NASAA

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April 14, 2017

The Honorable Mike Crapo
Chairman
Senate Committee on Banking, Housing & Urban Affairs
534 Dirksen Senate Office Building
Washington DC 20510

The Honorable Sherrod Brown
Ranking Member
Senate Committee on Banking, Housing & Urban Affairs
534 Dirksen Senate Office Building
Washington DC 20510

Re: Request for Proposals to Foster Economic Growth

Dear Chairman Crapo and Ranking Member Brown:

On behalf of the North American Securities Administrators Association (NASAA),[1] I am pleased to submit the following three proposals to the Committee's attention. These proposals, if enacted, will strengthen investor confidence leading to economic growth that creates jobs and builds wealth for Americans.

1. Proposal to promote economic growth and increase economic efficiency by improving oversight of and transparency regarding the offering and sale of securities exempted from registration requirement pursuant to Securities and Exchange Commission Rule 506 of Regulation D.

2. Proposal to promote economic growth by providing essential clarity regarding Congress's intent in using the term "qualified purchaser" in the Securities Act of 1933.

3. Proposal to promote economic growth and enable consumers and investors to more effectively participate in the economy by diversifying the regulatory perspective of the Securities and Exchange Commission.

NASAA strongly believes that each of the proposals enumerated above would change policy in a manner that would benefit the economy, and encourage consumers, investors, and other market participants to participate in the economy in a more effective and efficient manner.

Thank you for your consideration of NASAA's views. Please do not hesitate to contact me or Michael Canning, NASAA's Director of Policy, if we may be of any further assistance.

Sincerely,

Mike Rothman
NASAA President and Minnesota Commerce Commissioner

[1] The oldest international organization devoted to investor protection, the North American Securities Administrators Association, Inc. (NASAA) was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

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NASAA Recommendation #1: ***Congress should increase investor confidence and transparency in the private securities marketplace by providing state and federal regulators with access to more timely information about the private placement marketplace and modest new tools to police these markets for fraud and bad-actors. Congress should also establish meaningful consequences for issuers who fail to file Form D.***

1. Brief Description of Proposal:

NASAA proposes that Congress take steps to update the Regulation D, Rule 506 regulatory framework through enhanced filing requirements. Specifically, NASAA recommends that the Committee approve legislation that would direct the U.S. Securities and Exchange Commission ("SEC") to make a minor, three-part revision to the Form D filing requirements. The first element of the proposed revision would require that, in instances where public solicitation and advertising are used in a Rule 506 offering, the issuer is required to submit a Form D filing prior to engaging in such public solicitation or advertising. The second element of the proposed revision would provide that, in instances where no solicitation or advertising is to be used in a Rule 506 offering, the issuer be required to file a Form D prior to the date of the first sale of securities. Finally, the third element of the proposed revision would mandate the filing of a closing amendment for all Rule 506 offerings.

NASAA also strongly urges Congress to require the SEC to promptly establish meaningful consequences for issuers who fail to file Form D. Given that filing Form D is such a critical part of the exemption, and given that it is such a simple condition to satisfy, a reasonable consequence for failure to file form D would be loss of the exemption.[1]

2. Impact on Economic Growth:

For well over a decade, Rule 506 has been the most heavily used exemption for small businesses seeking capital. Although the Rule 506 exemption is used successfully by many legitimate issuers, the exemption in some cases operates as a haven for fraud.[2]

State securities regulators are the primary *de facto* regulator of offerings conducted under Rule 506 pursuant to their antifraud authority. Prior to removal of the long-standing ban on general solicitation and advertising mandated under the JOBS Act and implemented in Rule 506(c), state securities investigators could be assured that any securities offering relying on general solicitation was registered with the SEC if it was "publicly" advertised on the internet or elsewhere. State securities regulators commonly encourage investors in their states to "investigate before they invest." This often results in state regulators communicating directly with investors who are seeking information about issuers and potential investments. With the removal of the general solicitation and advertising prohibition in 2012[3]

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[1] See, NASAA Comments in Response to Release Nos. 33-9416, 34-69960, IC-30595 (File No. S7-06-13), "Amendments to Regulation D, Form D and Rule 156 under the Securities Act." (September 27, 2013) available at http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Comment-Letter-re-Form-D.pdf.

