

September 24, 2019

Via Email to rule-comments@sec.gov

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

Re: File Number S7-08-19
Concept Release on Harmonization of Securities Offering Exemptions

Dear Ms. Countryman,

OpenDeal Inc. (collectively with its subsidiaries, “Republic”) respectfully submits this letter in response to the request for comment by the Securities and Exchange Commission (the “Commission”) on its Concept Release on Harmonization of Securities Offering Exemptions, File No. S7-08-19 (the “Release”). We thank the Commission for its efforts in publishing the Release and the opportunity to provide our comments.

As a family of companies that includes a regulated crowdfunding portal, a registered broker-dealer and an exempt reporting adviser, Republic supports the Commission’s stated interest in seeking ways to simplify, harmonize and improve the exempt offering framework to promote capital formation and expand investment opportunities while maintaining appropriate investor protections. Republic has been a mission-driven organization since its inception, with a focus on supporting companies founded by female, minority, veteran, immigrant and other entrepreneurs underserved by traditional venture financing – over 50% of the capital deployed through Republic’s crowdfunding platform has supported underrepresented founders and we expect this level of support to continue for the foreseeable future. Accordingly, we have focused our comments on areas where we believe that the Commission can take steps to expand and facilitate access to capital for emerging private companies, particularly within the context of Regulation Crowdfunding (“Reg. CF”), and responsibly allow a broader cross-section of investors to hold an economic interest in these companies and the cutting-edge industries and technologies that they often represent.

I. Regulation Crowdfunding’s Maximum Offering Amount and Financial Statement Disclosure Requirements

Currently, an issuer is permitted to raise a maximum aggregate amount of \$1.07 million in a 12-month period in reliance on Reg. CF. In the Adopting Release for Reg. CF, the Commission noted that while many commenters on the proposed rules believed that the offering limit was too low, it was “concerned about expanding the offering limit of the exemption beyond the level specified in Section 4(a)(6) at the outset of the adoption of final rules.”¹ After three years of experience, we believe that the \$1.07 million offering limit has and, unless raised significantly, will continue to severely impair the utility of Reg. CF. In many cases, Republic has found that issuers conducting a Reg. CF offering will need to spend additional time and expense pursuing other exempt offering types (either after or in conjunction

¹ See Release No. 33-9974 (Oct. 30, 2015), at 17.

with their Reg. CF offering) to meet their funding needs, as Reg. CF proved an incomplete solution. Given the nature of the exemptions utilized in these cases, such concurrent and subsequent offerings typically were not open to the public and did not provide the same levels of disclosure or oversight as a Reg. CF offering. Similarly, Republic has encountered many potential issuers that are unwilling to expend the time and cost associated with conducting a Reg. CF offering when faced with the reality that they will not be able to fulfill their capital needs thereby due to the offering limit.² For background, in its latest report on private company financing trends, Wilson Sonsini Goodrich & Rosati found that the *median* amount raised for Series Seed financings in the second quarter of 2019 was \$2.7 million, while the *median* amount raised for Series A financings was \$10.6 million over the same period.³ In evaluating raising the offering limit, we note that we and other crowdfunding industry stakeholders are unaware of any instances of outright fraud by Reg. CF issuers, which we believe underscores the effectiveness of the gatekeeper role that crowdfunding intermediaries have played.⁴

If it maintains this unrealistically low offering limit, the Commission will not only continue to push issuers away from Reg. CF and towards other exempt offering types not open to the general public, but also impede the capital formation efforts of founders who do not have access to financing sources necessary to even avail themselves of such exemptions. One of the goals of the Jumpstart Our Business Startups Act (the “JOBS Act”) was to help startups and small businesses lacking such access raise capital through investments from the “crowd”.⁵ However, female, minority, veteran and immigrant entrepreneurs, as well as entrepreneurs based in Middle America, often struggle to obtain exposure to and capital from traditional venture investors. Because of the current offering limit, the promise of Reg. CF to provide the means for such underserved entrepreneurs to obtain necessary funding from their customers, friends, family and other early supporters is only partially realized.

