September 24, 2019

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

Submitted via rule-comments@sec.gov

Re: File No. S7–08–19

Dear Ms. Countryman:

I am pleased to provide these comments regarding the *Concept Release on Harmonization of Securities Offering Exemptions*.[1] The Securities and Exchange Commission (SEC or "Commission") is to be commended for undertaking this much-needed project. There is room to substantially improve the regulatory environmental for both entrepreneurial capital formation and exempt offerings generally while also either maintaining or improving investor protection.

The Harmonization Process

Largely because Congress became impatient with three decades of Commission inaction,[2] the statutes and the regulations governing exempt offerings are now very much intertwined. For example, section 4(b) of the Securities Act required that Rule 506 of Regulation D be amended to permit general advertising or general solicitation.[3] Furthermore, many of the exemptions (including crowdfunding, the small issues exemption (i.e. Regulation A) and 4(a)(7), among others) now have detailed statutory provisions governing their operation that cannot be changed by a rule-making.

[1] "Concept Release on Harmonization of Securities Offering Exemptions," *Federal Register*, Vol. 84, No. 123, June 26, 2019, pp. 30460-30522 (RIN 3235–AM27) https://www.govinfo.gov/content/pkg/FR-2019-06-26/pdf/2019-13255.pdf.

[2] Prior to the 2012 JOBS Act, the last major initiative *by the Commission* in the exempt offerings area was Regulation D, promulgated in 1982. "Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers of Sales" (Release No. 33-6389), Federal Register, No. 47 (March 16, 1982), p. 1125. The small issues exemption (Regulation A) had become very nearly a dead letter under Commission neglect. In 2011, the year before the JOBS Act, only one Regulation A offering was completed; "Factors That May Affect Trends in Regulation A Offerings," United States Government Accountability Office, July 2012 (GAO-12-839). See also Rutheford B Campbell, Jr., "Regulation A: Small Businesses' Search for a Moderate Capital," *Delaware Journal of Corporate Law*, Vol. 31, pp. 71-123 (2006) https://uknowledge.uky.edu/cgi/viewcontent.cgi?article=1125&context=law_facpub; Stuart R. Cohn and Gregory C. Yadley, "Capital Offense: The SEC's Continuing Failure to Address Small Business Financing Concerns," 4 *NYU Journal of Law and Business*, Vol 4, pp. 1-87 (Fall 2007) https://scholarship.law.ufl.edu/cgi/viewcontent.cgi?article=1257&context=facultypub.

[3] This provision was enacted by section 201(a)(1) of The Jumpstart Our Business Startups (JOBS) Act, Public Law 112–106, April 5, 2012 http://www.gpo.gov/fdsys/pkg/PLAW-112publ106/pdf/PLAW-112publ106.pdf.

The Commission has broad authority to improve the exempt offerings area.[4] The Commission is therefore able to make incremental improvements on its own and it should do so. But to achieve a genuinely satisfactory result for investors and issuers, the Commission must work with Congress. A genuinely harmonized, rational, coherent, scaled disclosure, exempt offering regime is only possible with the collaboration of Congress and the Commission. Thus, the Commission needs to make a break with its practice of many years. It needs to enter into an open dialog with Congress, in public, about how to reform the statutory rules governing entrepreneurial capital formation and, more broadly, exempt offerings.

I would strongly recommend that the SEC propose to Congress (and the public) recommended statutory revisions. For any given existing exemption, or a proposed new framework, this could take the form of either one recommended set of statutory revisions or a series of options that reflect different policy preferences. It is likely that a more coherent, technically sound and less *ad hoc* statutory regime would result if the SEC takes the lead in presenting well-crafted options to Congress and the public as a starting point for reform.

The Importance of Entrepreneurial Capital Formation

Entrepreneurship matters. It fosters discovery and innovation.[5] Entrepreneurs also engage in the creative destruction of existing technologies, economic institutions and business production or management techniques by replacing them with new and better ones.[6] Entrepreneurs bear a high degree of uncertainty and are the source of much of the dynamism in our economy.[7] New, start-up businesses account for much, if not most, of the net job creation in the economy.[8]

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[4] Provided by, notably, Securities Act sections 3, 4 and 28.

[5] Israel M. Kirzner, *Competition and Entrepreneurship* (University of Chicago Press: 1973); Israel M. Kirzner, "Entrepreneurial Discovery and the Competitive Market Process: An Austrian Approach," *Journal of Economic Literature*, Vol. 35, No. 1 (1997); Randall Holcombe, *Entrepreneurship and Economic Progress* (Routledge: 2006); William J. Baumol, *The Microtheory of Innovative Entrepreneurship* (Princeton University Press: 2010).

[6] See, e.g., Joseph Schumpeter, *Capitalism, Socialism, and Democracy* (1942; Routledge: 1976), pp. 81-86 http://digamo.free.fr/capisoc.pdf; W. Michael Cox and Richard Alm, "Creative Destruction," *Concise Encyclopedia of Economics* (Liberty Fund: 2010) http://www.econlib.org/library/Enc/CreativeDestruction.html; Henry G. Manne, "The Entrepreneur in the Large Corporation," in *The Collected Works of Henry G. Manne*, Vol. 2 (Liberty Fund: 1996).

[7] Frank H. Knight, *Risk, Uncertainty, and Profit* (Houghton Mifflin: 1921) http://www.econlib.org/library/Knight/knRUP.html; Richard J. Cebula, Joshua C. Hall, Franklin G. Mixon Jr. and James E. Payne, *Economic Behavior, Economic Freedom, and Entrepreneurship* (Edward Elgar: 2015).

[8] Magnus Henrekson and Dan Johansson, "Gazelles as Job Creators: A Survey and Interpretation of the Evidence," *Small Business Economics*, Vol. 35 (2010), pp. 227–244 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1092938; Ryan Decker, John Haltiwanger, Ron Jarmin, and Javier Miranda, "The Role of Entrepreneurship in US Job Creation and Economic Dynamism," *Journal of Economic Perspectives*, Vol. 28, No. 3 (Summer 2014), pp. 3–24 http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.28.3.3; Salim Furth, "Research Review: Who Creates Jobs? Start-up Firms and New Businesses," Heritage Foundation Issue Brief No. 3891, April 4, 2013 http://www.heritage.org/research/reports/2013/04/who-creates-jobs-startup-firms-and-new-businesses. In terms of the neo-classical growth model, entrepreneurship is an important factor affecting the rate of technological change and the marginal productivity of capital. See, e.g., Robert M. Solow, *Growth Theory: An Exposition* (Oxford University Press: 2000). Legal institutions, human capital and other factors are also important determinants of economic growth. See N. Gregory Mankiw, David Romer and David N. Weil, "A Contribution to the Empirics of Economic Growth," *The Quarterly Journal of Economics*, Vol. 107, No. 2 (May, 1992), pp. 407-437 https://eml.berkeley.edu/~dromer/papers/MRW_QJE1992.pdf; Robert J. Barro, *Economic Growth*, 2nd edition (MIT Press: 2003).

Entrepreneurs innovate, providing consumers with new or better products. They provide other businesses with innovative, lower cost production methods and are, therefore, one of the key factors in productivity improvement and real income growth.[9] The vast majority of economic gains from innovation and entrepreneurship accrue to the public at large rather than entrepreneurs.[10] Entrepreneurs are central to the dynamism, creativity and flexibility that enables market economies to consistently grow, adapt successfully to changing circumstances and create sustained prosperity.[11] Entrepreneurship promotes the common good, prosperity and a higher standard of living. Among the most important factors impeding entrepreneurship are securities laws that restrict entrepreneurs' access to the capital needed to launch or grow their businesses.[12] After all, without capital to launch a business, other impediments to entrepreneurial success are moot.

Sometimes, an entrepreneur has sufficient capital to launch and grow his or her business from personal savings, including profits from previous entrepreneurial ventures, and retained earnings. Often, however, an entrepreneurial firm will need capital from outside investors or lenders.[13] Other than friends or family, outside investors are typically described as "angel investors" or "venture capitalists."[14] Typically, "angel investors" are individuals who invest at the early "seed

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[9] Ralph Landau, "Technology and Capital Formation," in *Technology and Capital Formation*, Dale W. Jorgenson and Ralph Landau, editors (MIT Press: 1989).

[10] Yale economist William Nordhaus has estimated that 98 percent of the economic gains from innovation and entrepreneurship are received by persons other than the innovator. See William D. Nordhaus, "Schumpeterian Profits in the American Economy: Theory and Measurement," NBER Working Paper No. 10433, April 2004 https://www.nber.org/papers/w10433.pdf.

[11] See, Decker *et al*, *supra*; C. Mirjam van Praag and Peter H. Versloot, "What is the Value of Entrepreneurship? A Review of Recent Research," *Small Business Economics*, Volume 29, Issue 4 (December 2007), pp 351-382 https://link.springer.com/content/pdf/10.1007%2Fs11187-007-9074-x.pdf; David R. Burton, "Improving Entrepreneurs' Access to Capital: Vital for Economic Growth," Heritage Foundation Backgrounder No. 3182, February 14, 2017 https://www.heritage.org/sites/default/files/2017-02/BG3182.pdf; Deirdre N. McCloskey *Bourgeois Equality: How Ideas, Not Capital or Institutions, Enriched the World* (University of Chicago Press: 2016); Adam Thierer, *Permissionless Innovation: The Continuing Case for Comprehensive Technological Freedom* (Mercatus Center: 2016); David R. Burton, "Building an Opportunity Economy: The State of Small Business and Entrepreneurship," Testimony before the Committee on Small Business, United States House of Representatives, March 4, 2015 https://www.heritage.org/testimony/building-opportunity-economy-the-state-small-business-and-entrepreneurship; George Gilder, "Capitalism is an Information and Learning System," Remarks, November 15, 2018 https://www.heritage.org/markets-and-finance/event/capitalism-information-and-learning-system; Friedrich A. Hayek, "The Use of Knowledge in Society," *The American Economic Review*, Vol. 35, No. 4 (September, 1945), pp. 519-530 https://www.econlib.org/library/Essays/hykKnw.html.

[12] Banking laws and practices are a contributing factor. For a short introduction to the problems, see SEC Commissioner Daniel M. Gallagher, "Whatever Happened to Promoting Small Business Capital Formation?," September 17, 2014 http://www.sec.gov/News/Speech/Detail/Speech/1370542976550#.VFfbI8mGklQ.

[13] See, e.g., "2013 State of Entrepreneurship Address: Financing Entrepreneurial Growth," Kauffman Foundation Research Paper, February 5, 2013 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2212743; *The Oxford Handbook of Venture Capital*, Douglas Cumming, Editor (Oxford: 2012).

[14] See Angel Capital Association http://www.angelcapitalassociation.org/ and National Venture Capital Association http://www.nvca.org/. See also Ibrahim, Darian M., "Should Angel-Backed Start-ups Reject Venture Capital?," *Michigan Journal of Private Equity & Venture Capital Law*, Vol. 2, pp. 251-269 http://scholarship.law.wm.edu/cgi/viewcontent.cgi?article=2734&context=facpubs; Abraham J.B. Cable, "Fending For Themselves: Why Securities Regulations Should Encourage Angel Groups," *University of Pennsylvania Journal of Business Law*, Vol. 13, No. 1, Fall 2010, pp. 107-172 https://www.law.upenn.edu/journals/jbl/articles/volume13/issue1/Cable13U.Pa.J.Bus.L.107%282010%29.pdf; Darian M. Ibrahim, "The (Not So) Puzzling Behavior of Angel Investors," *Vanderbilt Law Review*, Vol. 61, p. 1405-

stage" while "venture capitalists" are firms or funds that make investments later in the firms' life-cycle after "proof of concept." In principle, Regulation A and Regulation CF would allow ordinary investors to invest in young firms and for young firms to find a new source of capital. So far, they have been of minor importance largely due to the regulatory and statutory structure of these exemptions. Firms seeking outside investors are often the most dynamic, high growth companies.[15]

Exempt Offerings Generally

Introduction

As Figure 1 on the Concept Release shows, exempt offerings are the most important means of raising capital in the U.S. The amount of capital raised in exempt offerings is twice that raised in registered offerings. In 2018, $2.9 trillion was raised in the exempt offering market as opposed to $1.4 trillion in the registered market.[16] Regulation D is the single most important means by which capital is raised in exempt offerings (See Table 2).

The first rule governing any reform in this area should be "Do No Harm." This is particularly true with respect to Regulation D, especially Rule 506. This lightly regulated space has worked well and is the single most important means of raising capital in the U.S.

Fundamental Reform

Ideally, Congress and the Commission would be willing to fundamentally rethink the regulation of small company capital formation. A coherent, scaled, simplified disclosure regime with a limited number of exemptions should be developed and implemented by Congress and the Commission, It should govern both initial and continuing disclosure, and be integrated across the various exemptions and categories of reporting company such that larger firms with more investors and more capital at risk have greater disclosure obligations. Policy-makers should consider the cost of compliance, the investor protection benefits of the added disclosure, the cost

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1452 (2008) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=984899; Brent Goldfarb, Gerard Hoberg, David Kirsch and Alexander Triantis, "Does Angel Participation Matter? An Analysis of Early Venture Financing," Angel Capital Association, April 4, 2008 http://www.angelcapitalassociation.org/data/ACEF/ACEFDocuments/Does%20Angel%20Participation%20Matter%20-%20Analysis%20of%20Early%20Venture%20Financing.pdf.

[15] Sampsa Samila and Olav Sorenson, "Venture Capital, Entrepreneurship, and Economic Growth, *Review of Economics and Statistics*, February, 2011, Vol. 93, No. 1, pp. 338-349 http://martinprosperity.org/media/agrawal/3SorensonSamila.pdf; Dane Stangler, "High-Growth Firms and the Future of the American Economy, Kauffman Foundation, March 9, 2010 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1568246.

[16] Part of the reason for this is that Congress and, to a lesser extent, the SEC have imposed increasingly onerous requirements on public companies. For a short discussion, see the section entitled "Reducing Regulatory Burdens on Small Public Companies" in David R. Burton, "Securities Disclosure Reform," Heritage Foundation Backgrounder No. 3178, February 13, 2017 https://www.heritage.org/sites/default/files/2017-02/BG3178.pdf or David R. Burton, "Reducing the Burden on Small Public Companies Would Promote Innovation, Job Creation, and Economic Growth," Heritage Foundation Backgrounder No. 2924, June 20, 2014 http://www.heritage.org/research/reports/2014/06/reducing-the-burden-on-small-public-companies-would-promote-innovation-job-creation-and-economic-growth.

to investors of being denied investment opportunities by investment restrictions and the cost to the public of lost economic growth, capital formation, innovation, and job creation caused by the regulation of issuers.

It is worth considering a simplified set of exemptions. One possibility would be to establish three categories as follows:

A Proposal for a Reformed Exemption and Disclosure Regime

Type of Issuer	Type of Solicitation		Size (Public Float/ Number of Beneficial Owners or Holders of Record)		Secondary Market Status
Private	Private	and	Below specified threshold A	and	Not National Securities Exchange, Venture Exchange traded (but some organized secondary market permitted)
Quasi-Public (“Venture Firms”)	General	or	Above specified threshold A	and	Not National Securities Exchange traded (Venture Exchange or ATS trading permitted)
Public (Registered)	General	and	Above specified threshold B	or	National Securities Exchange (or ATS) Traded

In such a regime, private companies would have no legally mandated disclosure requirements. Disclosure requirements would be negotiated by the private parties involved much as they usually are now. The private exemption here is effectively the same as Rule 506(b) or section 4(a)(2) offerings.[17] A company would be deemed private if it did not engage in general solicitation, was below some specified number of beneficial owners,[18] holders of record or, perhaps, some measure of non-insider share value (analogous to public float) – call this threshold

[17] A decision would need to be made regarding the Rule 502(b) disclosure requirements with respect to sales to non-accredited investors if the accredited investor concept is retained.

[18] There would need to be reasonable, administrable look-through rules if beneficial ownership were to replace the holder of record threshold. This problem has largely been solved by the tax system with respect to income reporting. Moreover, in the contemplated regulatory regime, the impact of the step up from private to quasi-public status would not be so discontinuous as the step-up from private to public today, this break point would be of less importance.

A – and its shares were not traded on a venture exchange, alternative trading system (ATS) or national securities exchange. Secondary sales would be restricted.[19]

Public companies could engage in general solicitation and would be (1) above a specified measure of size (threshold B) or (2) have shares traded on a national securities exchange (or, at the issuer's option, an ATS). Disclosure obligations would be scaled based on some measure of size (probably public float). This is the category that most companies that are full reporting companies, smaller reporting companies, emerging growth companies and perhaps the largest Regulation A plus companies would fall into.

Companies that were neither "public" nor "private" would be intermediate "quasi-public" or "venture" companies. They could engage in general solicitation and sell to the public. Disclosure obligations would be scaled based on some measure of size (perhaps public float if traded on a venture exchange (or an ATS) or the number of beneficial owners or holders of record otherwise). These are the kind of companies that are meant to use the crowdfunding and Regulation A exemptions and would probably include some companies that are smaller reporting companies today.

Blue sky laws regarding registration and qualification would be preempted in all cases. State anti-fraud laws would remain operative.[20]

Companies would report based on the category they were in (private, quasi-public or public). Disclosure obligations would be scaled within the quasi-public and public category. Registration statements should be dramatically simplified, describing the security being offered but the quarterly (10-Q), annual (10-K) and major event (8-K) reporting would become the core of the disclosure system rather than registration statements (except in the case of initial quasi-public or venture offerings (transitioning from private company status) or initial public offerings (transitioning from private or quasi-public/venture status)).

Although it is far from clear that it should be retained,[21] some accredited investor limitations measuring wealth, income or sophistication could be applied to private offerings should policy makers wish to limit those who may invest in private companies. In that case, however, something similar to the current section 4(a)(2) exemption or a statutory exemption for micro issuers would need to remain. Otherwise, a few people starting a bar, restaurant, retail store or service business would run afoul of the securities laws.