[2] See NASAA Enforcement Report: 2015 Report on 2014 Data, NASAA Enforcement Section (September 2015) available at http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2011/08/2015-Enforcement-Report-on-2014- Data_FINAL.pdf; NASAA Enforcement Report: 2014 Report on 2013 Data, NASAA Enforcement Section (October 2014)" available at http://www.nasaa.org/wp-content/uploads/2011/08/2014-Enforcement-Report-on-2013- Data_110414.pdf.

[3] Title II of the Jumpstart our Business Startups (JOBS) Act allowed, under Rule 506 of Regulation D, the general solicitation of, and widespread advertising to, all investors (including non-accredited investors), so long as the actual sale is made to accredited investors. This provision was implemented as new Rule 506(c) of Regulation D.

(in other words, allowing an issuer to publicly and broadly advertise their potential investment without a securities registration requirement), a state investigator will not be able to determine whether the issuer is advertising an unregistered, non-exempt, offering to the general public or engaging in a compliant Rule 506(c) offering.

Requiring the proposed modest corrections to the Form D filing requirements will address the practical realities that are presently faced by state enforcement personnel. Simply requiring a Form D filing prior to any public solicitation or sale will ensure that state securities regulators, and the SEC, will be able to determine an issuer's intent to rely on Rule 506(c). The proposed corrections will enable state regulators to respond to questions from investors in their states about publicly advertised offerings, and further enable local investors, who can easily access Form D filings, to get basic background information about "legitimate" offerings before they invest. Making this correction will ultimately enhance investor confidence and further Congress's goal of helping businesses in their capital raising efforts.

3. Impact on the ability of consumers, market participants, and financial companies to participate in the economy:

Congress's enactment of policies consistent with NASAA's recommendations will pave the way for a more robust and efficient Rule 506 marketplace. The efficiencies will arise from several factors.

First, the recommended policy changes will allow for more effective policing of the Rule 506 marketplace, and provide investors and market participants themselves with additional knowledge about the marketplace through timely disclosure and transparency. Establishing an effective framework for oversight of these offerings and improving transparency in the markets will serve both issuers and potential investors. To the extent that the recommended policy changes will afford accredited investors access to greater information about these markets and greater confidence that they are well regulated, such investors will be more likely to make informed investments in these markets.

Second, the filing of post-offering closing amendments with accurate and actual (i.e., not projected) sales data will provide an important source of information about private offerings for Congress, the SEC and state securities regulators. Presently, the lack of a true and complete understanding of the private placement market hampers both Congress's ability to foster growth in that market, and regulators' ability to police it for bad actors. A Form D closing amendment would allow Congress and regulators to better understand and evaluate how Rule 506 is working and who is investing in specific offerings. This would in turn provide Congress and the SEC with important information regarding potential future enhancements to the accredited investor definition, a process which will have to be repeated, and the use of Regulation D generally. The marketplace for Rule 506 offerings is far too large, and the accredited investor designation far too important, not to have access to accurate data.

Finally, the establishment of meaningful penalties for issuers that fail to file Form D stands to further improve the quality of data that is gathered about the private placement marketplace from filings

of Form D prior to any public solicitation or sale and as a closing amendment. For years, there has been potentially significant underreporting of data on the Regulation D market.[4]

4. Legislative Language:

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as Private Offering Improvement Act of 2017

SECTION 2. MANDATORY PRE-FILING OF FORM D FOR SECURITIES SOLD WITHOUT REGISTRATION UNDER THE SECURITIES ACT OF 1933 IN OFFERINGS BASED ON A CLAIM OF EXEMPTION UNDER RULE 506 OF REGULATION D OR SECTION 4(6) OF THAT STATUTE

(a) MODIFICATION OF RULES.—

(1) Not later than 90 days after the date of the enactment of this Act, the Securities and Exchange Commission shall revise its rules issued in section 230.503 of title 17, Code of Federal Regulations, to require the filing with the Commission of a notice of sales containing the information required by Form D (17 CFR 239.500) for each new offering of securities no later than the date on which a general solicitation or general advertising is used in connection with the offering or prior to the first sale of securities in the offering, whichever is earlier, unless the end of that period falls on a Saturday, Sunday or holiday, in which case the due date would be the first business day following such date.