The current offering limit also impacts the ability of crowdfunding portals to sustain their businesses. In addition to marketing and other revenue-generating teams, crowdfunding portals must develop substantial “back-office” functions, including compliance, legal and engineering teams, in order to ensure that their platforms are operated in a compliant manner and they perform their gatekeeper roles properly. The costs associated with such operations can easily reach millions of dollars per year. To fund operations, crowdfunding portals need to charge commissions, which are typically based on the size of the relevant offering. As preparing to host an offering is time-consuming and involves a significant amount of fixed costs, a low offering limit restricts crowdfunding portals’ ability to achieve profitability. Without a sustainable economic model, crowdfunding portals, and ultimately Reg. CF itself, will cease to be viable.

² In the Report to the Commission, Regulation Crowdfunding (Jun. 18, 2019) (the “Reg. CF Report”), the Staff of the Commission found that the average issuer incurred \$22,479 in costs associated with conducting a Reg. CF offering (before paying commissions to intermediaries and escrow agents) and expended 241 hours of human capital.

³ See The Entrepreneurs Report – Private Company Financing Trends 1H 2019, available at: <https://www.wsgr.com/publications/PDFSearch/entreport/1H2019/private-company-financing-trends.htm>.

⁴ See, e.g., the Reg. CF Report, at 42-44.

⁵ See, e.g., congressional statements regarding crowdfunding bills that were precursors to the JOBS Act: 157 CONG. REC. S8458-02 (daily ed. Dec. 8, 2011) (statement of Sen. Jeff Merkley) (“In recent years, small businesses and startup companies have struggled to raise capital. The traditional methods of raising capital have become increasingly out of reach for many startups and small businesses. There is another option, but Congress must act to authorize it and provide for appropriate safeguards. Low-dollar investments from ordinary Americans may help fill the void, providing a new avenue of funding to the small businesses that are the engine of job creation. The CROWDFUND Act would provide startup companies and other small businesses with a new way to raise capital from ordinary investors in a more transparent and regulated marketplace.”)

We recommend that the Commission raise the offering limit for all types of potential issuers so that any early-stage company could fulfill its capital needs relying on Reg. CF alone. Specifically, we believe that the offering limit should be raised to at least \$5.0 million, and preferably up to \$10.0 million, per 12-month period. In conjunction with raising the offering limit, we suggest that the Commission impose a requirement that an issuer seeking to raise \$5.0 million or more must provide audited financial statements. While in our experience the financial statement disclosure requirements are by far the most burdensome aspect of conducting a Reg. CF offering for most issuers, we believe that the ability to raise such amounts would justify the time and expense involved in undertaking an audit for many issuers and that requiring audited financial statements would be an appropriate investor protection enhancement for capital raises at or above the \$5.0 million level.

In light of the significant burden associated therewith and taking investor protection considerations into account, we do not believe that it is appropriate to impose an audit requirement for initial Reg. CF offerings below the \$5.0 million level. We also recommend that reviewed financial statements not be required for initial Reg. CF offerings below \$1.0 million and that financial statements prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) not be required for initial Reg. CF offerings below \$0.5 million. We believe that these thresholds better reflect both the stage of development at which issuers raising such amounts would be, as well as the needs of their investors, and that the adoption thereof would not increase the risk of fraud or investor harm when considered in the totality of Reg. CF’s safeguards. Similarly, we believe that repeat Reg. CF issuers should not be required to provide audited financial statements, reviewed financial statements or U.S. GAAP financial statements until the aggregate amount of securities that they have sold and are currently offering pursuant to Reg. CF reaches \$5.0 million, \$1.0 million or \$0.5 million, respectively.