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[19] Attention should be paid to improving private secondary markets. If the accredited investor concept were retained, secondary sales should be fostered by an improved version of 4(a)(7). Enabling investors to realize the full value of their shares in secondary sales and promoting liquidity is an important aspect of investor protection.

[20] Blue Sky registration and qualification requirements are highly counterproductive. Capital routinely seeks to avoid the substantial delay, costs and regulatory risk of state registration and qualification requirements (especially in merit review states). There is little actual evidence that Blue Sky registration and qualification requirements materially improve investor protection. For a discussion of these issues, see Rutheford B. Campbell Jr., "The Case for Federal Pre-Emption of State Blue Sky Laws," Chapter 6, *Prosperity Unleashed: Smarter Financial Regulation*, Norbert J. Michel, Editor (The Heritage Foundation: 2017) http://thf-reports.s3.amazonaws.com/2017/ProsperityUnleashed.pdf.

[21] See, for example, Thaya Brook Knight, "Your Money's No Good Here: How Restrictions on Private Securities Offerings Harm Investors," Cato Institute Policy Analysis No. 833, February 9, 2018 https://www.cato.org/sites/cato.org/files/pubs/pdf/pa833.pdf.

There are effectively at least 13 categories of firms issuing securities. They are:

(1) private companies using section 4(a)(2);
(2)-(5) private companies using Regulation D (Rule 504 and Rule 506 (with and without non-accredited investors);[22]
(6)-(7) small issuer Regulation A companies (two tiers);
(8)-(10) crowdfunding companies (three tiers);
(11) smaller reporting companies;
(12) emerging growth companies; and
(13) fully reporting public companies.

Each of these categories has different initial and continuing disclosure obligations, different classes of investors that can invest in the offering and a host of other differences. The existing disclosure regime is not coherent in that in many cases smaller firms have greater disclosure requirements and the degree and type of disclosure differs significantly by the type of offering even for firms that are otherwise comparable in all meaningful respects.

To accomplish disclosure reform while maintaining the basic current exemption structure, Congress would need to amend:

1. Securities Act Schedule A (which currently contains a list of 32 disclosure requirements and is about 5 pages in length)
2. Securities Act sections 4A (crowdfunding), 7 and 10 (relating to registration statements and prospectuses)
3. Securities Exchange Act sections 13, 14, 14A, 16 and 21E (relating to periodic and other reports, proxies, shareholder approvals, disclosure concerning directors, officers and principal shareholders and the safe harbor relating to forward looking statements)[23]

A revised Schedule A would list all disclosure requirements applicable to a fully reporting public company and also indicate which provisions did not apply to smaller reporting companies and companies falling into other categories. It would, in effect, become the roadmap to which companies had to comply with which disclosure requirements.

Implementing the complete reform program outlined above would involve substantial changes to other provisions in the law, notably sections 3, 4 and 4A of the Securities Act (relating to exempted securities, exempted transactions and crowdfunding, respectively). This would replace the current patchwork of 13 different exemptions, each with a different set of exemption and disclosure rules, with three major issuer categories (private, quasi-public ("venture") and public) and two scaled disclosure categories (larger and smaller) within the quasi-public ("venture") and public exemption categories.

[22] Rule 502(b) imposes significantly greater disclosure requirement on issuers that sell to non-accredited investors in both Rule 505 and Rule 506(b) offerings.
[23] In addition, conforming amendments elsewhere in the Securities Act and the Securities Exchange Act would need to be made.

Such a regime would constitute a major improvement over the current one. It would be simpler, result in fewer regulatory difficulties and costs, protect investors and promote capital formation.

Incremental Reform

The alternative, of course, is incremental reform of the existing exemptions. Such reforms are discussed below in response to specific requests for comment.

Response to Specific Requests for Comment

Request for Comment 1. Does the existing exempt offering framework provide appropriate options for different types of issuers to raise capital at key stages of their business cycle? For example, are there capital raising needs specific to any of the following that are not being met by the current exemptions: Small issuers; startup issuers; issuers in a particular industry, such as technology, biotechnology, manufacturing, or consumer products; issuers in different geographic regions, including those in rural areas or those affected by natural disasters; or issuers led by minorities, women, or veterans? What types of changes should we consider to address any such gaps in the exempt offering framework? Would legislative changes be necessary or beneficial to address any such gaps?

Response 1: In general, the current exemption regime is confusing to entrepreneurs and non-specialist counsel. It is not rational or harmonized. The differences between the offering and continuing disclosure requirements for the different exemptions simply do not make sense based on any coherent policy rationale. They simply evolved, *ad hoc,* over the years. The regulatory burden has a particularly adverse impact on small and start-up firms with limited resources and sophistication.

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

Response 2: As discussed below, there are many incremental reforms that can improve the situation for both issuers and investors. Perhaps the most underrated problem is the adverse impact that both blue sky laws and federal rules have on secondary markets. This has a pronounced negative impact on investors in non-registered securities because it reduces the liquidity of their investment dramatically, increases transactions cost substantially and reduces the price received by investors seeking to sell their securities. Furthermore, because the lack of a reasonably robust secondary market in exempt securities makes the securities less attractive, it has an adverse impact on issuers seeking to raise capital.

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

Response 3: Yes, the existing exempt offering framework is too complex. The complexity is largely a function of the fact that the offering, continuing disclosure and other requirements are not harmonized, integrated and scaled across exemptions. See the discussion above under "Fundamental Reform" for how a much simpler integrated approach might work.

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

Response 4: Regulation D is not too complex and that is, in my judgment, why it is such a success. Other exemptions are too complex. Some of the complexity is a function of the statutes and some of it was introduced by Regulation A and Regulation CF. Much of the complexity is simply a function of the variation, sometimes minor, in initial and continuing disclosure requirement, bad actor provisions, time periods, integration rules, investor limitations and so on. Crowdfunding (especially Tier 3 and the regulation of portals) is too complex (see discussion below).

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

Response 5: In general, the focus should be on the sale because a sale is a much brighter line than an offer and because investor protections are much more relevant. An offeree that never buys a security needs little "protection." Such a change in focus also has the potential to solve many of the issues surrounding firms' "testing the waters."

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

- How should we evaluate whether our existing exemptions appropriately promote efficiency, competition, and capital formation? For example, in evaluating our exempt offering market, should we consider whether investors have more opportunities to participate in exempt offerings? To appropriately evaluate the market, should we consider the cost of capital for a variety of issuers? What other indicators should we consider?
- How should we evaluate whether our exemptions provide adequate investor protection? For example, is there quantitative data available that shows an increased incidence of fraud in particular types of exempt offerings or in the exempt market as a whole? If so,

> what are the causes or explanations and what should we do to address it? What other factors should we consider in assessing investor protection?

Response 6: The four basic metrics should be (1) the impact on capital formation, especially entrepreneurial capital formation, (2) the costs imposed on issuers and investors, (3) investor protection (primarily fraud, material misrepresentation or omission and the cost to investors of being denied investment opportunities by investment restrictions) and (4) the cost to the public of lost economic growth, capital formation, innovation, and job creation caused by the regulation of issuers. But the information available to assess these metrics is insufficient.

Data available to the Commission and Congressional policymakers with respect to securities markets, securities offerings, securities market participants and securities law enforcement is seriously deficient. This becomes evident when what is available to the Commission and Congress in the securities regulation field is compared to, for example, the Internal Revenue Service Statistics of Income and IRS Databook relevant to tax policy,[24] the data provided with respect to health care by the National Center for Health Statistics, the Centers for Medicare & Medicaid Services and others,[25] the data provided regarding labor and employment by the Bureau of Labor Statistics and others,[26] education data,[27] transportation data[28] and the general economic data provided by the Bureau of Economic Analysis[29] or the Census[30] and so on.

The Division of Economic and Risk Analysis (DERA) should substantially improve the collection and regular publication of data on securities offerings, securities markets and securities law enforcement and publish an annual data book of time series data on these matters. With a budget of about $72 million and about 175 employees, it has adequate resources to do so.[31] It should conduct surveys and collect information internally available (both data from filings and from enforcement actions). It should publish on a regular basis time series data in compliance with OMB's Standards and Guidelines for Statistical Surveys and the Paperwork Reduction Act. DERA should consult with the Office of Management and Budget (OMB) Office of Information and Regulatory Affairs (OIRA) and the Interagency Council on Statistical Policy and secure advice from key statistic agencies such as the Census Bureau and the Bureau of Economic Analysis regarding the most effective means of collecting information and protecting the privacy of those providing the information.

Specifically, DERA should publish annual data on:

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[24] Tax Statistics https://www.irs.gov/statistics.
[25] The National Center for Health Statistics https://www.cdc.gov/nchs/index.htm; The Centers for Medicare & Medicaid Services (CMS), Research, Statistics, Data & Systems https://www.cms.gov/Research-Statistics-Data-and-Systems/Research-Statistics-Data-and-Systems.html.
[26] Bureau of Labor Statistics https://www.bls.gov/; National Labor Relations Board. Graphs & Data https://www.nlrb.gov/news-outreach/graphs-data; U.S. Equal Employment Opportunity Commission, Statistics https://www.eeoc.gov/eeoc/statistics/.
[27] National Center for Education Statistics https://nces.ed.gov/.
[28] Bureau of Transportation Statistics https://www.bts.gov/.
[29] Bureau of Economic Analysis http://www.bea.gov/.
[30] Census Bureau, Data Tools and Apps https://www.census.gov/data/data-tools.html.
[31] Fiscal Year 2019 Congressional Budget Justification, United States Securities and Exchange Commission, pp 15-17, 39 https://www.sec.gov/files/secfy19congbudgjust.pdf.

(1) the number of offerings and offering amounts by type (including type of issuer[32], type of security[33] and exemption used[34]);
(2) ongoing and offering compliance costs by size and type of firm and by exemption used or registered status (e.g. emerging growth company, smaller reporting company, fully reporting company) including both offering costs and the cost of ongoing compliance;
(3) enforcement (by the SEC, state regulators and SROs), including the type and number of violations,[35] the type and number of violators and the amount of money involved;
(4) basic market statistics such as market capitalization by type of issuer and type of security; the number of reporting companies, Regulation A issuers, crowdfunding issuers and the like; trading volumes by exchange or ATS; and
(5) market participants, including the number and, if relevant, size of broker-dealers, registered representatives, exchanges, alternative trading systems, investment companies, registered investment advisors and other information.

This data should be presented in time series over multiple years (including prior years to the extent possible) so that trends can be determined.

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

Response 7: Clearly, the internet has transformed how information is conveyed and any rulemaking should take this into account. Allowing firms to use the internet to convey information will reduce costs and be convenient for all involved. Probably, however, steps need

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[32] By industry; by measures of size such as gross revenues, assets or employees; by age (i.e. years in existence); reporting status; and so on.
[33] Common stock, preferred stock, bond, (and whether the bond or preferred stock is convertible into common stock), other classes of security, whether options or warrants were attached; and so on.
[34] Regulation D (Rule 504 and 506 (including 506(b) and 506(c)); Regulation A (Tier 1 and Tier 2); Crowdfunding (Tiers 1, 2 & 3); non-Regulation D section 4(a)(2) offerings, Rule 144A and other exemptions.
[35] Civil or Criminal (referrals, convictions, settlements); with respect to broker-dealers (Breach of Fiduciary Duty, Suitability violations, Negligence, Failure to Supervise, Misrepresentation, Fraud, Breach of Contract, Omission of Facts, Violation of Blue Sky Laws, Unauthorized Trading, Manipulation, Churning); issuer violations by type of violation (e.g. fraud, non-compliance with Regulation S-K, Regulation S-X, failure to file an 8-K, Regulation A, Regulation CF, etc.) and type of issuer ((private issuer, Regulation A issuer, crowdfunding issuer, reporting company, investment company, registered investor advisor, broker-dealer, registered representative, etc.).

to be taken so that disclosure documents are taken a bit more seriously than software licensing or web site terms of service agreements that are rarely read.

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

Response 8: The exemptions should be harmonized and scaled so that the obligations of transitioning the issuer's status are not so discontinuous.

Request for Comment 9. Would rule changes that simplify, harmonize, and improve the exempt offering framework have an effect on the registered public markets? For example, would a more streamlined exempt market encourage more issuers to offerings, and result in less capital being raised in the registered market over time? Are there changes to the current exempt offering framework that we should consider to help issuers transition to a registered public offering without undue friction or delay? Are there changes to the exempt offering framework that we should consider to encourage more issuers to enter the registered public markets? Would these changes increase the costs to issuers? Would these changes benefit investors or particular classes of investors? Would legislative changes be necessary or beneficial to address any such changes?

Response 9: Regulation A and Regulation CF securities are not, of course, registered securities but they are quasi-public in that general solicitation is permitted, mandatory disclosure requirements exist and the securities are not restricted (after one year in the case of crowdfunding). Thus, it is probably correct to think of these markets as a form of "public" or quasi-public market. But they will not truly resemble the public market until the secondary market issues are addressed. Improving the attractiveness of Regulation A and Regulation CF will make more private companies consider using these exemptions.

But the bottom line is that the costs and regulatory risk of being a public company is why the public markets are in relative decline and why companies are going public so much later in their life cycle. These costs and risks are incurred because of provisions adopted in the name of investor protection (with some exceptions). In fact, because of these provisions the vast majority of Americans are denied the opportunity to invest in high return (albeit high-risk) investments and the returns to entrepreneurial success are increasingly limited to accredited investors. This is because most of the growth occurs and most of the returns are received before the company becomes a public company.

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

Response 10: “Investor protection” is a central part of the SEC’s mission.[36] But the term “investor protection” is a very ambiguous term that can cover, at least, four basic ideas. The first is protecting investors from fraud or misrepresentation. This is a fundamental function of government. The second is providing investors with adequate information to make informed investment decisions. Although a legitimate function of the securities laws, this requires policy-makers to carefully balance the costs (which are typically underestimated by regulators and policy-makers) and benefits (which are typically overestimated by regulators and policy-makers) of mandatory disclosure.[37] See Response 13 below for an extended discussion of costs and benefits. The third is protecting investors from investments or business risks that regulators deem imprudent or ill-advised. This is not an appropriate function of government and can be highly counterproductive. See also Response 12 below. The fourth is protecting investor freedom of choice or investor liberty and, thereby, allowing investors to achieve higher returns and greater liquidity. This primarily requires regulators to exercise restraint, or eliminate existing regulatory barriers, both in the regulation of primary offerings by issuers and of secondary market sales by investors to other investors. In practice, this aspect of investor protection is almost entirely ignored by state and federal regulators.

The law should not, even in principle, adopt a regulatory regime that is designed to protect all investors from every conceivable ill. Even in the case of fraud, there needs to be a balancing of costs and benefits. Securities law should deter and punish fraud but, given human nature, it will never entirely eliminate fraud. The only way to be certain that there would be no fraud would be to make business impossible. In other words, the socially optimal level of fraud is not zero.[38] While fraud imposes significant costs on the person who is defrauded, preventing fraud also has significant costs (both to government and to law abiding firms or investors) and at some point the costs of fraud prevention exceed the benefits, however defined, of preventing fraud.[39] It is up to policy-makers to assess this balance and make appropriate judgments in light of the evidence.

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[36] “The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation,” http://www.sec.gov/about/whatwedo.shtml#intro. The statutory charge is “Whenever pursuant to this title the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.” See §3(f) of the Securities Exchange Act of 1934 and §2(b) of the Securities Act of 1933.

[37] See the discussion above and, for example, “Some Limits and Drawbacks of MD,” section in Luca Enriques and Sergio Gilotta, “Disclosure and Financial Market Regulation,” in *The Oxford Handbook on Financial Regulation*, edited by Eilís Ferran, Niamh Moloney, and Jennifer Payne (Oxford, 2015) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2423768 and http://ukcatalogue.oup.com/product/9780199687206.do.

[38] Gary S. Becker, "Crime and Punishment: An Economic Approach," in *Essays in the Economics of Crime and Punishment*, Gary S. Becker and William M. Landes, eds. (Columbia University Press: 1974) http://www.nber.org/chapters/c3625.pdf; Richard A. Posner, "An Economic Theory of the Criminal Law," Vol. 85, *Columbia Law Review* 1193-1231 (1985) http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=2827&context=journal_articles.

[39] This short discussion abstracts away from many subsidiary issues, including the relative efficacy of civil and criminal penalties, the degree of deterrence that is socially optimal, measurement issues and the like. For a recent review of some of the issues, see Keith N. Hylton, "The Theory of Penalties and the Economics of Criminal Law," Vol. 1, No. 2 , *Review of Law And Economics*, (2005) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=337460.