SECTION 3: MANDATORY FILING OF POST-OFFERING CLOSING AMENDMENT FOR SECURITIES OFFERED OR SOLD IN A MANNER DESCRIBED IN SECTION 2

(a) MODIFICATION OF RULES.—

(1) Not later than 90 days after the date of the enactment of this Act, the Securities and Exchange Commission shall revise its rules issued in section 230.503 of title 17, Code of Federal Regulations, to require the filing with the Commission of a post-offering closing amendment with sales data and any other such information as the Commission determines.

(2) Not later than 90 days after the date of the enactment of this Act, the Securities and Exchange Commission shall revise its rules issued in section 230.503 of title 17, Code of Federal Regulations, to specify that the failure of an issuer to file a form with the Commission as required pursuant to that section shall result in loss of the exemption from registration for that offering.

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[4] "Underreporting could occur in all years because Regulation D filings can be made prior to the completion of the offering, and amendments to reflect additional amounts sold generally are not required if the offering is completed within one year and the amount sold does not exceed the original offering size by more than 10%. Second, as previously described, Rule 503 requires the filing of a notice on Form D, but filing a Form D is not a condition to claiming a Regulation D safe harbor or exemption. Hence, it is possible that some issuers do not file a Form D for offerings relying on Regulation D." Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2014," U.S. Securities and Exchange Commission, October 2015, Scott Bauguess, Rachita Gullapalli, and Vladimir Ivanov, *available at* https://www.sec.gov/dera/staff-papers/white-papers/unregistered-offering10-2015.pdf.

SECTION 3: RELATIONSHIP WITH EXISTING RULES AND REGULATIONS

(a) REGULATIONS REMAIN IN EFFECT -

(1) Section 230.503 of title 17, Code of Federal Regulations, as revised pursuant to this section, shall continue to be treated as a regulation issued under section 4(2) of the Securities Act of 1933 (15 U.S.C. 77d(2)).

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__NASAA Recommendation #2__: **Congress should clarify the definition of the term "qualified purchaser" in the Securities Act of 1933 by amending Section 18(b) of the Securities Act to align it with the definition of the same term in section 2(a)(51)(A) of the Investment Company Act of 1940.**

1. Brief Description of Proposal:

NASAA proposes that Congress should take steps to limit the imprudent level of discretion that the U.S. Securities and Exchange Commission ("SEC") presently enjoys when defining the term "qualified purchaser" in the Securities Act of 1933 for purposes of rulemaking. Specifically, NASAA proposes that Congress should clarify the term "qualified purchaser" in the Securities Act of 1933 by amending the Act and redefining the "qualified purchaser" term in a manner that is identical to the definition of the exact same term in the Investment Company Act of 1940.

2. Impact on Economic Growth:

The National Securities Markets Improvement Act of 1996 ("NSMIA") and the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act") accorded the SEC broad authority to define the scope of "qualified purchasers" to whom securities could be sold without registration under Section 18(b) of the Securities Act. But whereas Congress evidently intended the SEC to use a regulatory scalpel and carve out precise exemptions for certain categories of investors, the SEC has applied a cudgel. The scope of "qualified purchasers" encompassed by SEC regulations (namely, Rule 256 of Regulation A, 17 C.F.R. § 230.256) is too broad and precludes state regulators from reviewing offerings that ought to be scrutinized.

State regulators have particular strengths that uniquely qualify them to effectively oversee certain exempt securities that are offered or sold to retail investors. Because state regulators are geographically close and accessible to both investors and local businesses, they are often in a better position than the SEC to communicate with them about an offering, to prevent abuse and improve the overall quality of the deal for the investor and business alike. The proximity of state regulators to investors also puts them in the best position to deal aggressively with securities law violations when they do occur, efficiently policing private markets to reduce fraud. By policing private markets state regulators directly protect investors and help promote the level of investor confidence that is essential to healthy capital formation.