II. Regulation Crowdfunding’s Investment Limits

Currently, investors are limited in the amounts they are allowed to invest in all Reg. CF offerings over the course of a 12-month period, as follows: (i) if either of an investor’s annual income or net worth is less than \$107,000, then their 12-month investment limit is the greater of: \$2,200 or 5% of the lesser of their annual income or net worth; (ii) if both annual income and net worth are equal to or more than \$107,000, then their 12-month investment limit is 10% of the lesser of their annual income or net worth and (iii) in no event shall the aggregate amount of securities sold to an investor through all Reg. CF offerings in a 12-month period exceed \$107,000, regardless of the investor’s annual income or net worth. In our experience, the application of this formula is often very confusing for both investors and issuers and can be difficult for crowdfunding portals to track, especially when investors invest across multiple platforms. For example, we have found that investors can be unreliable disclosers of their Reg. CF investments on other platforms, not due to any attempt to mislead but rather because they are confused as to which of their investments were made pursuant to Reg. CF versus other channels. We encourage the Commission to adopt a simpler and more intuitive approach that would base investment limits for non-accredited investors on the *greater* of annual income or net worth and implement them on a *per offering* rather than a *cumulative 12-month* basis. These changes would also align the investment limits for non-accredited investors under Reg. CF more closely with those of Tier 2 of Regulation A.

We believe that the Reg. CF investment limits for accredited investors should be eliminated. In discussing this topic in the Adopting Release for Reg. CF, the Commission expressed its view that “crowdfunding transactions were intended under Section 4(a)(6) to be available equally to all types of investors” and noted that “issuers can rely on other exemptions to offer and sell securities to accredited investors and institutional investors.”⁶ However, as noted above forcing startups and small businesses to spend additional time and expense pursuing other exempt offering types after or in conjunction with a

⁶ See Release No. 33-9974 (Oct. 30, 2015), at 28.

Reg. CF offering is not only inefficient, but in our experience a key reason why many potential issuers choose to forgo conducting a Reg. CF offering at all. In addition, pushing issuers and investors away from Reg. CF and towards other exempt offering types with less rigorous (or no) substantive disclosure obligations or oversight is counterproductive from an investor protection standpoint. Accordingly, we recommend that the Commission eliminate Reg. CF investment limits for accredited investors, which would also align Reg. CF more closely with Regulation A and Regulation D. In conjunction with eliminating accreditator investor investment limits, we suggest that the Commission impose a requirement that crowdfunding intermediaries take reasonable steps to verify each prospective accredited investor's status in the event that such investor wished to avail themselves thereof (*i.e.*, verification of accredited status should only be required to the extent that an investor wanted to invest more than a non-accredited investor with the same annual income and net worth would be able to). In light of the burden on investors and crowdfunding intermediaries associated therewith, we recommend that documentation-based verification only be required once and that the relevant intermediary be permitted to rely on self-certifications by the investor thereafter.

III. Accredited Investor Definition

In considering the types of investors that should qualify as “accredited investors”, we are supportive of expanding the definition to allow individuals to qualify based on measures of sophistication other than annual income and net worth. In operating its crowdfunding platform, Republic has encountered numerous examples of investors who would not meet the annual income or net worth tests demonstrating high levels of financial literacy and sophistication. In particular, the platform's required communications channels often reveal non-accredited investors asking issuers insightful and often complex questions about their businesses, competitors, financial statements and offering documentation. While we believe that these types of engaged investors are able to fend for themselves and should qualify as “accredited”, we recognize the need for objective standards.

Accordingly, we recommend that the Commission modify the definition of “accredited investor” to include individuals who hold relevant professional credentials (*e.g.*, FINRA licenses, CFA certification or specific graduate degrees in business, finance, economics or law). However, given the significant time and expense associated with obtaining such credentials, we also recommend that Commission allow crowdfunding intermediaries to develop and administer examinations (in a form approved by the Commission or FINRA) pursuant to which individuals could qualify as accredited investors. In addition, we believe that an issuer's existing previously-accredited investors should retain grandfathered “accredited” status with respect to future offerings of such issuer's securities to provide protection from investment dilution.