About three-fifths of the states conduct "merit review."[40] Under merit review, state regulators decide whether a securities offering is too risky or unfair to be offered within their state, effectively substituting their investment judgment for that of investors. Merit review is wrong in principle. Moreover, it is very unlikely that regulators make better investment decisions than investors. Lastly, merit review is expensive and it delays offerings considerably.[41]

There are at least eight reasons to doubt that government regulators have better investment judgment than private investors investing their own money. First, there is an inability for a central regulatory authority to collect and act upon information as quickly and accurately as dispersed private actors.[42] Government has a reputation for being ponderous and slow to act for a reason.[43] In the context of securities regulation, it is highly doubtful that government regulators have a better understanding of business and the markets than those participating in those markets. Second, private investors have strong incentives to be good stewards of their own money, both in the sense of not taking unwarranted risk and in the sense of seeking high returns. In addition, investors may seek to invest for reasons that do not involve pecuniary gain, including support of the persons launching an enterprise or support for a social enterprise that has a dual mission. Government regulators have an entirely different set of incentives. Third,

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[40] For a dated but detailed look at blue sky laws see, "Report on the Uniformity of State Regulatory Requirements for Offerings of Securities That Are Not "Covered Securities," Securities and Exchange Commission, October 11, 1997 http://www.sec.gov/news/studies/uniformy.htm#seci. For a critique of blue sky laws, see Rutheford B. Campbell, Jr., "Federalism Gone Amuck: The Case for Reallocating Governmental Authority over the Capital Formation Activities of Businesses," 50 *Washburn Law Journal* 573 (Spring 2011) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1934825 ("In retrospect, there can be little doubt that the failure of Congress to preempt state authority over the registration of securities was a significant blunder."). See also Roberta S. Karmel, "Blue-Sky Merit Regulation: Benefit to Investors or Burden on Commerce?," *Brooklyn Law Review*, Vol. 53, pp. 105-125 (1987). The North American Securities Administrators Association, in its "Application for Coordinated Review of Regulation A Offering," delineates between merit review and disclosure jurisdictions. There are 49 participating jurisdictions, including Puerto Rico, the U.S. Virgin Islands and the District of Columbia. Of the states, 28 are merit review states, 16 are disclosure states and two (New Jersey and West Virginia) are "disclosure" states that "reserve the right" to make "substantitve comments." Four states do not, at this time, participate. http://www.nasaa.org/wp-content/uploads/2014/05/Coordinated-Review-Application-Sec-3b.pdf.

[41] Rutheford B. Campbell Jr., "The Insidious Remnants of State Rules Respecting Capital Formation," Vol. 78, *Washington University Law Quarterly*, pp. 407-434 (2000); Henry G. Manne and James S. Mofsky, "What Price Blue Sky: State Securities Laws Work Against Private and Public Interest Alike," *The Collected Works of Henry G. Manne*, Vol. 3 (Liberty Fund: 1996); Therese H. Maynard, "The Future of California's Blue Sky Law," 30 *Loyola of Los Angeles Law Review*, Vol. 30, pp. 1531-1556 (1997); Mark A. Sargent, "A Future for Blue Sky," *University of Cincinnati Law Review*, Vol. 62 (1993), pp. 471-512; James S. Mofsky and Robert D. Tollison, "Demerit in Merit Regulation," *Marquette Law Review*, Vol. 60 (1977), pp. 367-378; James S. Mofsky, *Blue Sky Restrictions On New Business Promotions* (Matthew Bender & Company: 1971); John P. A. Bell and Stephen W. Arky, "Blue Sky Restrictions on New Business Promotions," *The Business Lawyer*, Vol. 27, No. 1 (November 1971), pp. 361-365.

[42] Friedrich A. Hayek, "The Pretence of Knowledge," Lecture to the Memory of Alfred Nobel, December 11, 1974 http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/1974/hayek-lecture.html; Friedrich A. Hayek, *Individualism and Economic Order* (1948) https://mises-media.s3.amazonaws.com/Individualism%20and%20Economic%20Order_4.pdf; Friedrich A. Hayek, "The Use of Knowledge in Society," *American Economic Review*, September, 1945, Vol. 34, No. 4, pp. 519-530 http://www.econlib.org/library/Essays/hykKnw1.html; Friedrich A. Hayek, "Economics and Knowledge," *Economica*, (February, 1937), pp. 33–54 http://www.econlib.org/library/NPDBooks/Thirlby/bcthLS3.html.

[43] Peter Schuck, *Why Government Fails So Often and How It Can Do Better* (Princeton 2014); Clifford Winston, *Government Failure versus Market Failure: Microeconomics Policy Research and Government Performance*, (American Enterprise Institute and the Brookings Institution: 2006); William S. Peirce, *Bureaucratic Failure and Public Expenditure* (Academic Press: 1981).

individuals, not government officials, know their own risk tolerance and their own portfolios. Investing in a riskier security[44] can reduce the overall risk of a portfolio if the security in question is negatively correlated or even not highly covariant with price movements of the overall portfolio.[45] Fourth, government officials are people too, and exhibit the same irrationality and tendency to sometimes make poor decisions as anyone else. There is absolutely no reason to believe that regulators are less subject to the concerns identified by behavioral economics and the "libertarian paternalists" than are others. Moreover, since most securities regulators are lawyers and a legal education provides no training to make investment decisions, there is no particular reason to believe they have any relevant "expertise" that will make their investment decisions objectively better than those investing their own money. Fifth as public choice economics has demonstrated, government officials are not angels but act in their own self-interest.[46] This too is in keeping with basic common sense. Government officials have an interest in enlarging their agencies, increasing their power and improving their employment prospects.[47] They are no more benevolent than any other group of people, including issuers and investors, and there is no particular reason to believe that government regulators will act in the interest of investors when those interests conflict with their own interest. The analysis of politics, and the politicians and regulators that conduct politics, should be stripped of its "romance."[48] Sixth, government officials making investments have a notoriously bad track record.[49] Perhaps the most famous example of poor entrepreneurial investment judgment by a regulator is when securities regulators in Massachusetts barred Massachusetts citizens from investing in Apple Computer during its

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[44] A security with a high degree of unique risk (as opposed to market or systemic risk).

[45] This is often called a negative beta or low beta investment. For a discussion of these issues, see, e.g., "Introduction to Risk, Return and the Opportunity Cost of Capital" in Richard A. Brealey, Stewart C. Meyers and Franklin Allen, *Principles of Corporate Finance,* 8th Edition (McGraw-Hill: 2006) or most introductory finance textbooks.

[46] Gordon Tullock, Authur Seldon and Gordon L. Brady, *Government Failure: A Primer in Public Choice*, (Cato Institute: 2002).

[47] For a specific discussion of this issue with respect to securities regulation, see ; Luca Enriques and Sergio Gilotta, "Disclosure and Financial Market Regulation," in *The Oxford Handbook on Financial Regulation*, edited by Eilís Ferran, Niamh Moloney, and Jennifer Payne (Oxford, 2015) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2423768.

[48] William F. Shughart, "Public Choice," *Concise Encyclopedia of Economics*, David R. Henderson, editor (Liberty Fund 2007) http://www.econlib.org/library/Enc/PublicChoice.html. James M. Buchanan, *The Collected Works of James M. Buchanan, The Logical Foundations of Constitutional Liberty*, Volume 1, (Liberty Fund: 1999), page 46 from a lecture originally given at the Institute for Advanced Studies in Vienna, Austria in 1979. "My primary title for this lecture, 'Politics without Romance,' was chosen for its descriptive accuracy. Public choice theory has been the avenue through which a romantic and illusory set of notions about the workings of governments and the behavior of persons who govern has been replaced by a set of notions that embody more skepticism about what governments can do and what governors will do, notions that are surely more consistent with the political reality that we may all observe about us. I have often said that public choice offers a "theory of governmental failure" that is fully comparable to the "theory of market failure" that emerged from the theoretical welfare economics of the 1930's and 1940's."

[49] Burton W., Jr. Folsom Jr. and Anita Folsom, *Uncle Sam Can't Count: A History of Failed Government Investments, from Beaver Pelts to Green Energy* (2014); Howard Pack and Kamal Saggi, "The Case for Industrial Policy: A Critical Survey," World Bank Policy Research Working Paper 3839, February 2006 ("Overall, there appears to be little empirical support for an activist government policy even though market failures exist that can, in principle, justify the use of industrial policy.") http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-3839.

initial public offering.[50] It was deemed too risky of an investment. Seventh, in their capacity as regulators assessing risk, regulators have an increasingly obvious bad track record. Government regulators in the most recent financial crisis did no better than private actors in understanding risk.[51] Eighth, it is a reasonable hypothesis that government regulators are unduly risk averse. There are, at least, two reasons for this. Government tends to attract people who are risk averse. They have a lower risk tolerance than those making entrepreneurial investments.[52] Moreoever, government regulators' incentives will tend to make them unduly risk averse. An investment that goes bad may make the headlines and their regulatory judgment may be criticized. An investment that never happens because it does not receive regulatory approval will not make the headlines and their judgment will not be second guessed.

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

Response 11: Unquestionably, the Commission should adopt rule changes that will help make exempt offerings more accessible to a broader group of retail investors than those who currently qualify as accredited investors. See discussion below under "Accredited Investor."

Request for Comment 12. When the current exemptions from registration include offering limits or limits on the amount an individual investor may invest, what should we take into account to determine whether the limits and amounts are appropriate? Should the amounts of all offering limits or investment limits be subject to periodic inflation adjustments? If so, what inflation measure should we use for such adjustments and how often should the adjustments occur? Should we use dollar limits, or some other measure? For example, should individual investment limits be based on a percentage of the investor's income or investment portfolio? Do these limits impose any particular challenges, for example, by having different effects in different parts of the country due to regional differences? Should any investors be limited in how much they can invest?

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[50] Richard E. Rustin and Mitchell C. Lynch, staff reporters, "Apple Computer Set to Go Public Today: Massachusetts Bars Sale of Stock as Risky," *The Wall Street Journal*, Dec 12, 1980, p.5 http://online.wsj.com/public/resources/documents/AppleIPODec12_1980_WSJ.pdf.

[51] For example, then Federal Reserve Board Chairman Ben Bernanke said in February 2008, "Among the largest banks, the capital ratios remain good and I don't anticipate any serious problems of that sort among the large, internationally active banks that make up a very substantial part of our banking system," "Fed Chairman: Some Small US Banks May Go Under," CNBC with Reuters and AP, Thursday, February 28, 2008 http://www.cnbc.com/id/23390252. Only seven months later, the Emergency Economic Stabilization Act of 2008 established the Troubled Asset Relief Program (TARP), with his support, to bail out the big banks.

[52] Michael J. Roszkowski1 and John E. Grable, "Evidence of Lower Risk Tolerance among Public Sector Employees in their Personal Financial Matters," *Journal of Occupational and Organizational Psychology*, Vol. 82, No. 2, pp. 453–463, June 2009.

Response 12: I freely grant that were the Commission staff, or I, to provide investment advice to investors, we would suggest that diversification in a portfolio is usually a sound policy. However, the Commission is not, and should not be, in the business of giving investment advice or substituting its investment judgment or risk tolerance for that of individuals in the marketplace. That is effectively what limitations on how much investors can invest constitute. It is a type of creeping federal merit review. It does not take too much imagination to envision a federal regulatory regime that has specified diversification or other requirements for most investors that would seriously limit investors' options and which most entrepreneurs starting a business with their own funds would fail. Indeed, FINRA Rule 2111 relating to suitability requirements already imposes the broad outlines of such a system for transactions recommended by a broker-dealer.[53] The now withdrawn Department of Labor (DOL) fiduciary standards under the Employee Retirement Income Security Act (ERISA) raise similar issues.[54]

The principles underlying federal securities law are fraud prevention and full disclosure. The Commission should not get into the business of providing investment advice. It should not mandate that people maintain a particular portfolio. It should not mandate the level of risk that investors may choose to undertake.

These investment limitations are also administratively complex, difficult for issuers or the Commission to enforce and adds costs to both Regulation A and Regulation CF offerings. It requires investors to determine and disclose and for issuers to verify income or net worth.

Moreover, there is absolutely no statutory basis for such a provision in Regulation A. There is absolutely no reason to believe that Congress intended such a rule when it enacted Title IV of the JOBS Act. It did so in Title III but chose *not* to do so in Title IV. With respect to Regulation A, it is entirely an SEC creation and it should be reversed.

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

Response 13: Yes, the disclosure provisions should be harmonized across exemptions and scaled.

[53] The SEC's Regulation Best Interest has a few bothersome provisions as well.

[54] "Definition of the Term ''Fiduciary''; Conflict of Interest Rule—Retirement Investment Advice," Department of Labor, Final Rule, Federal Register, Vol. 81, No. 68, Friday, April 8, 2016, pp. 20946-21002 http://webapps.dol.gov/FederalRegister/PdfDisplay.aspx?DocId=28806.

Appropriate mandatory disclosure requirements can promote capital formation, the efficient allocation of capital and the maintenance of a robust, public and liquid secondary market for securities.[55] The reasons for this include (1) that the issuer is in the best position to accurately and cost-effectively produce information about the issuer,[56] (2) that information disclosure promotes better allocation of scarce capital resources or has other positive externalities,[57] (3) that the cost of capital may decline because investors will demand a lower risk premium,[58] (4) that

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[55] Frank B. Cross and Robert A. Prentice, "The Economic Value of Securities Regulation," *Cardozo Law Review* Vol. 28, No. 1 (2006), pp. 333–389; Bernard S. Black, "The Legal and Institutional Preconditions for Strong Securities Markets," Vol. 48, *UCLA Law Review*, pp. 781-855 (2001) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=182169; Luca Enriques and Sergio Gilotta, "Disclosure and Financial Market Regulation," in *The Oxford Handbook on Financial Regulation*, edited by Eilís Ferran, Niamh Moloney, and Jennifer Payne (Oxford, 2015) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2423768.

[56] Marcel Kahan, "Securities Laws and the Social Cost of 'Inaccurate' Stock Prices," Vol. 41, No. 5, *Duke Law Journal*, pp. 977-1044 (1992) http://scholarship.law.duke.edu/dlj/vol41/iss5/1/; John C. Coffee, Jr., "Market Failure and the Economic Case for a Mandatory Disclosure System," *Virginia Law Review*, Vol. 70 (1984), pp. 717-753; Joel Seligman, "The Historical Need for a Mandatory Corporate Disclosure System," Vol. 9, No. 1, *Journal of Corporation Law* (1983), p. 1, reprinted in *Selected Articles on Federal Securities Law*, F. E. Gill, Editor (American Bar Association Section of Business Law: 1991).

[57] Jeffrey Wurgler, "Financial Markets and the Allocation of Capital," *Journal of Financial Economics*, Vol. 58, No. 187 (2000), http://people.stern.nyu.edu/jwurgler/papers/capallocation.pdf; R. David Mclean, Tianyu Zhang, and Mengxin Zhao, "Why Does the Law Matter? Investor Protection and its Effects on Investment, Finance, and Growth," *The Journal of Finance*, Vol. 67, No. 1, pp. 313–350 (2012); Ronald A. Dye, "Mandatory versus Voluntary Disclosures: The Cases of Financial and Real Externalities," *The Accounting Review*, Vol. 65, No. 1 (1990), pp. 1-24; Brian J. Bushee and Christian Leuz, "Economic Consequences of SEC Disclosure Regulation: Evidence from the OTC Bulletin Board," Journal *of Accounting and Economics*, Vol. 39, No. 2 (2005), pp. 233–264 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=530963; Joseph A. Franco, "Why Antifraud Provisions Are Not Enough: The Significance of Opportunism, Candor and Signaling in the Economic Case for Mandatory Securities Disclosure." *Columbia Business Law Review*, Vol. 2002, No. 2, pp. 223-362 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=338560; Paul M. Healy & Krishna G. Palepu, "Information Asymmetry, Corporate Disclosure, and The Capital Markets: A Review of the Empirical Disclosure Literature," *Journal of Accounting and Economics*, Vol. 31, pp. 405-440 (2001) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=258514; Anat R. Admati and Paul C. Pfleiderer, "Forcing Firms to Talk: Financial Disclosure Regulation and Externalities," *Review of Financial Studies*, Vol. 13, No. 3, pp. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=103968.

[58] Christine A. Botosan, "Evidence That Greater Disclosure Lowers the Cost of Equity Capital," *Journal of Applied Corporate Finance*, Vol. 12, No. 4 (2000), pages 60-69 reprinted in *Corporate Governance at the Crossroads: A Book of Readings*, Donald H. Chew, Jr. and Stuart L. Gillan, Eds. (McGraw-Hill/Irwin: 2005); Charles P. Himmelberg, R. Glenn Hubbard and Inessa Love, "Investor Protection, Ownership, and the Cost of Capital," World Bank Policy Research Working Paper No. 2834 (2002) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=303969.

disclosure makes it easier for shareholders to monitor management[59] and (5) that disclosure makes fraud enforcement easier because evidentiary hurdles are more easily overcome.[60]

The baseline for measuring the benefits of mandatory disclosure is not zero disclosure. Firms would disclose considerable information even in the absence of legally mandated disclosure. It is, generally, in their interest to do so.[61] Even before the New Deal securities laws mandating disclosure were enacted, firms made substantial disclosures and stock exchanges required disclosure by listed firms.[62] Firms conducting private placements today make substantial disclosures notwithstanding the general absence of a legal mandate to do so.[63] The reason is fairly straightforward. In the absence of meaningful disclosure about the business and a commitment, contractual or otherwise, to provide continuing disclosure, few would invest in the business and those that did so would demand substantial compensation for the risk they were undertaking by investing in a business with inadequate disclosure.[64] Voluntary disclosure allows firms to reduce their cost of capital and, therefore, they undertake to disclose information even in the absence of a legal mandate to do so.

Mandatory disclosure laws impose costs, often very substantial costs. These costs do not increase linearly with company size. Offering costs are larger as a percentage of the amount raised for small offerings. They therefore have a disproportionate adverse impact on small firms. Moreover, the benefits of mandated disclosure are also less for small firms because the number

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[59] The interests of shareholders and management are often not coincident and may considerably conflict. Corporate managers often will operate firms as much for their own benefit as that of shareholders and shareholders may have difficulty cost-effectively preventing this. This incongruity of interest is often described as the agent-principal problem or collective action problem and is significant in larger firms where ownership and management of the firm are separate and ownership is widely held. See Michael C. Jensen and William H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure," *Journal of Financial Economics*, Vol. 3, No. 4, 1976, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=94043 also reprinted in *Economics of Corporation Law and Securities Regulation* (Aspen Publishers: 1980), Kenneth E. Scott and Richard A. Posner, Editors; Paul G. Mahoney, "Mandatory Disclosure as a Solution to Agency Problems," Vol. 62, No. 3, *University of Chicago Law Review*, pp. 1047-1112 (1995); Merritt B. Fox, "Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment," *Virginia Law Review*, Vol. 85, No. 7 (1999), pp. 1335-1419.