State and federal regulators are most effective when working in a cooperative manner. The SEC's decision to undermine state authority through enactment of preemptive rulemaking frustrates this goal. State regulators cannot do their job where the SEC is empowered to preempt the states and prevent them from fulfilling their indispensable role in facilitating and overseeing small-sized offerings.[5]

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[5] *See* Letter from Andrea Seidt, NASAA President and Ohio Securities Commissioner, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated Mar. 24, 2014, *available at* http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Comment-File-S7-11-13-03242014.pdf (expressing NASAA's strong belief that the Commission's attempt to preempt state registration in the proposed Regulation A rulemaking exceeded the Commission's statutory authority and fails to adequately consider all relevant costs and potential harm to both issuers and investors); *see also* Brief of NASAA as *Amicus Curiae* Supporting Petitioners, *Lindeen v. SEC*, 825 F.3d 646 (D.C. Cir. 2016) *available at* http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2011/08/Amicus-Curiae-Brief-of-the-NASAA-and-Addendum-Combined.pdf.

3. Impact on the ability of consumers, market participants, and financial companies to participate in the economy:

Consumers, investors and other market participants benefit when regulations are developed purposefully and in a manner that is consistent with Congress's intent. The term "qualified purchaser" in the Securities Act of 1933 is inherently flawed. In creating the "qualified purchaser" term under the National Securities Markets Improvement Act of 1996, Congress clearly expressed its intent that the term be used to denote "sophisticated investors, capable of protecting themselves in a manner that renders regulation by State authorities unnecessary."[6] However, because Congress imposed this critical limitation through the inclusion of language in the Committee Report and Legislative History – as opposed to in the statute itself – the term "qualified purchaser" has emerged as legislative loophole susceptible to almost unlimited regulatory manipulation. By amending the Securities Act to specify the qualifications required for an investor to be recognized as a "qualified purchaser," Congress can close this loophole.

4. Legislative Language:

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the Qualified Purchaser Clarification and Harmonization Act of 2017

SECTION 2. QUALIFIED PURCHASER

(a) USE OF DEFINITION FROM THE INVESTMENT COMPANY ACT OF 1940.—

(1) Section 18(b)(3) of the Securities Act of 1933 (15 U.S.C. 77r(b)(3)) is amended by striking ''as defined by the Commission by rule. In prescribing such rule, the Commission may define the term 'qualified purchaser' differently with respect to different categories of securities, consistent with the public interest and the protection of investors.'' and inserting ''as defined in section 2(a)(51)(A) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(51)(A))''.

(2) Section 18(b)(4)(D)(ii) of the Securities Act of 1933 (15 U.S.C. 77r(b)(3)) is amended by striking ''as defined by the Commission pursuant to paragraph (3) with respect to that purchase or sale." and inserting "as defined in section 2(a)(51)(A) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(51)(A))''.

(b) REPEAL OF REGULATION.—The Securities and Exchange Commission shall strike section 230.256 of title 317, Code of Federal Regulations.

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[6] H.R. Rep. 104-622, at 31 (1996) (Conf. Rep.), reprinted in 1996 U.S.C.C.A.N. 3877, 3893-94. Similarly, the Senate Committee on Banking, Housing, and Urban Affairs explained that "qualified purchasers" were the types of purchasers that, based on their wealth and sophistication, did not need the protection of state registration laws. *See* S. Rep. 104-293, at 15 (1996).

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<u>NASAA Recommendation #3</u>: Congress should amend the Securities and Exchange Act of 1934 to require the President to appoint at least one Commissioner to the U.S. Securities and Exchange Commission with demonstrated primary experience administering state securities laws.

1. Brief Description of Proposal:

NASAA proposes that Congress take steps to ensure that there is at least one member of the U.S. Securities and Exchange Commission ("SEC" or "Commission") who possesses experience serving as a state securities regulator or administering state securities laws.

2. Impact on Economic Growth:

There is too often a lack of familiarity with state securities laws and regulation on the five-member Commission charged with administering and enforcing all federal securities laws. On the federal level there is the SEC but a significant amount of responsibility is carried out on the state level. Well before the first federal securities law in 1933, and establishment of the Commission in 1934, on March 15, 1911 the first state securities law took effect. The same balanced regulatory approach – facilitating and preserving capital for legitimate investment opportunities – applied then as it does today. Missouri insurance executive Walter A. La Bar stated in an October 1911 issue of *The New York Times*, "This law means from four to eight million dollars of additional capital [is] available for bona fide investments. It also gives a legitimate company a better opportunity to secure funds, as heretofore investors found it difficult to separate 'the sheep from the goats'."[7]

By way of example, before Congress passed the Jumpstart Our Business Startups (JOBS) Act in 2012 and the SEC finished rulemaking implementing the JOBS Act on May 16, 2016 (i.e., Title III/federal crowdfunding), states began creating new exemptions from registration designed to facilitate local, community-based offerings. Referred to as state crowdfunding laws, states addressed the needs of its local businesses that sought to raise capital from customers and other local investors. However, in its efforts to pass state crowdfunding laws, the states had to seek support from the SEC to update and modernize the federal framework on which state crowdfunding laws (and other regional exemptions) relied.

