk for those who may be subject to high-pressure sales tactics and accordingly seek to verify without documentary proof.

- **Proposed Advance Form D Filing 15-Days Prior to First General Solicitation:**

Requiring the pre-filing of an Advance Form D fifteen days before the first general solicitation would likely prove unworkable. First, a pre-filing requirement will result in confusion and noncompliance because entrepreneurs are regularly engaged in efforts to raise capital, and the meaning of general solicitation is ambiguous and largely unknown to entrepreneurs. Second, if as the Commission has stated the benefit of Form D is the data and information it provides regarding the Rule 506 marketplace, this information can equally be provided by a Form D filing tied to a security sale or, if the Commission identifies compelling reasons, a term sheet offer. Third, given the limited nature of Form D disclosures, investors do not substantially rely on the filing in order to make investment decisions and state regulators can only confirm basic company information in response to investor inquiries. Fourth, it is unlikely that enforcement efforts will benefit from fifteen days' advance notice of a general solicitation when any allegations of fraud would more likely be tied to an actual sale or term sheet offer. Finally, the proposed pre-filing will likely generate defensive, precautionary filings that do not result in an actual term sheet offer. Therefore, when balancing the informational benefits of an advance filing with the likelihood of confusion, noncompliance, cost, and potential sanction for noncompliance, the Commission should consider:

- *Requiring the filing of an 'Initial' Form D within 15 days of the first sale of a security, or, at most, within 15 days of the first term sheet 'offer' as defined by contract law principles.* This approach will still satisfy the Commission's and state regulators' interest in gathering information about the marketplace, but will prevent costs and complications that arise from tying a filing requirement to a 'general solicitation.' Moreover, this approach will eliminate informational noise that would result from potential defensive and precautionary Advance Form D filings for offerings that are merely contemplated but never seriously pursued. It is far more valuable for the Commission to capture information surrounding actual transactions or term sheet offers rather than a filing tied to a single communication that states or implies an intention to seek investment.

- **Proposed Form D Closing and Amendment Requirements:**

The Commission has prudently proposed requiring a closing Form D filing thirty days after the termination of an offering in order to capture valuable information regarding the ultimate success of the offering and the total capital raised. However, the Commission may continue to require an issuer to file an amended Form D in the event of a change in the offering. For many startup and small business issuers, the fluidity of their corporate strategy results in frequent "pivots" in business plans and fundraising goals. Issuers may therefore be subject to an initial Form D filing, frequent amended filings, and a closing Form D amendment filing. Because investors do not substantially rely on the limited disclosures in a Form D filing to make an investment decision, and there is

little enforcement value in amended filings,¹² it is unclear what benefit the Commission derives from frequent filings related to the same offering. If the Commission's primary interest is information gathering, then the Commission should consider:

- *Eliminating the requirement for filing an amended Form D provided that an Initial Form D has been filed and a Form D closing amendment is filed within 30 days of the termination of the offering.* This approach will satisfy the Commission's interest in gathering information about the marketplace, but will reduce compliance costs where related benefits are nominal.

- **Proposed Penalties for Failure to Comply with Form D Filing Requirements:**

The Commission has proposed a one-year ban from the future use of Rule 506 for an issuer who violates Form D filing requirements and does not cure within the prescribed period of time or receive a waiver under Rule 507 from the Commission – a penalty which would likely risk capital inadequacy for many companies. Because the Commission's primary stated purpose for requiring Form D filings is to gather marketplace data and information, the proposed penalty is disproportionate when compared to the severity of the infraction. That said, the Commission does have an interest in ensuring compliance, but can do so in a way that helps educate issuers while punishing those who intentionally flout the requirement. The Commission should accordingly consider:

- *Creating a three strikes penalty system for issuers who fail to comply with Form D filing requirements.* Under this approach, a first-time infraction by an issuer (or officer or director) would result in a warning issued by the Commission, with subsequent infractions resulting in escalating penalties. This approach would satisfy the Commission's interest in educating potentially unaware issuers, while punishing those who knowingly are noncompliant; it would also better match the punishment to the severity of the infraction.