[60] Requiring certain written affirmative representations in public disclosure documents deters fraud because proving fraud becomes easier if the public, written representations are later found by a trier of fact to be inconsistent with the facts. Periodic reporting (such as 10-Ks, 10-Qs and 8-Ks) can help police secondary market manipulation by issuers and insiders.

[61] Roberta Romano, *The Advantage of Competitive Federalism for Securities Regulation*, (AEI Press: 2002); Paul M. Healy & Krishna G. Palepu, "Information Asymmetry, Corporate Disclosure, and The Capital Markets: A Review of the Empirical Disclosure Literature," *Journal of Accounting and Economics*, Vol. 31, pp. 405-440 (2001) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=258514.

[62] Frank Easterbrook and Daniel Fishel, *The Economic Structure of Corporate Law*, (Harvard University Press 1991); Michael J. Fishman and Kathleen M. Hagerty, "Disclosure Decisions by Firms and the Competition for Price Efficiency," *The Journal of Finance*, Vol. 44, No. 3, (1989), pp. 633-646 http://www.jstor.org/stable/pdfplus/2328774.pdf; George J. Stigler, "Public Regulation of the Securities Markets," *The Business Lawyer*, Vol. 19, No. 3 (April 1964), pp. 721-753; George J. Benston, "Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934," Vol. 63 No. 1, *American Economic Review* (March, 1973).

[63] The Regulation D safe harbor imposes certain additional requirements if the issuer sells securities under Rule 506(b) to any purchaser that is not an accredited investor. See 17 CFR §230.502(b).

[64] See, e.g., Maureen O'Hara and David Easley, "Information and the Cost of Capital," *Journal of Finance*, Vol. 59, No. 4, August, 2004 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=300715.

of investors and amount of capital at risk is less. Since the costs are disproportionately high and the benefits lower for smaller firms, disclosure should be scaled so that smaller firms incur lower costs.[65]

Disclosure also has a dark side in countries with inadequate property rights protection. In a study examining data from 70,000 firms, the World Bank has found that in developing countries mandatory disclosure is associated with significant exposure to expropriation, corruption and reduced sales growth.[66]

Nor should it be forgotten that many large businesses and large broker-dealers are quite comfortable with high levels of regulation because regulatory compliance costs constitute a barrier to entry and limit competition from smaller, potentially disruptive competitors because high compliance costs have a disproportionately negative impact on their smaller competitors.[67] Some have been quite forthright about this. Goldman Sachs CEO Lloyd Blankfein, for example, recently said:

> More intense regulatory and technology requirements have raised the barriers to entry higher than at any other time in modern history. This is an expensive business to be in, if you don't have the market share in scale. Consider the numerous business exits that have been announced by our peers as they reassessed their competitive positioning and relative returns.[68]

The securities bar, accounting firms doing compliance work and regulators all also have a strong pecuniary interest in maintaining complex rules.[69]

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[65] Craig M. Lewis, "The Future of Capital Formation," Chief Economist and Director of the Division of Economic and Risk Analysis, MIT Sloan School of Management's Center for Finance and Policy's Distinguished Speaker Series, April 15, 2014 http://www.sec.gov/News/Speech/Detail/Speech/1370541497283#.VITmIsmwU0Q; Jeff Schwartz, "The Law and Economics of Scaled Equity Market Disclosure," *Journal of Corporation Law*, Vol. 39 (2014), p. 347; C. Steven Bradford, "Transaction Exemptions in the Securities Act of 1933: An Economic Analysis," Vol. 45, *Emory Law Journal* (1996), pp. 591-671 http://digitalcommons.unl.edu/cgi/viewcontent.cgi?article=1088&context=lawfacpub. There is also strong argument that scaling should also be a function of the age of the firm, so that relatively young firms with limited compliance experience and, typically, limited cash flow and resources should have lesser disclosure requirements than more mature firms. See Table 3.3 in Susan M. Phillips and J. Richard Zecher, *The SEC and the Public Interest*, (MIT Press 1981). See also "Economic Analysis," Securities and Exchange Commission, "Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act," *Federal Register*, Vol. 79, No. 15, January 23, 2014, pp. 3972-3993 [Release Nos. 33-9497, 34-71120 and 39-2493; File No. S7-11-13] http://www.gpo.gov/fdsys/pkg/FR-2014-01-23/pdf/2013-30508.pdf.

[66] Tingting Liu, Barkat Ullah, Zuobao Wei and Lixin Colin Xu, "The Dark Side of Disclosure: Evidence of Government Expropriation from Worldwide Firms," World Bank Policy Research Working Paper 7254, May 2015 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2602586.

[67] Johan E. Eklund and Sameeksha Desai, "Entry Regulation and Persistence of Profits in Incumbent Firms," Swedish Entrepreneurship Forum Working paper 2013:25 https://entreprenorskapsforum.se/wp-content/uploads/2013/06/WP_25.pdf; Susan E. Woodward, "Regulatory Capture and the U.S. Securities and Exchange Commission," in James R. Barth, R. Dan Brumbaugh and Glenn Yago, editors, *Restructuring Regulation and Financial Institutions*, (Springer: 2001) http://www.sandhillecon.com/pdf/RegulatoryCapture.pdf; George J. Stigler, "The Theory of Economic Regulation," *The Bell Journal of Economics and Management Science*, Vol. 2, No. 1 (1971), pp. 3-21.

[68] "Regulation Is Good for Goldman," *Wall Street Journal*, February 11, 2015.

[69] See, e.g., Roberta S. Karmel, *Regulation by Prosecution: The Securities and Exchange Commission vs.*

There is no small degree of truth in the observation of Georgetown law professors Donald Langevoort and Robert Thompson that "[m]ost all of securities regulation is educated guesswork rather than rigorous cost–benefit analysis because we lack the ability to capture the full range of possible costs or benefits with anything remotely resembling precision."[70] The benefits, and to a lesser extent the costs, of mandatory disclosure are notoriously difficult to measure although the benefits are probably substantially less than commonly thought.[71] The limited empirical literature examining the issue tends to find little, and often no, net benefit.[72] As Yale Law School

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Corporate America (Simon & Schuster: 1982) at p. 18 where she states:

> The other Commissioners seemed to feel that the staff was their constituency and that by supporting staff they were necessarily acting in the public interest. …
>
> Most of my close business and personal friends are securities lawyers, and many of them are SEC alumni. I belong to a tight-knit community of interesting and decent people, whose livelihoods depend on the continued existence and vitality of the SEC.

Karmel was an SEC Commissioner from 1977-1980. For a general discussion of these issues, see Paul H. Rubin and Martin J. Bailey, "The Role of Lawyers in Changing the Law," *The Journal of Legal Studies*, Vol. 23, No. 2 (1994), pp. 807-831; Michelle J. White, "Legal Complexity and Lawyers' Benefit from Litigation," *International Review of Law and Economics* (1992) Vol. 12, No. 3, pp. 381-395 http://econweb.ucsd.edu/~miwhite/complexity.pdf.

[70] Donald C. Langevoort and Robert B. Thompson, ""Publicness" in Contemporary Securities Regulation after the JOBS Act," *Georgetown Law Journal*, Vol. 101, pp. 337-386 (2013) http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=1985&context=facpub. The lack of data available to policy makers regarding the private capital markets, compliance costs, SEC and other regulator enforcement actions and the types of securities laws violations that occur in practice is startling. Steps need to be taken to rectify this lack of data so that policy makers can make policy in something other than a largely data free environment.

[71] See "Some Limits and Drawbacks of MD," section in ; Luca Enriques and Sergio Gilotta, "Disclosure and Financial Market Regulation," in *The Oxford Handbook on Financial Regulation*, edited by Eilís Ferran, Niamh Moloney, and Jennifer Payne (Oxford, 2015) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2423768; Omri Ben-Shahar and Carl E. Schneider, "The Failure of Mandated Discourse," *University of Pennsylvania Law Review*, Vol. 159, pp. 647-749 (2011) http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=2066&context=journal_articles.

[72] Elisabeth de Fontenay, "Do the Securities Laws Matter? The Rise of the Leveraged Loan Market," *Journal of Corporation Law*, Vol. 39, No. 4, pp. 725-768 (2014) http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=5944&context=faculty_scholarship; Robert Daines and Charles M. Jones, "Truth or Consequences: Mandatory Disclosure and the Impact of the 1934 Act," Working Paper, May 2012 https://www.law.stanford.edu/publications/truth-or-consequences-mandatory-disclosure-and-the-impact-of-the-1934-act; Christian Leuz and Peter D. Wysocki, "Economic Consequences of Financial Reporting and Disclosure Regulation: A Review and Suggestions for Future Research," Working Paper http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1105398; Paul M. Healy & Krishna G. Palepu, "Information Asymmetry, Corporate Disclosure, and The Capital Markets: A Review of the Empirical Disclosure Literature," *Journal of Accounting and Economics*, Vol. 31, pp. 405-440 (2001); J. Richard Zecher, "An Economic Perspective of SEC Corporate Disclosure," Vol. 7, No. 3, *Journal of Comparative Business and Capital Market Law* (1985), pp. 307-315 http://scholarship.law.upenn.edu/jil/vol7/iss3/7/; Frank H. Easterbrook and Daniel R. Fischel, "Mandatory Disclosure and the Protection of Investors," Vol. 70, *Virginia Law Review* (1984), pp. 669-715 http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=2176&context=journal_articles; "Chapter 3. Corporate Disclosure," in Susan M. Phillips and J. Richard Zecher, *The SEC and the Public Interest*, (MIT Press: 1981); Homer Kripke, *The SEC and Corporate Disclosure: Regulation in Search of a Purpose* (Harcourt Brace Jovanovich: 1979); George J. Benson, *Corporate Financial Disclosure in the U.K. and the U.S.A.*, (Institute of Chartered Accountants: 1976); George J. Benston, "Corporate Financial Disclosure in the UK and the USA," *The Accounting Review*, Vol. 53, No. 4 (Oct., 1978), pp. 1019-1021. For two pioneering economic studies finding no measurable benefit from the Securities Act of 1933, see George J. Stigler, "Public Regulation of the Securities

Professor Roberta Romano has written, "the near total absence of measurable benefits from the federal regulatory apparatus surely undermines blind adherence to the status quo."[73]

Disclosure requirements have become so voluminous that they obfuscate rather than inform, making it more difficult for investors to find relevant information.[74] Over the past 20 years, the average number of pages in annual reports devoted to footnotes and "Management's Discussion and Analysis" has quadrupled.[75] The number of words in corporate annual 10-Ks has increased from 29,996 in 1997 to 41,911 in 2014.[76] Very few investors, whether professional or retail, are willing to wade through lengthy disclosure documents, often running hundreds of pages of dense legalese, available on the Securities and Exchange Commission (SEC) EDGAR database[77] or multitudinous state blue sky filings in the forlorn hope that they will find something material to their investment decision that is not available elsewhere in shorter, more focused, more accessible materials. Many of these more accessible materials are, of course, synopses of both the mandated disclosure documents[78] and other voluntarily disclosed information such a shareholder annual reports or materials provided to securities analysts by companies. But the fact that the vast majority of investors rely on these summary materials strongly implies that the legal requirements exceed what investors find material to their investment decisions.

The core problem with the current U.S. securities regulation system is its negative impact on small, start-up and emerging growth companies and, therefore, the adverse impact it has on entrepreneurship and the growth potential of the economy.[79] It is quite clear that existing regulations, usually imposed in the name of investor protection,[80] go beyond those necessary to

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Markets," *The Business Lawyer*, Vol. 19, No. 3 (April 1964), pp. 721-753 and George J. Benston, "Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934," Vol. 63 No. 1, *American Economic Review* (March, 1973).

[73] Roberta Romano, "Empowering Investors: A Market Approach to Securities Regulation," *Yale Law Journal*, Vol. 107, pp. 2359-2430 (1998) http://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?article=2976&context=fss_papers .

[74] Troy A. Paredes, "Blinded by the Light: Information Overload and Its Consequences for Securities Regulation," *Washington University Law Quarterly*, Vol. 81 (2003), pp. 417-485, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=413180; Commissioner Troy A. Paredes, "Remarks at The SEC Speaks in 2013," February 22, 2013 http://www.sec.gov/News/Speech/Detail/Speech/1365171492408#.Ut2WJbROmM8. See also, Keith F. Higgins, "Disclosure Effectiveness," Remarks Before the American Bar Association Business Law Section Spring Meeting, Director, Division of Corporation Finance, April 11, 2014 http://www.sec.gov/News/Speech/Detail/Speech/1370541479332#.VItSmXt4zYg.

[75] Ernst & Young, "Now is the Time to Address Disclosure Overload," No. 2012-18, June 21, 2012 http://www.lexissecuritiesmosaic.com/gateway/sec/speech/%24FILE_TothePoint_BB2367_DisclosureOverload_21June2012.pdf.

[76] Vipal Monga and Emily Chasan, "The 109,894-Word Annual Report: As Regulators Require More Disclosures, 10-Ks Reach Epic Lengths; How Much is Too Much?," *Wall Street Journal*, June 1, 2015 http://blogs.wsj.com/cfo/2015/06/02/the-109894-word-annual-report/ .

[77] The Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system http://www.sec.gov/edgar/searchedgar/webusers.htm#.U_ZaTmOC2So.

[78] Usually, the federal Forms 10-K, 10-Q or 8-K.

[79] Once the discussion is broadened to financial regulation generally speaking, other major problems also must be considered, including "too big to fail," bank regulation, federal loan guarantees, monetary policy, limited small business access to credit and the like.

[80] There are exceptions. For example, the conflict mineral disclosure requirements do nothing to "protect investors." See 17 CFR §240.13p-1; "Conflict Minerals," Final Rule, November 13, 2012

deter fraud and achieve reasonable, limited, scaled disclosure for small firms. Existing rules seriously impede the ability of entrepreneurial firms to raise the capital they need to start, to grow, to innovate and to create new products and jobs.[81]

On the other hand, the United States securities markets are the largest, deepest capital markets in the world. The U.S. stock market dwarfs the securities markets of most countries. U.S. market capitalization as a percentage of national income is greater than all major developed countries except Switzerland.[82] U.S. private capital markets are broad and deep compared to other countries.[83] This implies that the U.S. securities regulatory regime is broadly reasonable compared to those in most other countries, although other factors such as property rights protection, taxation (of both domestic and foreign investors), the legal ability or willingness of banks to undertake equity investment and the degree of corruption should also be considered.

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

Response 14: In general, no. Requiring gatekeepers reduces investor choice and autonomy and increases investor transactions costs. It reduces the efficiency of the market.

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

Response 15: No. Requiring gatekeepers reduces investor choice and autonomy and increases investor transactions costs. It reduces the efficiency of the market. However, requiring an accredited co-investor would be less damaging than requiring broker-dealer involvement.

Request for Comment 16. Should we consider a more unified approach to the exempt offering framework that focuses on the types of investors permitted to invest in the offering and the size of the offering, tailoring the additional investor protections and conditions to be applied based on

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http://www.sec.gov/rules/final/2012/34-67716.pdf. See also David R. Burton, "How Dodd–Frank Mandated Disclosures Harm, Rather than Protect, Investors," Heritage Foundation Backgrounder No. 4526, March 10, 2016 http://www.heritage.org/research/reports/2016/03/how-doddfrank-mandated-disclosures-harm-rather-than-protect-investors.

[81] For a more complete discussion of the economic importance of entrepreneurship and existing impediments to entrepreneurship, see David R. Burton, "Building an Opportunity Economy: The State of Small Business and Entrepreneurship," Testimony before the Committee on Small Business, United States House of Representatives, March 4, 2015 https://www.heritage.org/testimony/building-opportunity-economy-the-state-small-business-and-entrepreneurship .

[82] See "Global Market Cap to GNI/GDP Ratios for 28 Countries," Siblis Research, December 31, 2018 http://siblisresearch.com/data/market-cap-to-gdp-ratios/; Market Capitalization of Listed Domestic Companies (% of GDP) 1975 – 2018, World Bank http://data.worldbank.org/indicator/CM.MKT.LCAP.GD.ZS.

[83] Broad in the sense that a high number of firms participate in equity markets and deep in the sense that markets are liquid with large numbers of investors investing large amounts of capital.

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

Response 16: See discussion above under “Exempt Offerings Generally: Fundamental Reform.”

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

Response 17: In general, democratizing access to private offerings by broadening the definition of accredited investor is positive and creating barriers to investment or imposing some form of backdoor federal “merit” review via portfolio restrictions is negative. See discussion under accredited investor below and response 10 above.

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

Response 18: See discussion above under “Exempt Offerings Generally: Fundamental Reform.”

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

Response 19: I have no comment at this time.

The Accredited Investor Definition

Introduction

Although Regulation D has become the dominant means of raising capital in the United States, particularly for entrepreneurs, the vast majority of Americans are effectively prohibited from investing in Regulation D securities. Only about 10 percent of U.S. households qualify.[84] Thus, most Americans are prohibited by the securities laws from investing in the most promising, high-return (although risky) investments. Although there are strong arguments to be made that the accredited investor concept should be jettisoned entirely,[85] policymakers have shown a consistent desire to limit access to private placements to some degree. As discussed below, however, they have also shown an interest in increasing access to these investments as well.

Response to Specific Requests for Comment

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

Response 20: The monetary thresholds should be retained. The "sophisticated investor" concept currently in Regulation D should be expanded by providing a series of bright-line tests. See discussion below in response 27.