In implementing any changes to the definition of “accredited investor”, we recommend that the Commission retain the current annual income and net worth tests for accreditation as we believe that they remain relevant measures of sophistication and ability to sustain risk of loss. We also believe that any modification thereto would be highly disruptive. Similarly, we recommend that the Commission require FINRA to align the definition of “accredited investor” set forth in FINRA Rule 5123 with the Rule 501 definition as we disagree with the assertion that the annual income and net worth tests for accreditation are insufficient to justify exemption from the FINRA rule.

IV. Testing the Waters Under Regulation Crowdfunding

Issuers are currently prohibited from “testing the waters” (*i.e.*, soliciting interest) for a potential Reg. CF offering before their Form C is filed. As a result, companies cannot assess investor interest in their offering before having to commit the time and expense necessary to conduct a Reg. CF offering and potentially face the negative inferences that customers, employees and future financing sources may draw

from the public failure of an offering. However, other exemptions impose limited or no restrictions at the time of the offer, focusing instead on investor protections at the time of sale. For example, Regulation A allows issuers to “test the waters” both before and after their Form 1-A is filed, subject to issuer compliance with rules on filing of solicitation materials and disclaimers.

We believe that issuers should be permitted to “test the waters” for potential Reg. CF offerings subject to similar requirements, and that the existing Reg. CF offering framework can easily be leveraged to provide adequate investor protection safeguards in connection therewith. For example, since issuers must conduct Reg. CF offerings through crowdfunding portal and broker-dealer intermediaries, we suggest that the Commission impose a requirement that any “testing the waters” process also be conducted solely through an intermediary’s platform. Such a requirement would provide oversight and ensure that any solicitation materials are appropriately documented and included with the issuer’s Form C to be filed in advance of the launch of the formal offering period and any sales. Any risk of investor harm resulting from such a process would be mitigated by the fact that the intermediaries would not permit any sales to be effected until the issuer files its Form C and otherwise complies with the requirements of Reg. CF. Such solicitation materials would also remain subject to the antifraud and other civil liability provisions of the federal securities laws. In addition, we believe that such changes would enhance the utility of Reg. CF by permitting the crowd to help companies decide whether or not to conduct a Reg. CF offering in the first place and further align Reg. CF more closely with Regulation A.

V. Section 12(g) Exemption for Regulation Crowdfunding Offerings

Securities issued pursuant to Reg. CF are conditionally exempted from the record holder count under Section 12(g) of the Securities Exchange Act of 1934, as amended (“Section 12(g)”), if the following conditions are met: (i) the issuer is current in its ongoing annual reports required pursuant to Reg. CF; (ii) the issuer has total assets as of the end of its most recently completed fiscal year of \$25 million or less; and (iii) the issuer has engaged the services of a transfer agent registered with the Commission. As a result, Section 12(g) registration of equity securities issued pursuant to Reg. CF is required if, on the last day of its fiscal year, an issuer has total assets greater than \$25 million and the class of equity securities is “held of record” by 2,000 persons or 500 persons who are not accredited investors. In the Proposing Release for Reg. CF, the Commission suggested permanently exempting securities issued pursuant to Reg. CF, expressing its belief that “the size of the issuer should not affect the availability of the exemption because conditioning the exemption on the issuer not exceeding a certain amount of total assets would impose an additional burden on successful issuers that unsuccessful issuers would not face, which in turn would discourage growth.”⁷ However, the Commission ultimately adopted Rule 12g-6 with the \$25 million total asset test and other conditions described above.