- **Proposed Form D Disclosure Amendments:**

The Commission has proposed a number of amendments to Form D, some of which require disclosure of information that could harm the interests of a private company if made public or could increase the risk of lawsuits. Private companies typically safeguard certain information relating to internal strategy, existing investors, and financial performance from competitors and the media. While potential investors in these companies should ask for and have access to such information, it violates the nature of private markets to require public disclosure. Indeed, there is a difference between reaching out to a discrete group of investors on a confidential basis (even those with whom you do not have a pre-existing relationship), and publicly disclosing your private information. Moreover, certain proposed disclosure amendments regarding the use of proceeds would require information that many issuers will be hard-pressed to provide accurately, and could open issuers up to increased risk of liability. The Commission should accordingly consider:

- *Redacting certain proposed amended disclosures from the public versions of a Form D filing.* Under this approach, proposed amendment to Item 3 (relating to individuals who directly or indirectly control the company), Item 16 (relating to use of proceeds), and Items 21 and 22 (relating to general solicitation

¹² We find it compelling that the Commission noted in the Proposals that it acted in 1986 to eliminate a required six-month and closing amendment filing because “[t]he information contained in the original notification ha[d] proved sufficient for the Commission’s enforcement surveillance for compliance with the requirements of Regulation D.” Proposals at 27, n. 55 (quoting Form D and Regulation D, Release No. 33-6663 (Oct. 2, 1986)). We accordingly see little benefit in requiring amended filings in addition to a closing filing.

and investor verification methodologies) should, at the least, be redacted from the publicly available Form D filing.

- *Altering the proposed amended disclosure requirement related to Item 16 so that an issuer must only disclose whether funds raised are being used to repurchase or retire existing securities or to discharge indebtedness.* Under this approach, issuers will not be required to allocate the percentage of offering proceeds being used for other purposes. This is appropriate since many startup or small business issuers are not able in practice to provide such specificity on use of proceeds given frequently changing priorities, business plans, and capital-raising targets. Requiring such detailed disclosure would likely only result in increased potential issuer liability for failing to perform as specified in the Form D.

- **Proposed Legends in General Solicitation Materials:**

The Commission has proposed that legends with specified content disclosures be included in all general solicitations, but such an approach may be unworkable and overly burdensome. First, while there is new technology that allows compressed links to websites, compliance will be problematic given the nature of modern modes of communication. For example, a ‘tweet’ is limited to 140 characters, thereby rendering it impossible to include legend language in the specific tweet communication. Second, it may be an undue burden on issuers to have to include similar language in all advertising materials, both in terms of advertising cost and time consumed ensuring compliance. Finally, as previously noted, it is questionable whether boilerplate disclosures are effective in communicating risks to investors in the most efficient and effective manner. The Commission should accordingly consider:

- *Promoting the use of educational materials that incorporate the user experience to ensure that investors have the opportunity to learn about the risks of investing.* As previously discussed, the Commission should explore ways to provide investors with questions they should ask and considerations and data they should consider before making an investment in a private offering. To the extent that links are required in general solicitation materials, it may be more efficient to provide compressed links to informational websites such as Investor.gov.
- *Shifting the legend disclosure requirement to term sheets rather than advertising materials.* Because it would be costly and burdensome to require disclosures in all solicitation communications, the Commission should consider imposing this requirement on documents that constitute an actual offer as understood by contract law principles. To the extent that the Commission wants to flag for the public what are intended to be solicitation materials, as opposed to actual offering materials, it may be more efficient to require inclusion of a specified icon or symbol in the communication.

- **Proposed Temporary Submission of General Solicitation Materials:**

The Commission has proposed that all written general solicitation materials be submitted to the Commission for a two-year period. We suggest that the Commission review the CrowdCheck comment letter for reasons this approach may prove to be unworkable.¹³ The Commission should accordingly consider:

- *Exploring data and social media mining technologies that can more efficiently and effectively allow the Commission to analyze and supervise general solicitations.* By updating its technology via low cost surveillance tools, the Commission could reduce its need to maintain a solicitation ‘drop box.’

¹³ See letter from Sara Hanks, CEO, CrowdCheck, Inc. (July 18, 2013), available at: <http://www.sec.gov/comments/s7-06-13/s70613-6.pdf>.

Moreover, targeting and filtering technologies would more likely capture problematic general solicitations that may not have been submitted to the Commission in the first place.

- *Working with Internet platforms to permit appropriate Commission access to solicitation data.* Many Internet platforms have expressed a willingness to work with the Commission to provide access to market data. This collaborative approach should prove more effective in providing the SEC with access to key data and information.

We again thank you for the opportunity to present these recommendations as the Commission continues its important work on implementing the JOBS Act. We appreciate the Commission's efforts to date, and hope that this letter is helpful. Please let us know if we can provide any additional information, and we would be honored to have the opportunity to continue this discussion in person.

Sincerely,



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