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

- Leave the current income and net worth thresholds in place, subject to investment limits;
- Create new, additional inflation-adjusted income and net worth thresholds that are not subject to investment limits;
- As recommended by the Advisory Committee on Small and Emerging Companies in 2016, index all financial thresholds for inflation on a going-forward basis;

[84] "Report on the Review of the Definition of 'Accredited Investor'," U.S. Securities and Exchange Commission, December 18, 2015, Table 4.2 https://www.sec.gov/files/review-definition-of-accredited-investor-12-18-2015.pdf.
[85] See, for example, Thaya Brook Knight, "Your Money's No Good Here: How Restrictions on Private Securities Offerings Harm Investors," Cato Institute Policy Analysis No. 833, February 9, 2018 https://www.cato.org/sites/cato.org/files/pubs/pdf/pa833.pdf.

- Permit spousal equivalents to pool their finances for purposes of qualifying as accredited investors;
- Revise the definition as it applies to entities with total assets in excess of $5 million by replacing the $5 million assets test with a $5 million investments test and including all entities rather than specifically enumerated types of entities; and
- Grandfather issuers' existing investors that are accredited investors under the current definition with respect to future offerings of their securities.

Response 21: The monetary thresholds should be retained and certainly not increased. Regulation D is a success story. Investor access to these offerings should not be reduced. Outside our large metropolitan areas, there are very few people that qualify. Entrepreneurs' access to capital in smaller cities and towns or in rural America would be dramatically reduced if the thresholds were raised.

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

- Permit individuals with a minimum amount of investments to qualify as accredited investors;
- Permit individuals with certain professional credentials to qualify as accredited investors;
- Permit individuals with experience investing in exempt offerings to qualify as accredited investors;
- Permit knowledgeable employees of private funds to qualify as accredited investors for investments in their employer's funds;
- Permit individuals who pass an accredited investor examination to qualify as accredited investors; and
- Permit individuals, after receiving disclosure about the risks, to opt into being accredited investors.

Response 22: People who are dispensing financial advice to others because they are licensed or otherwise credentialed should be treated as sophisticated/accredited investors. People who pass an exam demonstrating the requisite investment knowledge should be treated as sophisticated/accredited investors. See also response 27.

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

Response 23: In general, no, because it would require the SEC to go further down the road of regulating the portfolios of investors and introduce unwanted complexity to Regulation D. See also response 12.

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

Response 24: Expanding the definition will increase investor choice and provide greater access to high-return (but higher risk) investments. It will also increase entrepreneurs' access to capital with all of the attendant public benefits. See "The Importance of Entrepreneurial Capital Formation" above.

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

Response 25: I have no comment at this time.

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

Response 26: In general, the income thresholds in foreign countries are lower than in the United States and, to my knowledge, these lower limits have not caused problems.[86] This certainly argues against raising the limits and should cause regulators to consider lowering the U.S. income limits for determining accredited investor status.

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

[86] "Report on the Review of the Definition of 'Accredited Investor'," U.S. Securities and Exchange Commission, December 18, 2015, Table 3.2 https://www.sec.gov/files/review-definition-of-accredited-investor-12-18-2015.pdf.

appropriateness of the investment in an exempt offering on a transaction-by-transaction basis, or would it be appropriate to make the assessment looking at the investor's investment portfolio as a whole?

Response 27: Rule 506 permits up to 35 "sophisticated investors" to purchase Rule 506 offerings. The problem is that the regulatory definition of what constitutes a sophisticated investor is very amorphous. It turns on whether the investor has such "knowledge and experience in financial and business matters" that the investor "is capable of evaluating the merits and risks of the prospective investment."[87] The risk to an issuer of selling to an investor that the issuer deemed sophisticated but a court or regulator later deems to be unsophisticated is the risk having their entire offering disqualified or being subject to rescission demands by investors in subsequent litigation.[88] Accordingly, many issuers are very reluctant to rely on the sophisticated investor provisions of Regulation D. In fact, only 10 percent of offerings have any non-accredited investors and they typically account for a minor portion of the capital raised.[89]

Either the SEC or Congress should change the definition of "accredited investor" for purposes of Regulation D to include persons who have met specific statutory bright-line tests that determine whether an investor has the "knowledge and experience in financial and business matters" to be "capable of evaluating the merits and risks of the prospective investment." Specifically, the SEC or Congress should provide that someone is an accredited investor for purposes of Regulation D who has:

(1) passed a test demonstrating the requisite knowledge, such as the General Securities Representative Examination (Series 7), the Securities Analysis Examination (Series 86), or the Uniform Investment Adviser Law Examination (Series 65)[90]or a newly created accredited investor exam testing for substantive investment knowledge;

(2) met relevant educational requirements, such as an advanced degree in finance, accounting, business, or entrepreneurship; or

(3) acquired relevant professional certification, accreditation, or licensure, such as being a certified public accountant, chartered financial analyst, certified financial planner, registered representative or registered investment advisor representative.[91]

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[87] Rule 501(e) excludes all accredited investors from the calculation of the number of purchasers. Rule 506(b)(2)(ii) requires that "each purchaser who is not an accredited investor either alone or with his purchaser representative(s) has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, or the issuer reasonably believes immediately prior to making any sale that such purchaser comes within this description." The shorthand for this requirement is that they must be a "sophisticated investor."

[88] Rescission demands, of course, are only made if the investment turns out to have been a poor investment.

[89] 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, Division of Economic and Risk Analysis, July 2013 http://www.sec.gov/divisions/riskfin/whitepapers/dera-unregistered-offerings-reg-d.pdf.

[90]Financial Industry Regulatory Authority, "Series 7 Exam–General Securities Representative Examination (GS)," http://www.finra.org/industry/compliance/registration/qualificationsexams/qualifications/p011051 (accessed August 27, 2018).

[91] The Commission would have to establish a process whereby private certifications were listed. The certifying organization would petition the SEC and be required to demonstrate that its certification required those certified to have a level of knowledge comparable to the contemplated accredited investor exam or the Series 7 exam.

On November 11, 2017, the House passed the Fair Investment Opportunities for Professional Experts Act (H. R. 1585), introduced by Representative Schweikert. This legislation would codify the current income ($200,000 single; $300,000 joint) and net worth (residence exclusive $1 million) thresholds.[92] It would provide the SEC authority that it already has to deem as accredited "any natural person the Commission determines, by regulation, to have demonstrable education or job experience to qualify such person as having professional knowledge of a subject related to a particular investment, and whose education or job experience is verified by the Financial Industry Regulatory Authority."[93] Lastly, it would provide that "any *natural person* who is currently licensed or registered as a broker or investment adviser" is an accredited investor.[94] (Emphasis added.)

This last provision is a drafting error. People often refer to their "stockbroker" by which they mean the individual they speak to at the brokerage firm. However, as a matter of law, the "broker" is the firm, not an individual or "natural person" who works at the broker-dealer.[95] In 2017, there were 3,726 securities firms (brokers) that employed 630,132 registered representatives (natural persons).[96] Broker-dealers are legal entities, usually corporations or limited-liability companies. Currently, there are no natural persons who are brokers.[97] What the bill's authors undoubtedly intended is for licensed individuals who work for brokers to be treated as accredited. Those individuals are registered representatives, not brokers. There are over 13,000 investment advisers registered with the SEC. All, or virtually all, of them are firms not natural persons.[98]

The version of the Fair Investment Opportunities for Professional Experts Act introduced by Senators Tillis and Cortez Masto is better drafted than the House-passed legislation, and would increase access to private offerings to a much greater degree.[99] Like the House bill, it would codify the current income and net-worth thresholds.[100] It would, however, index them for future inflation.[101] It would treat as accredited "any natural person who is currently licensed or registered as a broker, dealer, *registered representative*, investment adviser, or *investment adviser representative*."[102] (emphasis added.) The bill does not, therefore, have the same drafting error discussed above that is contained in the House bill. It would have the effect of allowing registered representatives and investment adviser representatives who provide investment advice to others to make investments in private offerings themselves. The bill also

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[92]H.R. 1585, 115th Congress, §2(a)(2), proposed Securities Act Section 2(a)(15)(B)-(C).
[93]H.R. 1585, 115th Congress, §2(a)(2), proposed Securities Act Section 2(a)(15)(E).
[94]H.R. 1585, 115th Congress, §2(a)(2), proposed Securities Act Section 2(a)(15)(D).
[95]See Securities Exchange Act §3(a)(4)-(5) for the definition of broker and dealer.
[96]Financial Industry Regulatory Authority, "Statistics," https://www.finra.org/newsroom/statistics.
[97]U.S. Securities and Exchange Commission, "Company Information About Active Broker–Dealers," March 2007–August 2018, https://www.sec.gov/help/foiadocsbdfoiahtm.html. None of the 3,847 registered broker–dealers are natural persons.
[98]U.S. Securities and Exchange Commission, "Information About Registered Investment Advisers and Exempt Reporting Advisers," June 2006–August 2018, https://www.sec.gov/files/data/information-about-registered-investment-advisers-and-exempt-reporting-advisers/ia080118.zip. The author has not individually reviewed all 13,000 registrations, but a perusal of the list indicates that no less than 99 ½ percent of registered investment advisors are entities.
[99]S. 2756, 115th Congress.
[100]S. 2756, 115th Congress, §2(a), proposed Securities Act section 2(a)(15)(A)(ii)-(iii).
[101]S. 2756, 115th Congress, §2(a), proposed Securities Act section 2(a)(15)(A)(ii)-(iii).
[102]S. 2756, 115th Congress, §2(a), proposed Securities Act section 2(a)(15) (A)(v).

instructs the SEC to issue regulations treating as accredited any natural person that the SEC determines to have demonstrable education, job, or professional experience, sophistication or knowledge, to qualify such person as an accredited investor and sets forth criteria that the SEC should use in drafting the rule.[103] Provided the SEC adopted bright-line tests in its rule, this provision could be highly useful.

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

Response 28: I have no comments at this time.

Request for Comment 29. If an investment limit is implemented for investors considered to be accredited investors because they are advised by registered financial professionals, what should we take into consideration in setting the amount of the limit? Should the limit vary depending on the particular exemption relied on for the offering or be consistent for all exempt offerings? Should the limit vary depending on the type of issuer conducting the exempt offering (*e.g.*, whether the issuer is an operating company or a pooled investment fund, whether the issuer has a class of securities registered under the Exchange Act, or whether the issuer is subject to any on-going disclosure requirements)? Would varying limits increase complexity for issuers and investors? Should the limit be applied on a per-offering basis or some other basis? Should the limit be determined on an aggregate basis for all securities purchased in exempt offerings over the course of a year or some other time period?

Response 29: The SEC should strongly consider giving greater guidance with respect to the purchaser representative concept in Regulation D and provide bright line tests. See response 27. In general, if an investor has received sophisticated independent advice with respect to an investment, they should be treated as accredited for purposes of that investment.

[103] S. 2756, 115th Congress, §2(a), proposed Securities Act section 2(a)(15)(A)(vi)-(vii).

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

Response 30: Having bright-line safe harbors is the key to usability and aids enforcement. See responses 27 and 28.

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

Response 30: I have no comment at this time.

The Public-Private Threshold (Securities Exchange Act Section 12(g))

Response to Specific Requests for Comment

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

Response 32: The securities laws draw a distinction between public and private companies, imposing a wide variety of disclosure obligations on public companies that are not imposed on private companies. Originally, this distinction was generally a distinction between firms whose securities were traded on stock exchanges and those that were not. The Securities Acts Amendments of 1964[104] broadened the requirements to register and make periodic disclosures to any company with 500 or more shareholders of record.[105] The 2012 JOBS Act liberalized this rule by allowing a firm to have up to 2,000 accredited investors before having to register.[106]

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[104] Pubic Law No. 467, 88th Congress, 2d Session (Aug. 20, 1964). See also Richard M. Phillips and Morgan Shipman, "An Analysis of the Securities Acts Amendments of 1964," *Duke Law Journal* (1964) http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1941&context=dlj.

[105] See section 12(g) of the Securities Exchange Act. Most investors hold their stock under "street name" so that all of the stock held by various customers of a particular broker-dealer is held on the records of the company as one holder of record – the broker-dealer. In addition, many investors may combine to form and invest in a special purpose vehicle that in turn actually invests in the company. The special purpose vehicle counts as only one shareholder of record. The regulations do not require the issuer to "look-through" the special purpose vehicle investor. In addition, mutual funds, closed-end funds or private equity funds are, in effect, entities that represent the investment of many individual investors yet they too would constitute just one holder of record.

[106] In addition, under the JOBS Act, investors who bought securities pursuant to the Title III crowdfunding exemption are not counted toward the section 12(g) limit.

Thus, the distinction between public and private firms is probably best thought of as between a firm with widely held ownership (public) as opposed to closely held ownership (private).[107] Given the breadth of ownership, the aggregate value of investments made, the fact that management is a more effective producer of information than multiple outside investigators with limited access to the relevant facts absent mandatory disclosure, the agent-principle or collective action problem and various other factors, imposing greater disclosure obligations on larger, widely held firms is appropriate. It is, however, important that even the disclosure and other obligations of public companies be scaled. Compliance costs have a disproportionate adverse impact on small firms and the benefits are correspondingly less because small firms have fewer investors with less capital at risk.

It is far from clear, that the current "holder of record" method of drawing the distinction between public and private firms is the best. The number of beneficial owners, public float or market capitalization – all metrics used in connection with other securities law provisions – are probably better than the traditional shareholder of record measure.[108] The number of holders of record bears little relationship to any meaningful criteria of when disclosure should be mandated or when disclosure or other requirements should be increased. Its primary, and non-trivial, virtue is ease of administration. However, this virtue may be over-stated. For income tax purposes, broker-dealers effectively report the income and other tax attributes to first tier beneficial owners.

The Private Offerings Exemption (Regulation D)

Introduction

Regulation D is a success story. It is the leading method of raising capital in the U.S. The first rule governing policymakers in this area should be "Do No Harm." It is a success because it is a lightly regulated means of raising capital and because of the preemption of state Blue Sky registration and qualification laws with respect to Rule 506 offerings since the enactment of the National Securities Markets Improvement Act of 1996.[109] It is the primary means by which entrepreneurs raise capital.

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[107] Regulation A and crowdfunding securities are public in the sense they may be sold to all investors and the securities are not restricted securities (in the case of crowdfunding, after one year). They are not public in the sense that the issuer is not subject to the requirements of a reporting company. The term quasi-public is meant to encompass these types of companies and companies that would be in a similar situation under alternative regulatory regimes.

[108] For a discussion of these issues, see Donald C. Langevoort and Robert B. Thompson, ""Publicness" in Contemporary Securities Regulation after the JOBS Act," *Georgetown Law Journal*, Vol. 101, pp. 337-386 (2013) http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=1985&context=facpub.

[109] The National Securities Markets Improvement Act of 1996 (NSMIA) amended section 18 of the Securities Act (15 USC 77r(a)) to exempt from state securities regulation any covered security. 15 USC 77r(b)(4)(E) provides that "[a] security is a covered security with respect to a transaction that is exempt from registration under this subchapter pursuant to … commission rules or regulations issued under section 77d(2) of this title, except that this subparagraph does not prohibit a State from imposing notice filing requirements that are substantially similar to those required by rule or regulation under section 77d(2) of this title that are in effect on September 1, 1996. Section 77d(2) is the U.S. code reference to section 4(2) of the Securities Act (now section 4(a)(2)), to wit, transactions by an issuer not involving any public offering. Only Rule 506 of Regulation D relied on this provision. See "Revision

Response to Specific Requests for Comment

Request for Comment 33. Should we consider any changes to Rule 506(b) or 506(c)? Do the requirements of Rules 506(b) and 506(c) appropriately address capital formation and investor protection considerations? Alternatively, should we retain Rules 506(b) and 506(c) as they are?

Response 33: Yes. See responses 27 and 42.

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

Response 34: No. If the Commission and Congress adopt an incremental reform approach, the two should be kept separate but reformed along the lines discussed in responses 27 and 42. If a more fundamental approach is pursued, then 506(c) belongs in the quasi-public "venture" category. Analytically, 506(c) offerings are not really "private" offerings.

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

Response 35: It is quantitatively unimportant today as a matter of economic impact but it is important as a matter of principle to not entirely bar non-accredited investors from Regulation D. It should be made important by providing bright-line tests regarding sophistication. See response 27.

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

Response 36: In principle, private 506(b) and 4(a)(2) disclosure requirements should be privately negotiated. In practice, it is not my impression that the 506(b) information requirements with respect to non-accredited have caused significant problems.

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of Certain Exemptions from Registration for Transactions Involving Limited Offers of Sales," *Federal Register*, Vol. 47 (March 16, 1982), p. 11251. Rule 505 and Rule 504 rely instead on section 3(b) of the Securities Act.

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

Response 37: Adopting a rule similar to the provisions of the Helping Angels Lead Our Startups Act (the “HALOS Act”) would help entrepreneurs seeking capital to find investors. This bill passed the House in the 115th Congress.[110]

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

Response 38: In principle, private 506(b) and 4(a)(2) disclosure requirements should be privately negotiated.

Request for Comment 39. Should information requirements apply to accredited investors in offerings under either Rule 506(b) or 506(c)? If so, what type of information requirements would be appropriate? Should any such information requirements apply to all accredited investors, whether natural persons or entities?

Response 39: In principle, private 506(b) and 4(a)(2) disclosure requirements should be privately negotiated.

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

Response 40: The primary impediment to the use of Rule 506(c) is probably the income verification requirements. This was a predictable impact of the SEC rule.[111] See response 42.

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

Response 41: I know of no such data.

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[110] H.R.79, 115th Congress. In the 116th Congress it is H.R. 1909.

[111] David R. Burton, Comments on Proposed Rule "Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings," October 5, 2012 http://www.sec.gov/comments/s7-07-12/s70712-118.pdf.

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

Response 42: The primary impediment to the use of Rule 506(c) is probably the income verification requirements. The final rule created a safe harbor that inevitably, in practice, became the rule. Thus, “reasonable steps to verify” effectively means obtaining tax returns or comprehensive financial data proving net worth. Many investors are reluctant to provide such sensitive information to issuers with whom they have no relationship as the price of making an investment and, given the potential liability, accountants, lawyers and broker-dealers are unlikely to make certifications except perhaps for very large, lucrative clients. Issuers seek to avoid the compliance costs and regulatory risks.