This joint federal-state effort was supported both by Republican and Democratic SEC Commissioners but would have benefited significantly by a state representative on the five-member Commission. In remarks prior to the vote, SEC Commissioner Piwowar described the state-federal collaboration on intrastate crowdfunding as a "perfect alley-oop pass…for a seemingly can't-miss slam dunk,"[8] and he similarly noted that "state securities regulators have been vigorously enforcing blue sky laws well before the creation of the Commission…[t]oday's adoption properly views them as important and capable partners in facilitating capital formation and protecting investors."[9] SEC Commissioner Stein described the proposed rules as "an opportunity to partner with state regulators to facilitate the success and growth of community-based businesses."[10]

State securities regulators are on the front-lines of investor protection, focusing more than any other regulator on protecting retail investors who may lack the expertise, experience, and resources to protect

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[7] A Century of Investor Protection, 1911-2011, by NASAA, available at http://www.nasaa.org/wp-content/uploads/2011/07/100_Years_Commemorative_FINAL.pdf.

[8] Statement at Open Meeting on Regulation Crowdfunding and on Securities Act Rules 147 and 504, Commissioner Michael S. Piwowar (Oct. 30, 2915), available at sec.gov/news/statement/piwowar-regulation-crowdfunding-147-504.html.

[9] Id.

[10] Statement at Open Meeting on Securities Act Rules 147 and 504, Commissioner Kara M. Stein (Oct. 30, 2915), available at sec.gov/news/statement/statement-rules-147-and-504-stein.html.

their own interests, and their perspective should be represented on the Commission. In view of the significant role that the states play in regulating securities in the United States, especially in regard to the protection of retail investors and promotion of capital formation for truly small and local businesses, the absence of a state regulatory perspective on the SEC deprives the Commission of important expertise that would benefit the economy generally and small business particularly. Indeed, an individual with relevant state experience would from his or her first day of service bring a perspective informed by experiences from Main Street America where investor protection is personal and capital formation means real jobs in the communities they served. Moreover, such an action would be consistent with other steps Congress has taken in the past to ensure adequate representation of certain critical viewpoints and expertise on other federal financial regulatory bodies.[11]

3. Impact on the ability of consumers, market participants, and financial companies to participate in the economy:

Enhanced understanding of and communication between state and federal securities regulators will benefit American investors, America's capital markets, and the public. By requiring the nomination of at least one SEC Commissioner with experience as a state securities regulator, Congress can lay a foundation for enhanced communication and understanding between state and federal securities regulators, and increase the likelihood that there will be at least one member of the SEC directly familiar with the relationships between securities laws, grassroots investor protection, and small business capital formation.

4. Legislative Language:

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE

This Act may be cited as The State Securities Regulatory Perspective Act

SECTION 2. MEMBERSHIP OF THE SECURITIES AND EXCHANGE COMMISSION AMENDED

(a) IN GENERAL.—Paragraph (a) of section 4 of the Securities and Exchange Act of 1934 (12 U.S.C. 241) is amended by inserting after the third sentence the following: ''In selecting members of the Commission, the President shall appoint at least one Commissioner with demonstrable primary experience administering the securities laws in a U.S. state, territory, or District of Columbia.''

(b) EFFECTIVE DATE. — The amendment made by this section shall take effect on the date of enactment of this Act and apply to appointments made on and after that effective date, excluding any nomination pending in the Senate on that date.

[11] For example, in 1995 Congress enacted legislation requiring that the Federal Deposit Insurance Corporation's Board include one member with "State bank supervisory experience." (12 U.S. Code § 1812(a)(1)). In 2015, Congress similarly enacted a requirement that at least one member of the Federal Reserve Board of Governors have experience as a community banker or community bank supervisor. (See, Terrorism Risk Insurance Program Reauthorization Act of 2015 (H.R. 26, Pub.L. 114–1), Sec. 109(a)).