We recommend that the Commission revisit this decision and eliminate the total asset test from Rule 12g-6. As the Commission noted in the Adopting Release for Reg. CF, “[c]rowdfunding contemplates the issuance of securities to a large number of holders, which could increase the likelihood that Section 4(a)(6) issuers would exceed the thresholds for triggering reporting obligations under Section 12(g).”⁸ In our experience, Reg. CF issuers and intermediaries typically do not take steps to determine the accreditation status of investors at all, let alone on an annual basis, and many Reg. CF offerings have more than 500 participants. Taken together, the current rules mean that successful and fast-growing Reg. CF issuers may face compelled registration under Section 12(g) much earlier in their lifecycles than they otherwise would. This risk is not lost on potential issuers and represents another common reason that companies forgo conducting Reg. CF offerings. We believe that such an outcome directly contradicts the intention of the JOBS Act and Reg. CF to encourage broad investor bases. We also believe that the

⁷ See Release No. 33-9470 (Oct. 23, 2013), at 278.

⁸ See Release No. 33-9974 (Oct. 30, 2015), at 328-329.

reporting system under Reg. CF provides Reg. CF investors with adequate ongoing disclosure until such time as the issuer would otherwise be required to register under Section 12(g).

VI. Regulation Crowdfunding’s Prohibition on Advertising Terms of the Offering

Rule 204 of Reg. CF provides that an issuer may not advertise the terms of its Reg. CF offering except by way of a brief notice that directs investors to the relevant intermediary’s platform and includes no more than limited specified information regarding the offering and the issuer. By way of example, the Commission explained in the Adopting Release for Reg. CF its expectation that such notices would “be similar to ‘tombstone ads’ under Securities Act Rule 134, except that the notices will be required to direct an investor to the intermediary’s platform through which the offering is being conducted, such as through a link directing the investor to the platform.”⁹ While as discussed above we believe that it would be appropriate for the Commission to require that any “testing the waters” process undertaken by Reg. CF issuers be conducted solely through an intermediary’s platform, we do not believe that issuers should be prohibited from engaging in broader marketing efforts once their Form C has been filed. We agree with the 2018 Small Business Forum that such rules are difficult to understand and “run counter to the intent of the law: to promote the democratization of investing.”¹⁰ Our experience supports this assertion as we have encountered many Reg. CF issuers (and investors) who find these restrictions confusing and counterintuitive. We do not believe that allowing issuers to engage in offering-related communications outside of the relevant platform’s channels after their Form C has been filed with the Commission would raise significant investor protection concerns, as all sales would remain restricted to the regulated platform. Such communications would also remain subject to the antifraud and other civil liability provisions of the federal securities laws. Accordingly, we recommend that the Commission permit Reg. CF issuers to engage in such communications.

VII. Eligible Issuers Under Regulation Crowdfunding

Currently, only issuers organized under, and subject to, the laws of a State or territory of the United States or the District of Columbia are eligible to use the Reg. CF exemption. Given the close integration of the U.S. and Canadian economies, markets and supply chains, we believe that the Commission should implement an exception for Canadian issuers. We do not believe that permitting Canadian issuers to utilize Reg. CF would raise any meaningful investor protection concerns and note that Canadian companies are eligible to conduct Regulation A offerings. We also note that the only two non-resident registered Reg. CF crowdfunding portals are based in Canada. Moreover, we have found substantial interest from Canadian companies in conducting a Reg. CF offering as a means of engaging and raising capital from their U.S.-based customers and other stakeholders, which we believe is consistent with the intention of the JOBS Act and Reg. CF. In light of the foregoing, we recommend that the Commission extend the eligibility for Reg. CF to Canadian issuers.

VIII. Commission Authority

We do not believe that legislative changes would be necessary or beneficial to implement the recommendations described above. To the extent required, we believe that the Commission should use its exemptive authority under Section 28 of the Securities Act of 1933, as amended, to do so.

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⁹ See Release No. 33-9974 (Oct. 30, 2015), at 139.

¹⁰ See Final Report of the 2018 SEC Government-Business Forum on Small Business Capital Formation (Jun. 2019), at 20.

We appreciate the opportunity to comment on the Release, and would be pleased to discuss our comments or any questions the Commission or its Staff may have.

Sincerely,

/s/ Kendrick Nguyen

Kendrick Nguyen
Founder and CEO of Republic

cc: Chuck Pettid
Maxwell R. Rich