Self-certification is permitted in the United Kingdom both for sophisticated investors and high net worth investors (income of £100,000 or more or net assets of £250,000 or more).[112] Self-certification should be allowed for all Rule 506 offerings and obtaining an investor self-certification should be deemed to constitute taking “reasonable steps to verify that purchasers of the securities are accredited investors” as required by the JOBS Act. Should policymakers choose not to adopt this approach, it would be possible to remove many of the problems associated with the SEC rule while still addressing unease that traditional self-certification (as is

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[112] See *Conduct of Business Sourcebook*, United Kingdom Financial Conduct Authority, sections 4.12.6-4.12.11, http://fshandbook.info/FS/html/handbook/COBS/4/12#DES583. A self-certified sophisticated investor is an individual who has signed, within the period of twelve months ending with the day on which the communication is made, a statement in the following terms:

"SELF-CERTIFIED SOPHISTICATED INVESTOR STATEMENT

I declare that I am a self-certified sophisticated investor for the purposes of the restriction on promotion of non-mainstream pooled investments. I understand that this means:

> (i) I can receive promotional communications made by a person who is authorised by the Financial Conduct Authority which relate to investment activity in non-mainstream pooled investments;
> (ii) the investments to which the promotions will relate may expose me to a significant risk of losing all of the property invested.

I am a self-certified sophisticated investor because at least one of the following applies:

> (a) I am a member of a network or syndicate of business angels and have been so for at least the last six months prior to the date below;
> (b) I have made more than one investment in an unlisted company in the two years prior to the date below;
> (c) I am working, or have worked in the two years prior to the date below, in a professional capacity in the private equity sector, or in the provision of finance for small and medium enterprises;
> (d) I am currently, or have been in the two years prior to the date below, a director of a company with an annual turnover of at least £1 million.

I accept that the investments to which the promotions will relate may expose me to a significant risk of losing all of the money or other property invested. I am aware that it is open to me seek advice from someone who specialises in advising on non-mainstream pooled investments.

routinely done in 506(b) offerings) is inadequate. This would be accomplished by requiring investors to make their self-certifications under penalty of perjury. This would make investors less willing to lie on their certifications to issuers since a criminal penalty for doing so would attach to their fraudulent behavior.

Section 1746 of Title 28 authorizes this approach. It reads:

> 28 USC §1746
>
> Unsworn declarations under penalty of perjury Wherever, under any law of the United States or under any rule, regulation, order, or requirement made pursuant to law, any matter is required or permitted to be supported, evidenced, established, or proved by the sworn declaration, verification, certificate, statement, oath, or affidavit, in writing of the person making the same (other than a deposition, or an oath of office, or an oath required to be taken before a specified official other than a notary public), such matter may, with like force and effect, be supported, evidenced, established, or proved by the unsworn declaration, certificate, verification, or statement, in writing of such person which is subscribed by him, as true under penalty of perjury, and dated, in substantially the following form:
>
> (1) If executed without the United States: "I declare (or certify, verify, or state) under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on (date).
> (Signature)
> (2) If executed within the United States, its territories, possessions, or commonwealths: "I declare (or certify, verify, or state) under penalty of perjury that the foregoing is true and correct. Executed on (date).
> (Signature)

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

Response 43: In the proposals I have made above, bright-line tests provide simple means of verification. A person either is or is not a Certified Public Accountant, a Registered Representative, a Certified Financial Planner, Chartered Financial Analyst and so on. They either have or do not have an advanced degree. They either passed or did not pass the accredited investor exam. They could easily prove their status and an issuer could easily verify that status.

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

Response 44: Having an exception for pre-existing substantive relationships makes sense since they would not be a problematic investor under 4(a)(2). I have no additional comment at this time.

Request for Comment 45. What other changes to Rule 506 should we consider when harmonizing our exempt offering rules? For example, should we amend Rule 503 to provide a deadline to file the Form D other than the current requirement to file the Form D no later than 15 calendar days after the first sale of securities in the offering? If so, what deadline would be more appropriate? Would a different deadline, or a deadline tied to the completion of the offering, facilitate issuers' compliance with the Form D filing requirement? What impact would any such changes have on the utility of Form D for the Commission, investors, or state securities regulators? Is the Form D information useful to investors? Should we consider any changes to the information required in Form D?

Response 45: The current system works well. Requiring a very simple closing Form D reporting the amount raised and the number of investors would help policymakers and regulators collect statistical information and better understand this important market.

The Private Offerings Exemption (Section 4(a)(2))

Response to Specific Requests for Comment

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

Response 46: This is an extremely important exemption. It is the exemption that most small businesses use and, typically, they do not even know it. Most "family and friends" businesses are closely-held and very small. They do not even think about the Commission. Most of the capital they raise is from the savings of family and friends and loans. In the absence of this provision, a few people joining together to start a bar, restaurant, retail store or service business would probably be in violation of the securities laws. While any given offering is small, there are about 700,000 new businesses started each year.[113] Assuming start-up capital of only $50,000 each on average, that would still amount to $35 billion. See discussion of Micro-Offering Exemption below.

Small Issues Exemption (Regulation A; Securities Act Section 3(b))

Introduction

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[113] Business Dynamics Statistics, Census Bureau, 2016 https://www.census.gov/programs-surveys/bds/data/data-tables/2016-firm-and-estab-release-tables.html.

The Commission had very nearly killed Regulation A.[114] In 2011, the year before the JOBS Act, only one Regulation A offering was completed.[115] Title IV of the JOBS Act gave it new life with what has come to be known as Regulation A plus. Yet the amount raised using Regulation A is a disappointment – albeit a predictable one.[116] Two Commission decisions have been the primary reason. Probably the most important reason was the Commission's decision to not preempt Blue Sky laws for Tier 1 offerings or Tier 2 secondary offerings. Tier 2 primary offerings are not subject to Blue Sky qualification requirements. This decision has meant that secondary markets have largely failed to develop, making the exemption relatively unattractive because investors have no cost-effective means of selling their investment. It has had a very substantial negative impact on Tier 1 offerings (only $61 million in 2018) and hurt Tier 2 ($675 million in 2018).[117] The fact that even relatively small offerings use Tier 2, that 2/3 of the offerings are Tier 2 and that about 90 percent of the capital is raised using Tier 2 all point to the negative impact of the Commission's decision regarding Blue Sky laws.[118] The NASAA coordinated review program is a failure and should be acknowledged as such. A secondary reason is the Commission's decision to add, on its own initiative, bureaucratic and costly rules limiting the amount an investor may invest in a Regulation A offering by income or net worth.

Response to Specific Requests for Comment

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

Response 47: If the Blue Sky preemption issues and the income or net worth limitations discussed in the introduction above were addressed, Regulation A could become a leading means for ordinary investors to invest in entrepreneurial companies. Blue Sky registration and qualification requirements for all primary and secondary offerings of any Regulation A offering should be preempted. The income and net worth limitations should be removed.

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[114] See Rutheford B Campbell, Jr., "Regulation A: Small Businesses' Search for a Moderate Capital," *Delaware Journal of Corporate Law*, Vol. 31, pp. 71-123 (2006) https://uknowledge.uky.edu/cgi/viewcontent.cgi?article=1125&context=law_facpub; Stuart R. Cohn and Gregory C. Yadley, "Capital Offense: The SEC's Continuing Failure to Address Small Business Financing Concerns," 4 *NYU Journal of Law and Business*, Vol 4, pp. 1-87 (Fall 2007) https://scholarship.law.ufl.edu/cgi/viewcontent.cgi?article=1257&context=facultypub.

[115] "Factors That May Affect Trends in Regulation A Offerings," United States Government Accountability Office, July 2012 (GAO-12-839).

[116] David R. Burton, Comments, "Proposed Rule Amendments for Small and Additional Issues Exemptions under Section 3(b) of the Securities Act," March 21, 2014 https://www.sec.gov/comments/s7-11-13/s71113-52.pdf.

[117] Concept Release, Table 2.

[118] For statistics, see Concept Release, Table 8.

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

Response 48: Increasing the threshold may make some companies that currently use registered IPOs use Regulation A and some larger private companies might as well but only if the secondary market issues are resolved.

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

Response 49: Allowing BDCs and SBICs to use Regulation A is desirable because it provides them a lower cost means of raising capital and ordinary investors a means of taking a diversified position in entrepreneurial companies.

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

Response 50: I have no comment at this time.

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

Response 51: They should be eliminated, primarily because they add considerable cost and administrative complexity but also because they constitute a type of creeping federal merit review. See discussion above in the introduction to this section and response 12.

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

Response 52: I know of no such data.

Request for Comment 53. Should we, as recommended by the 2018 Small Business Forum, permit the use of QR codes in lieu of a hyperlink to the most recent offering circular? Are there other technological solutions that we should consider, such as use of the issuer's website address, other URL addresses, or other methods or technologies that would facilitate access to such information? Should we define permissible delivery methods more broadly so as to allow subsequently developed delivery technologies that become generally accepted elsewhere in the marketplace to be used in lieu of a hyperlink to a qualified offering circular? If so, how should we define permissible delivery methods?

Response 53: I have no comment at this time.

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

Response 54: I have no comment at this time.

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

Response 55: They seem broadly reasonable.

Request for Comment 56. Should we, as recommended by the 2018 Small Business Forum, amend Regulation A to permit at-the-market offerings?

Response 56: I have no comment at this time.

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

Response 57: I have no comment at this time.

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

Response 58: Yes. Testing the waters can be important to a successful offering. In addition, I would note that moving the Commission's focus from offerings to sales would virtually eliminate this problem.

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

Response 59: I have no comment at this time.

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

Response 60: The NASAA coordinated review program is a failure and should be acknowledged as such. It introduces substantial costs and delays and key states do not participate. The Commission should review the offering. Blue Sky laws relating to qualification and registration should be preempted. And the states should get out of the business of imposing fees on entrepreneurs seeking to raise capital.

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

Response 61: Yes. Blue Sky laws relating to qualification and registration should be preempted. And the states should get out of the business of imposing fees on entrepreneurs seeking to raise capital.

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

Response 62. It would seem to me that once better secondary markets develop, Securities Exchange Act section 12(g) issues will become more important. I will provide supplemental comments on this issue.

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

Response 63: Whether an intermediary should register as a broker-dealer should be a function of whether they are acting as a broker-dealer not whether they “facilitate” a Regulation A offering.

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

Response 64: I have no comment at this time.

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

Response 65: I have no comment at this time.

Request for Comment 66. Are there any data available that show an increase or decrease in fraudulent activity in the Rule 504 market as a result of recent amendments? If so, what are the causes or explanations and what should we do to address them?

Response 66: I have no comment at this time.

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

Response 67: I have no comment at this time.

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

Response 68: I have no comment at this time.

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

Response 69: I have no comment at this time.

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

Response 70: I have no comment at this time.

<u>The Intrastate Offerings Exemption (Securities Act Section 3(a)(11))</u>

Response to Specific Requests for Comment

Request for Comment 71. To what extent are the intrastate exemptions being used? Do the requirements of the intrastate exemptions appropriately address capital formation and investor protection considerations? Are the intrastate exemptions useful to help issuers meet their capital-raising needs? We request data with respect to: (a) The use of Rule 147 and Rule 147A; (b) repeat use by the same issuers of Rule 147 or Rule 147A; (c) the use by issuers of alternative federal offering exemptions concurrently or close in time to an offer or sale under Rule 147 or Rule 147A; (d) fraud associated with, or issuer non-compliance with provisions of, Rule 147 or Rule 147A; (e) the role of intrastate broker-dealers and other intermediaries in offerings conducted pursuant to Rule 147 or Rule 147A; and (f) the application of state bad actor disqualification provisions in offerings conducted pursuant to Rule 147 or Rule 147A.

Response 71: I have no comment at this time.

Request for Comment 72. Are there any data available that show an increase or decrease in fraudulent activity in the intrastate offerings market as a result of recent amendments or the introduction of Rule 147A? If so, what are the causes or explanations and what should we do to address them?

Response 72: I have no comment at this time.

Request for Comment 73. Should we eliminate Rule 147 and retain Rule 147A? If we were to eliminate Rule 147 and Rule 504 (as described in Question 69 above), would issuers still rely on the intrastate exemption in Section 3(a)(11)?

Response 73: I have no comment at this time.

Request for Comment 74. Do the issuer requirements related to principal place of business and doing business appropriately capture the ‘‘intrastate’’ issuers for purposes of Rules 147 and 147A? If not, how should they be changed?

Response 74: I have no comment at this time.

Request for Comment 75. Does the requirement that an individual purchaser have his or her principal residence in a state or territory in order to be deemed a resident of such state or territory appropriately capture the ‘‘intrastate’’ investors for purposes of Rules 147 and 147A? What impact does this have on potential purchasers who have more than one place of residence? Would it be appropriate to revise the definition of intrastate purchasers to include those purchasers in a state who would qualify as residents under that state’s laws and regulations regarding intrastate offers and sales of securities? What input should states have in determining whether an offering is intrastate?

Response 75: I have no comment at this time.

Request for Comment 76. For a legal entity that was organized for the specific purpose of acquiring securities pursuant to Rule 147 or Rule 147A to be considered an in-state resident, all beneficial owners must be in-state residents. Do issuers face challenges in determining whether an entity was organized for the specific purpose of acquiring securities? If so, should we provide guidance on such determination?

Response 76: I have no comment at this time.

Request for Comment 77. What regulatory or legislative changes are needed to allow regional offerings that are not limited to one jurisdiction?

Response 77: I have no comment at this time.

Request for Comment 78. Should we consider any changes to either Rule 147 or Rule 147A? What effects would such changes have on capital formation and investor protection?

<u>The Crowdfunding Exemption (Securities Act Section 4(a)(6))</u>

Introduction

Firms using JOBS Act Title III crowdfunding will almost invariably be the smallest of small businesses. More established firms or those seeking more than $1 million will use Regulation D or, perhaps, Regulation A+. The core idea behind what became Title III crowdfunding was to permit very small companies to raise investment capital from a large number of people each of whom would invest small amounts via the internet with a minimum amount of regulation and expense.[119] This is analogous to the donative crowdfunding conducted on web platforms like Kickstarter.[120]

The story of the investment crowdfunding exemption is an object lesson is how a simple, constructive idea can be twisted by the Washington legislative process into a complex morass. Rep. Patrick McHenry introduced his Entrepreneur Access to Capital Act on September 14, 2011.[121] It was three pages long, less than one page if the actual legislative language were pasted into a Word document. It would have allowed issuers to raise up to $5 million and limited investors to making investments equal to the lesser of $10,000 or 10 percent of their annual income.[122] The exemption would have been self-effectuating, requiring no action by the SEC in order to be legally operative. The bill reported out of Committee and ultimately passed by the House was 14 pages long.[123] By the time the Senate was done with it, it had become 26 pages long.[124] Many of the additions were authorizations for the SEC to promulgate rules or requirements that it do so. The bill was incorporated into the JOBS Act as Title III of the Act. The Commission then piled on by adding many requirements not in the statute. FINRA's regulation of funding portals represents additional regulatory costs and another barrier to Title III crowdfunding being a success. This is far from the simple, straight-forward means of raising capital for small businesses laid out in Rep. McHenry's original bill.[125]

University of Florida Law professor Stuart Cohn put it this way:

> Is there any regulatory burden left unchecked by this supposedly favorable-to-small-business legislation? If so, Congress put icing on the cake by authorizing the SEC to make such other requirements as the Commission prescribes for the protection of investors. … Opportunity knocked, but what began as a relatively straightforward approach to assist small business capital-formation ended with a regulatory scheme laden with limitations, restrictions, obligations, transaction costs and innumerable liability concerns.[126]

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[119] For an early discussion of investment crowdfunding, see Edan Burkett, "A Crowdfunding Exemption? Online Investment Crowdfunding and U.S. Securities Regulation," *Tennessee Journal of Business Law*, Vol. 13, No. 1, pp. 63-106 63 (2011) http://trace.tennessee.edu/cgi/viewcontent.cgi?article=1235&context=transactions.
[120] https://www.kickstarter.com/.
[121] H. R. 2930, 112th Congress http://www.gpo.gov/fdsys/pkg/BILLS-112hr2930ih/pdf/BILLS-112hr2930ih.pdf.
[122] It also excluded crowdfunding investors from the holders of record count, pre-empted blue sky laws and entitled issuers to rely on investor self-certification as to income level.
[123] H. R. 2930, 112th Congress http://www.gpo.gov/fdsys/pkg/BILLS-112hr2930rh/pdf/BILLS-112hr2930rh.pdf.
[124] Senate Amendment to Title III of H.R. 3606 http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606eas/pdf/BILLS-112hr3606eas.pdf.
[125] For a different perspective, see Joan MacLeod Heminway, "How Congress Killed Investment Crowdfunding: A Tale of Political Pressure, Hasty Decisions, and Inexpert Judgments That Begs for a Happy Ending," *Kentucky Law Journal*, Vol. 102, No. 4, pp. 865-889 (2013-2014) http://law-apache.uky.edu/wordpress/wp-content/uploads/2014/07/9-Heminway.pdf (arguing that the crowdfunding statute is deeply flawed and that the SEC would do a better job than Congress). The statute is, of course, deeply flawed but here analysis assumes that the SEC would *ever* do anything about crowdfunding in the absence of a Congressional mandate. Given its history of inaction with respect to facilitating entrepreneurial capital formation, this is unlikely.
[126] Stuart R. Cohn, "The New Crowdfunding Registration Exemption: Good Idea, Bad Execution," *Florida Law Review*, Vol. 64, No. 5, pp. 1143, 1145 http://scholarship.law.ufl.edu/cgi/viewcontent.cgi?article=1032&context=flr.

The primary advantages of crowdfunding are that it enables small firms to access small investments from the broader public (i.e. from non-accredited investors) and that resale of the stock will not be restricted after one year.[127] In addition, crowdfunding shareholders are excluded from the count for purposes of the section 12(g) limitation relating to when a company must become a reporting company[128] and crowdfunding securities are treated as covered securities (i.e. blue sky registration and qualification laws are preempted for crowdfunding offerings).[129]

The history of the small issues exemption -- (pre-JOBS Act Regulation A), Regulation D Rule 504 and the previous Rule 505 -- demonstrates that overregulation can destroy the usefulness of an exemption.[130] It is simply too costly. Predictably, Title III crowdfunding is not living up to its potential.[131] It was used to raise only $55 million in 2018.[132]

Response to Specific Requests for Comment

Request for Comment 79. Do the requirements of Regulation Crowdfunding appropriately address capital formation and investor protection considerations? Do the costs associated with conducting a Regulation Crowdfunding offering dissuade issuers from relying on the exemption? If so, can we alleviate burdens in the rules or reduce costs for issuers while still providing adequate investor protection? For example, should we simplify any of the disclosure requirements for issuers in small offerings under Regulation Crowdfunding? For example, as recommended by the 2017 and 2018 Small Business Forums, for offerings under $250,000, should we limit the ongoing reporting obligations to actual investors (rather than the general public) and scale the disclosure requirements to reduce costs? Alternatively, as recommended by the 2016 Small Business Forum, should we allow issuers to provide reviewed rather than audited financial statements in subsequent offerings unless audited financial statements are available? How would such changes affect capital formation and investor protection? How would changes to the requirements affect issuer interest in the exemption and investor demand for securities offered under Regulation Crowdfunding? Would legislative changes be necessary or beneficial to make such changes?

Response 79: Requiring audited financial statements for a crowdfunding company is ludicrous. It is one of the most obvious examples of how the disclosure requirements do not fit together across exemptions. Issuers offering ten times this much (or more) need not obtain audited financials using other exemptions. But the requirement is statutory so I fail to see how the SEC can fix the problem other than seeking Congressional action. Congressional action, of course, would be welcome.

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[127] Securities Act section 4A(e).
[128] Securities Exchange Act section 12(g)(6).
[129] Securities Act section 18(b)(4)(C).
[130] "Factors That May Affect Trends in Regulation A Offerings," United States Government Accountability Office, July 2012 [GAO-12-839]; Rutheford B Campbell, Jr., “The Wreck of Regulation D: The Unintended (And Bad) Outcomes for the SEC's Crown Jewel Exemptions, The *Business Lawyer*, Vol. 66, p. 919-942, August, 2011 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1971200.
[131] David R. Burton, Comment Letter re: Crowdfunding, February 3, 2014 https://www.sec.gov/comments/s7-09-13/s70913-192.pdf.
[132] Concept Release, Table 2.

The disclosure requirements in the final rule are voluminous. There are 25 specific disclosure requirements — (a) through (y) — most of which have multipart requirements.[133] The statute is less demanding with 12 specific requirements.[134] So the SEC doubled the number of obligations that crowdfunding companies have. It should reduce them.

Companies that raise money via crowdfunding have significant ongoing-disclosure requirements as well. In furtherance of the one-sentence statutory continuing reporting requirement, the final SEC rule requires continuing reporting with respect to 12 multipart matters.[135] The bottom line is that these requirements are nearly as burdensome as those found in Regulation A. Crowdfunding companies are the smallest issuers, and it is inappropriate to impose this level of burden on the smallest companies. A better-scaled disclosure regime is needed.

The statutory income or net worth restrictions add substantial administrative cost and complexity. The tremendous costs, restrictions and risk imposed on funding portals means that it is unlikely that maintaining a funding portal will ever be a very profitable business. Broker-dealers are unlikely to show much interest in such a small market. And unless these rules are relaxed, Title III crowdfunding is unlikely to succeed.

Request for Comment 80. Should we retain Regulation Crowdfunding as it is?

Response 80: No. See response 79.

Request for Comment 81. Are there any data available that show fraudulent activity in connection with offerings under Regulation Crowdfunding? If so, what are the causes or explanations and what should we do to address them?

Response 81: I know of no such data.

Request for Comment 82. Should we increase the $1.07 million offering limit? If so, what limit is appropriate? For example, should we, as recommended by the 2017 Small Business Forum and the 2017 Treasury Report, consider increasing the offering limit to $5 million? What are the appropriate considerations for a maximum offering size? Should additional investor protections and/or disclosure requirements depend on the size of the offering? If the individual investment limits are preserved as they currently exist, will there be adequate investor demand to justify an increase in the offering limit, or would an increase in the individual investment limits also be required? Would legislative changes be necessary or beneficial to increase the offering limit?

Response 82: Few firms have proven willing to deal with the costs and obligations of Regulation CF to raise under a million dollars. Raising it to $5 million might make some firms that currently use Regulation A reevaluate Regulation CF. But crowdfunding was conceived as a way to help the smallest businesses raise small amounts of money from a large number of people over the internet. We should return to that idea rather than create Regulation A's close cousin. Running

[133] §227.201.
[134] Securities Act, Section 4A(b)(1).
[135] §227.202

two very similar exemptions (Regulation A Tier 1 and Regulation CF with a $5 million limit) does not really make a lot of sense.

Request for Comment 83. If we were to increase the offering limit, would Regulation Crowdfunding overlap with Rule 504 of Regulation D or with Regulation A? If there is overlap, should we still retain the overlapping exemptions? How could we rationalize and streamline these offering exemptions?

Response 83: Yes, it would overlap with Regulation A. See response 82.

Request for Comment 84. Should we modify the eligibility requirements for issuers or securities offered under Regulation Crowdfunding? Should we extend the eligibility for Regulation Crowdfunding to Canadian issuers or all foreign issuers? Should the eligibility requirements for Regulation Crowdfunding mirror the Regulation A eligibility requirements? For example, should we exclude issuers subject to a Section 12(j) order? Should we amend the types of securities eligible under Regulation Crowdfunding? Should we extend the eligibility for Regulation Crowdfunding to issuers subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act? Are there other eligibility limitations we should consider? Would legislative changes be necessary or beneficial to make such changes?

Response 84: I have no comments at this time.

Request for Comment 85. Should we, as recommended by prior Small Business Forums, permit issuers to offer securities through SPVs under Regulation Crowdfunding? If so, are there additional requirements that would be appropriate to ensure investor protection? Would legislative changes be necessary or beneficial to make such changes? Are there other ways we should modify our regulations to allow investors to invest in pooled crowdfunding vehicles that are advised by a registered investment adviser?

Response 85: Yes. Some issuers, and for that matter, some investors may find SPVs to be attractive. Issuers would benefit from having to deal with only one lead investors. Investors may find it attractive to allow a lead investor to monitor and deal with the company and may trust the lead investor’s judgment and expertise.

Request for Comment 86. Should we revise the rules that require issuers to provide reviewed or audited financial statements? If so, how? At what level should issuers be required to provide reviewed or audited financial statements? For example, if we were to increase the offering limit, should reviewed financial statements only be required for offerings over $1 million and audited financial statements only be required for offerings over another higher limit, such as the Regulation A Tier 1 limit? Would legislative changes be necessary or beneficial to make such changes?

Response 86: Yes, but. Requiring audited financial statements for a crowdfunding company is ludicrous. It is one of the most obvious examples of how the disclosure requirements do not fit together across exemptions. Issuers offering ten times this much (or more) need not obtain audited financials using other exemptions. But the requirement is statutory so I fail to see how the SEC can fix the problem other than seeking Congressional action. Congressional action, of course, would be welcome. In fact, Congress should rewrite Title III.

The SEC could, of course, use its general exemptive authority to create a whole new streamlined crowdfunding exemption and let Title III crowdfunding die on the proverbial vine. This probably would probably be best accomplished by having a lightly regulated tier in Regulation A.

Request for Comment 87. As generally recommended by the 2015, 2017, and 2018 Small Business Forums and the 2017 Treasury Report, should we eliminate, increase, or otherwise amend the individual investment limits? If we should change the investment limits, what limits are appropriate and why? Should we require verification of income or net worth for larger investments, such as $25,000 and higher? Should certain investors be subject to higher limits or exempt from the limits altogether? For example, should accredited investors be exempt from the investment limits or should accredited investors be subject to higher limits? If accredited investors are subject to higher investment limits or exempt from investment limits, should we require verification of accredited investor status? Should we make changes to rationalize the investment limits for entities by entity type, not income? If investment limits are raised to allow an offering to be successful with fewer investors, would such a change have an effect on the use of the exemption? Would legislative changes be necessary or beneficial to make such changes?

Response 87: The investment limits should be eliminated but that would require Congressional action. Accredited investors should not be subject to them. They can invest in Regulation D offerings with much less mandated disclosure.

Request for Comment 88. As generally recommended by the 2016 and 2017 Small Business Forums, should we allow issuers to test the waters or engage in general solicitation and advertising prior to filing a Form C? If so, should we impose any limitations on such communications to ensure adequate investor protection? Would legislative changes be necessary or beneficial to make such changes?

Response 88: Yes, issuers should be able to test the waters.

Request for Comment 89. As recommended by the 2018 Small Business Forum, should we allow for more communication about the offering outside of the funding portal’s platform channels? If so, what would be the benefits of allowing more communications? Would there be investor protection concerns? Are there limitations we should impose on those communications?

Response 89: I have no comments at this time.

Request for Comment 90. Should the Section 12(g) exemption for securities issued in reliance on Regulation Crowdfunding be modified? For example, should it be revised to follow the Section 12(g) exemption for Regulation A Tier 2 securities?

Response 90: I plan to provide supplemental comments with respect to section 12(g) issues.

Request for Comment 91. Do the costs associated with facilitating offerings under Regulation Crowdfunding or operating as a Crowdfunding intermediary dissuade intermediaries from facilitating offerings under the exemption? If so, should we modify the requirements to alleviate burdens or reduce costs for crowdfunding intermediaries while still providing adequate investor protection? If so, which ones and how? Should we modify any of the requirements regarding crowdfunding intermediaries to better meet the needs of issuers and investors? If so, which ones and how? For example, as recommended by the 2017 and 2018 Small Business Forums, should we allow intermediaries:

> • To receive as compensation securities of the issuer having different terms than the securities of the issuer received by investors in the offering; or
> • To co-invest in the offerings they facilitate? In addition, as recommended by the 2018 Small Business Forum, should we clarify the ability of funding portals to participate in Regulation A and Rule 506 offerings? Would legislative changes be necessary or beneficial to make such changes?

Response 91: Intermediaries need to be able to make money or they will leave the business. Currently the costs and risks are too high. One of the notable risks is that the SEC final rule treats funding portals as issuers, turning the funding portals into insurers of issuers against fraud by issuers that use their funding portal. This dramatically increases the risk that funding portals face and makes funding portals a much less viable alternative to a broker-dealer. Funding portals are intermediaries not issuers. Funding portals should only be liable for fraud or misrepresentation if they participated in the fraud or were negligent in discharging their due diligence obligations.

Request for Comment 92. To the extent not already addressed in the questions above, would legislative changes be necessary or beneficial to address any recommended changes to Regulation Crowdfunding? Alternatively, should we consider using our exemptive authority under Section 28 of the Securities Act to adopt an alternative exemption for crowdfunding offerings to complement Section 4(a)(6)? If so, how should we structure the exemption to facilitate capital formation while still ensuring adequate investor protection? Is there anything else we should do to reduce the accounting, legal, and other inelastic costs associated with Regulation Crowdfunding?

Response 92: The Senate amendment to Title III of the JOBS Act made a mess of it. But the Commission has made it worse by piling additional requirements on crowdfunding issuers and funding portals. The Commission can take steps to improve Title III crowdfunding by revising Regulation CF. That would help but statutory changes are almost certainly necessary if crowdfunding is to be a success.

With respect to use its section 28 exemptive authority, it may make sense to write a new, streamlined crowdfunding exemption but another approach would be to create a lightly regulated tier in Regulation A.

<u>Micro-Offering Exemption</u>

Introduction

Section 4(a)(2) of the Securities Act exempts "transactions by an issuer not involving any public offering." There is no definition of a public offering or, conversely, of what is not a public offering (that is, a private placement) in the Securities Act or, for that matter, in the securities regulations. Thus, in principle, a few guys forming a small little business (such as a local restaurant) who are a little too public in seeking investors (for example, telling a local reporter about their plans when they run into him at the local high school football game, or standing up at the local Rotary Club meeting seeking partners) can run afoul of the securities laws.[136]

In this hyper-litigious country, and given the potentially catastrophic impact that unjust enforcement of the law would entail, it is appropriate to create a bright-line safe harbor for very small offerings. If you are raising a small amount of money from a few people most of whom you know already, you should not have to hire a securities lawyer, do a private placement offering memorandum, and file a Form D or otherwise risk being pursued by federal or state regulators, or more likely, being successfully sued by disgruntled investors if the business fails or does not have the hoped for returns.

The Commission should adopt a rule or Congress should amend the Securities Act to create a safe harbor so that any offering (within a 12-month period),

1. Exclusively to people with whom the issuer (or its officers, directors, or 10 percent or more shareholders) has a substantial pre-existing relationship; or
2. involving 35 or fewer other persons; or
3. of less than $500,000,

is deemed not to involve a public offering for purposes of Securities Act section 4(a)(2).[137] The exemption would be self-effectuating.

We do not want to rope every business in the country into the securities laws. Some businesses are private enough, closely held enough and small enough that, absent fraud, the SEC simply should not be involved. That should be the point of this exemption. And there should be bright lines that non-specialists can read and be sure that these businesses are okay.

Response to Specific Requests for Comment

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[136] Assuming they do not have a substantial pre-existing relationship with everyone in the room. Now, if they comply with the investor verification procedures and make a compliant Rule 506(c) offering (by selling only to accredited investors), they could perhaps save their situation. The odds are, however, they will not even have heard of Rule 506 and not have the vaguest idea that their actions would be a violation of the securities laws. Getting a small investment from Uncle Fred who lives in the next state would mean than even the intrastate exemption would be unavailable.

[137] The original version of the Micro Offering Safe Harbor Act (H.R. 4850, 114th Cong.) would accomplish this objective by creating a separate exemption (rather than a safe harbor under section 4(a)(2). The version reported out of committee and passed by the House (as Title II of the Accelerating Access to Capital Act of 2016 (H.R. 2357)) is much narrower and imposes various conditions on the exemption

Request for Comment 93. Should we add a micro-offering or micro-loan exemption? If so, please describe the parameters of such a potential exemption. In suggesting parameters, consider how the small offering size should affect the potential requirements.

Response 93: Yes. A safe harbor should be created such that an offering is deemed not to involve a public offering within the meaning of Securities Act section 4(a)(2) if, within a 12-month period, the offering:

1. is made exclusively to people with whom the issuer (or its officers, directors, or 10 percent or more shareholders) has a substantial pre-existing relationship; or
2. is made to 35 or fewer other persons; or
3. involves sales of less than $500,000.

The exemption would be self-effectuating. It could be a separate exemption but a safe harbor within 4(a)(2) is easier since it means that the generally sound rules governing private securities would control.

Request for Comment 94. Should there be limits on the types of securities that may be offered under such an exemption? For example, should the exemption be limited to debt securities? Are there inherent differences in debt offerings, such as the general liquidation preference of debt holders, which would protect investors in these types of offerings? Does the inclusion of equity or other types of securities in this type of offering raise concerns for investors or does it expand investor options in a way that would benefit them?

Response 94: The exemption should apply to debt and equity. The securities would be unregistered, not “covered securities” and therefore restricted.

Request for Comment 95. What would be the appropriate aggregate offering limit for such an exemption? For example, would $250,000 or $500,000 in a 12-month period be appropriate? Would another limit be appropriate? What are the appropriate considerations for the offering limit?

Response 95: $500,000. To get a simple, one establishment restaurant, store or other business off the ground with some working capital, that is what it will often take.

Request for Comment 96. What type of investor protections should be required? For example, should investors be limited on how much they can invest in any one offering? If so, what should the limit be? Are there other protections we should consider? Should there be investor requirements, such as a financial sophistication requirement?

Response 96: If any of these suggestions are adopted, the exemption will be close to useless. If securities counsel (as opposed to a generalist business lawyer) needs to be retained, it will be close to useless. This has to be a self-effectuating non-bureaucratic exemption for the smallest, typically unsophisticated businesses in the country. Some businesses are private enough, closely held enough and small enough that, absent fraud, the SEC simply should not be involved.

Request for Comment 97. Should the issuer be prohibited from engaging in general solicitation or advertising to market the securities?

Response 97: This is an interesting question. General solicitation is the *sine qua non* of a "public" offering in the sense that most people would understand the term and the authors of the Securities Act probably meant the term.[138] The issues raised are really the same as with Rule 506(b). In general, the answer is no, general solicitation or advertising should not be permitted. But going to an angel group meeting to make a pitch or standing up at a local Chamber of Commerce meeting and mentioning that you are seeking capital to launch a new venture should not obviate the exemption. As mentioned briefly above, these rules need to be improved.

Ideally, the Commission would move the line on what constitute general solicitation for purposes of Rule 506 and a contemplated micro-offering exemption so that meetings with angels or organizations of which you are a member or even a blog on a web site are not general solicitation. Then general solicitation could be barred without causing practical difficulties in the real world of small business. If the Commission does not take this step, then I would recommend that general solicitation not be explicitly barred and that as long as one of the three tests is met, the exemption would obtain.

Request for Comment 98. Should there be disclosure requirements or notice filing requirements?

Response 98: No. See response 96.

Request for Comment 99. Should we require the offering to take place through a registered intermediary, such as broker-dealer or funding portal?

Response 99: Absolutely not. See response 96.

Request for Comment 100. Should the securities issued under the exemption contain resale restrictions? If so, what resale restrictions are appropriate? Should the securities be deemed ‘‘restricted securities’’ under Rule 144(a)(3) (similar to securities acquired from the issuer that are subject to the resale limitations of Rule 502(d)) or have a 12-month resale restriction (similar to Regulation Crowdfunding)?

Response 100: They should be restricted securities subject to same rules as securities sold under 4(a)(2).

Request for Comment 101. Should the securities sold in the transaction be considered a ‘‘covered security’’ such that the issuer would not be required to register or qualify the offering with state securities regulators?

Response 101: No.

[138] *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953), of course, puts a very different "fend for yourself" complexion on the meaning of "public."

Request for Comment 102. Should there be issuer eligibility requirements, such as bad actor disqualification provisions or exclusion of investment companies or non-U.S. issuers?

Response 102: Excluding investment companies or non-U.S. issuers would be fine. The general state and federal anti-fraud laws would and should apply. That should be sufficient but a properly drafted bad actor disqualification provisions should do no harm.

Request for Comment 103. Are there other perceived gaps in the current exempt offering framework that we should address? If so, why are the existing exemptions from registration inadequate? For example, are the existing exemptions unavailable due to the nature of the securities being offered or characteristics of the issuer? Or are the existing exemptions not feasible or attractive to issuers due to compliance costs or similar concerns? Are regulatory changes needed in light of the geographic concentration of certain types of offerings?

Response 103: I have no additional comments at this time.

Integration

Response to Specific Requests for Comment

Request for Comment 104. Should we articulate one integration doctrine that would apply to all exempt offerings? If so, what should that integration doctrine be? For example, should we articulate that two or more exemptions, or an exemption and a registered offering, will not be deemed to be part of the same offering if the issuer is able to satisfy the requirements of the exemption(s) at the time of sale? If so, should we still aggregate the total number of nonaccredited investors for purposes of multiple Rule 506(b) offerings that occur less than six months apart? Would one consistent integration doctrine make it easier for issuers to transition from one exemption to another and, ultimately, to a registered offering? Would there be any investor protection concerns if we were to articulate one integration doctrine for all exempt offerings?

Response 104: These issues are important. The present state of the law is not satisfactory. I intend to provide supplementary comments regarding integration.

Request for Comment 105. Throughout the Securities Act rules, where a safe harbor does not apply, should we replace the five-factor test with the new analysis articulated in connection with Regulation A and Rules 147 and 147A (*i.e.*, whether each offering complies with the requirements of the exemption that is being relied on for the particular offering), consistent with the 2016, 2017, and 2018 Small Business Forum recommendations? Are there other integration analyses that we should consider? Should we consider whether other categories of transactions clearly do not need to be integrated into other offerings, similar to the treatment of offerings conducted in accordance with Regulation S, Rule 144A, and Rule 701?

Response 105: I have no comment at this time.

Request for Comment 106. Should we shorten the six-month integration safe harbor in Rule 502(a) of Regulation D? If so, what time period is appropriate? 90 days? 30 days? What are the appropriate considerations for an alternate time period?

Response 106: I have no comment at this time.

Request for Comment 107. Consistent with Regulation A and Rules 147 and 147A, for issuers relying on an exemption that permits general solicitation and advertising, such as the exemption under Rule 506(c), should we provide an integration safe harbor for offers and sales of securities prior to the commencement of that offering?

Response 107: I have no comment at this time.

Request for Comment 108. Should we specifically revise Rule 152 to clarify that offers and sales that do not involve any form of general solicitation or advertising prior to the completion of those transactions would not be integrated with subsequent offers and sales of securities that involve general solicitation or advertising? Consistent with the 2016, 2017, and 2018 Small Business Forum recommendations, should we revise Rule 152 to provide an integration safe harbor for an issuer that conducts a Rule 506(c) offering and then subsequently engages in a registered public offering?

Response 108: I have no comment at this time.

Request for Comment 109. Should we revise Rule 155? For example, should we define a private offering as an exempt offering that does not involve any form of general solicitation or advertising? In addition, should we expand Rule 155(c) to include an abandoned offering that involved general solicitation followed by a private offering?

Response 109: I have no comment at this time.

Request for Comment 110. Should we consider other integration safe harbors? If so, please describe the parameters of such potential safe harbors. For example, as recommended by the 2015 Small Business Forum, should we provide additional guidance about concurrent offerings under Regulation Crowdfunding and Rule 506(c)? If so, should we provide guidance regarding issues that may arise when an intermediary seeks to host concurrent offerings? Conversely, should we eliminate any of the existing integration safe harbors? How would such changes affect capital formation and investor protection?

Response 110: I have no comment at this time.

Pooled Investment Funds

Response to Specific Requests for Comment

Request for Comment 111. To what extent do issuers view pooled investment funds as an important source of capital for exempt offerings? Do certain types of pooled investment funds facilitate capital formation more efficiently than others? For example, do private equity and venture capital funds provide more capital to issuers than registered investment companies and BDCs? From an issuer's perspective, are there benefits to raising capital from a pooled investment fund rather than from individual investors?

Response 111: I have no comment at this time.

Request for Comment 112. For small issuers, particularly those that seek to raise capital in micro-offerings, to what extent are angel funds an important source of capital?

Response 112: Angel *investors* are a critical source of capital, particularly for the smallest start-up companies. I have no information on the scale or important of angel *funds*.

Request for Comment 113. How have recent market trends affected retail investor access to growth-stage issuers that do not seek to raise capital in the public markets? To the extent that issuers are more likely to seek capital through exempt offerings, do existing regulations make investor access to this market through a pooled investment vehicle difficult?

Response 113: As discussed above, the accredited investor definition radically limits access to private markets for ordinary Americans. The regulatory impediments to the use of Regulation A and crowdfunding has a similar impact. Steps to improve the regulatory environment for pooled investments in entrepreneurial companies so that ordinary investors could take a diversified position in such companies would be welcome.

Request for Comment 114. Are there any regulatory provisions or practices, including those promulgated or engaged in by the Commission, that discourage or have the effect of discouraging participation by registered investment companies and BDCs in exempt offerings? For closed end funds and BDCs, are there any existing regulatory provisions or practices that discourage the introduction of investment products that focus on issuers seeking capital at key stages of their growth cycle? If so, how do these regulatory provisions or practices create barriers?

Response 114: I have no comments at this time.

Request for Comment 115. What restrictions should there be, if any, on the ability of closed-end funds, including BDCs, to invest in private funds, including private equity funds and hedge funds, and to offer their shares to retail investors? For example, should there be a maximum percentage of assets that closed-end funds and BDCs can invest in private funds? Should such closed-end funds be required to diversify their investments across a minimum number of private funds, if they are not restricting their offerings to accredited investors?

Response 115: Since closed end funds need not liquidate their positions when an investor in the fund sells his investment, there is no need to limit these funds exposure to private offerings.

Request for Comment 116. Should we consider making any changes to our rules regarding interval funds? If so, what types of changes? Should we modify the periodic intervals from the current three, six, or twelve months? Should a fund have flexibility to determine the length of its periodic interval? If so, should there be a maximum permitted periodic interval? Should we create a mechanism for investors to vote to determine the periodic interval? Should we amend or eliminate the minimum and/or maximum repurchase offer amount?

Response 116: I have no comments at this time.

Request for Comment 117. Should we shorten the minimum time at which an interval fund and other eligible funds can make a discretionary repurchase offer from the current period of two years after its last discretionary repurchase offer? 583 Should we amend the conditions under which a majority of the interval fund’s directors, including a majority of the fund’s directors who are not interested persons of the fund, can suspend or postpone a repurchase offer? 584 Should we allow interval funds to have more flexibility before a repurchase offer must commence, such as a five-year investment period with periodic repurchase offers thereafter? 585

Response 117: I have no comments at this time.

Request for Comment 118. Should we make any modifications as to which elements of an interval fund’s repurchase policy should be fundamental and changeable only by a majority vote of the outstanding voting securities? 586 What elements of a repurchase policy should be determined by a majority of the board or a majority of the non-interested directors? If the periods between repurchase offers become longer or less predictable, what measures, if any, should we take to facilitate sales of interval funds shares on the secondary market for investors who may need liquidity? If we were to permit interval funds to engage in repurchase offers less frequently and/or with less predictability than under our current rule, should we limit the purchase of such interval funds to sophisticated investors such as accredited investors or qualified purchasers?

Response 118: I have no comments at this time.

Request for Comment 119. Are there other measures that can be taken to decrease the compliance costs associated with the interval fund structure? Are there any changes that we should make to our rules to increase the efficiency of the repurchase offer notification and tender process, such as facilitating electronic or other notification? Should we have rules that permit interval funds to have multiple share classes? 587 Should we have rules that permit interval funds to utilize the series and trust structure used by openend funds to set up new interval funds? Would a series and trust structure make it easier to establish follow-on funds for new investments, rather than for the original fund to remain in a continuous offering?

Response 119: I have no comments at this time.

Request for Comment 120. Should we provide a transitory exemption from the diversification requirements in Section 5(b)(1) of the Investment Company Act during the initial stages of an interval fund so that the advisor has sufficient time to identify and invest in appropriate portfolio companies? 588 If so, would two years be a sufficient duration? Would similar changes need to be implemented to the diversification requirements under subchapter M of the Internal Revenue Code in order to make any changes under the Investment Company Act meaningful? To the extent an interval fund pursues a private equity or venture capital strategy that may result in the control of a portfolio company, what types of relief under the Investment Company Act, if any, should be provided for affiliated transactions and subject to what conditions? Would an interval fund need other types of relief and, if so, what conditions should apply?

Response 120: I have no comments at this time.

Request for Comment 121. Should we consider making any changes to our rules regarding tender offer funds? If so, what type of changes? To what extent would any changes to the interval fund rule lessen the need for tender offer funds? Should we permit tender offer funds to use the conditions described in Rule 23c3– 3(c) 589 in place of the Exchange Act tender offer rules, if investors in those tender offer funds are limited to accredited investors or qualified purchasers?

Response 121: I have no comments at this time.

Request for Comment 122. If a target date retirement fund were to seek a limited amount of exposure to exempt offerings in its portfolio, what measures, if any, should we consider taking to enable this? Similarly, if investment advisory services, including robo-advisers, that are focused on retirement savings seek to include a limited amount of exposure to securities from exempt offerings as part of a diversified retirement portfolio that they recommend to retail investors, should we consider making any changes to our rules to enable this? If so, what types of changes?

Response 122: I have no comments at this time.

Request for Comment 123. How do the restrictions on performance fees under the Advisers Act affect the offering of venture strategies by registered investment companies and BDCs? Should we make changes to the restrictions on performance fees?

Response 123: I have no comments at this time.

Request for Comment 124. What changes, if any, should be made to the regulatory regime with respect to SBICs and/or RBICs?

Response 124: I intend to file supplementary comments on these issues.

Request for Comment 125. Certain pooled investment funds, such as registered investment companies, BDCs, and SBICs, specifically qualify as accredited investors without satisfying any quantitative criteria such as a total assets or investments threshold. Should other types of pooled investment funds be similarly treated? For example, should we include Section 3(c)(7) funds? Should we include any venture capital fund as defined by Rule 203(l)– 1 under the Advisers Act? Should we include any qualifying venture capital fund, as recently added by the Economic Growth Act? Should we include RBICs?

Response 125: I have no comments at this time.

Request for Comment 126. The definition of ‘‘qualified client’’ under the Advisers Act specifically includes a ‘‘qualified purchaser’’ as defined by the Investment Company Act. Should we similarly define an ‘‘accredited investor’’ under Regulation D to specifically include a ‘‘qualified purchaser’’? Would that be a less costly approach for regulating offerings of Section 3(c)(7) funds?

Response 126: I have no comments at this time.

Request for Comment 127. The rules implementing the accredited investor and qualified client definitions have provisions for periodic reassessment of the quantitative thresholds, but the qualified purchaser definition does not. Should we consider a similar periodic reassessment for the qualified purchaser definition? If so, should the periodic reassessment for the three definitions occur at the same time?

Response 127: I have no comments at this time.

Request for Comment 128. Does the issue of secondary market liquidity have a significant effect on investors' decision-making with respect to whether to invest in pooled investment vehicles, particularly with respect to closed-end funds and BDCs?

Response 128: Secondary market liquidity has a pronounced impact on the attractiveness of an investment.

Request for Comment 129. Should we consider any changes to our rules to encourage the establishment or improvement of secondary trading opportunities for closed-end funds or BDCs? If so, what changes should we consider?

Response 129: I intend to file supplementary comments on these issues.

<u>Secondary Markets</u>

Response to Specific Requests for Comment

Request for Comment 130. Do concerns about secondary market liquidity have a significant effect on issuers' decision-making with respect to primary capital-raising options? Does secondary market liquidity affect the decision-making of individual investors? In considering which exemption may be best suited to a particular offering, do issuers take into account whether the securities issued in the transaction will be restricted securities and/or subject to other resale restrictions?

Response 130: The ability to sell shares in a secondary market is critical to investors (i.e. having an exit strategy). The lack of such a market makes an investment notably less attractive. Thus, the issuer will find it harder to sell to investors if such a market does not exist or is not likely to develop. Ergo, creating strong secondary markets for shares sold pursuant to the various exemptions is critical to fostering entrepreneurial capital formation.

Request for Comment 131. Issuers that are not currently subject to Exchange Act registration may prefer that their securities have restrictions on resale, due to concerns that trading in the securities could lead to a high number of record holders, which could trigger Section 12(g) registration. What effect would an exemption from Section 12(g) registration for certain exempt offerings, if introduced, extended, or made permanent, have on issuers' access to capital or secondary market liquidity? For example, should we, as recommended by the 2014 Small Business Forum, exempt purchasers and transferees of securities issued pursuant to Regulation A from the calculation of the number of registered holders under Section 12(g)? Would these types of changes provide benefits that could outweigh a decline in the rate at which issuers may become reporting companies?

Response 131: I plan to file supplemental comments on section 12(g) issues.

Request for Comment 132. Should we revise the Rule 144 non-exclusive safe harbor? If so, how should we revise Rule 144? For example, should we, as recommended by the 2012 and 2016 Small Business Forums, reduce the Rule 144 holding period for securities of issuers meeting the current public information requirement from six months to three months? Should we, as recommended by the 2012 Small Business Forum, reduce the Rule 144 holding period for securities of issuers not subject to the current information requirements from 12 months to six months?

Response 132: I have no comment at this time.

Request for Comment 133. Should we, as recommended by the Advisory Committee on Small and Emerging Companies and the 2013, 2014, and 2015 Small Business Forums, expand the safe harbors for secondary sales under Section 4(a)(1) for security holders that are not able to rely on Rule 144? If so, please describe the parameters of such potential safe harbors. How would the adoption of such additional safe harbors under Section 4(a)(1) affect capital formation, investor protection, and current market practices?

Response 133: I intend to provide supplemental comments on this issue.

Request for Comment 134. Investors who purchase in secondary transactions may not have access to current information about the issuer and its securities. Particularly if we expand the population of investors who may qualify as accredited investors, should we impose some type of issuer disclosure requirement in connection with resales? If so, should we consider a requirement similar to that required by Section 4(a)(7) or one similar to the manual exemption available in many states? What alternatives should we consider?

Response 134: I intend to provide supplemental comments on this issue.

Request for Comment 135. Are market participants using the Section 4(a)(7) resale exemption? We request data with respect to the use of the Section 4(a)(7) exemption.

Response 134: I have no comment at this time.

Request for Comment 136. In addition to Section 4(a)(7), secondary sales of securities may rely on other resale exemptions, such as those contained in Section 4(a)(1) and the related safe harbors under Rule 144 and Rule 144A, Section 4(a)(3), and Section 4(a)(4). Would additional resale exemptions or safe harbors be appropriate? If so, what other resale transactions should be exempt from the provisions of Section 5?

Response 136: I intend to provide supplemental comments on this issue.

Request for Comment 137. Should we extend federal preemption to additional offers and sales of securities, for example, by expanding the definition of ‘‘qualified purchaser’’? For example, should we preempt state securities registration or other requirements applicable to secondary sales of securities:

- Offered or sold pursuant to Section 4(a)(1) or 4(a)(3), if the issuer of such security is a Tier 2 Regulation A issuer and remains current in its ongoing reporting required under the rules, as recommended by the 2014 and 2015 Small Business Forums;
- Initially issued in a Tier 2 Regulation A offering, as recommended by the 2014–2018 Small Business Forums and the 2017 Treasury Report; or
- Initially issued in an offering registered under the Securities Act, as recommended by the 2015 Small Business Forum?

Response 137: As discussed above, Blue Sky laws with respect to secondary sales of Regulation A securities should be preempted. Doing so is critical to the develop of a strong secondary market and enabling ordinary investors to get fair value for their investment when resold.

Request for Comment 138. What other steps should we consider to improve secondary trading liquidity of securities exempt from registration? For example, should we consider permitting securities that were exempt from registration to trade on venture exchanges? If so, how should we define a venture exchange and under what circumstances should we permit trading on the venture exchange? Will allowing such securities to trade on venture exchanges prior to being fully seasoned have an effect on companies issuing such securities through exempt offerings? If so, what effect?

Response 138: In the current regime, smaller reporting companies' shares and Regulation A securities should be tradeable on an ATS or properly constituted venture exchange. In a more fundamental reformed regime, quasi-public or venture securities would trade on an ATS or venture exchange.[139]

Sincerely,

David R. Burton
Senior Fellow in Economic Policy
The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002

[redacted]

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[139] David R. Burton, "Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens: Venture Exchanges" Testimony before the Capital Markets and Government Sponsored Enterprises Subcommittee of the Committee on Financial Services, United States House of Representatives, May 13, 2015 https://financialservices.house.gov/uploadedfiles/05.13.2015_david_r._burton_testimony.pdf.