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October 11, 2019

By email to: rule-comments@sec.gov

Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

RE: File Number S7-08-19: NASAA Comment Letter Regarding Concept Release on Harmonization of Securities Offering Exemptions

Dear Ms. Countryman:

On behalf of the North American Securities Administrators Association, Inc. ("NASAA"),[1] I am writing in reference to the June 18, 2019 Concept Release on Harmonization of Securities Offering Exemptions (the "Concept Release")[2] published by the Securities and Exchange Commission (the "SEC" or "Commission"). NASAA welcomes the opportunity to comment on the important issues raised in the Concept Release.

I. Introduction

NASAA supports a reexamination of the private offering framework with the goal of strengthening and growing our public securities markets, and rejects the view that modernizing the securities regulatory framework requires expanding the availability of private offerings.[3] Instead, NASAA recommends that the SEC adopt regulations that will promote the expansion of the public markets for the benefit of all investors.

[1] Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA's 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.

[2] The Concept Release is available at https://www.sec.gov/rules/concept/2019/33-10649.pdf.

[3] *See NASAA's Legislative Agenda for the 116th Congress*, North American Securities Administrators Association (2019), (including recommendations to Congress regarding the private offering regime) *available at* https://www.nasaa.org/wp-content/uploads/2019/03/NASAA-Legislative-Agenda-for-116th-Congress.pdf.

Retail investors benefit most from the transparencies and liquidity that the public markets offer. But Congress and the Commission have enacted laws and regulations, especially in recent years, expanding issuers' ability to offer securities exempt from SEC registration. As a result, the private securities markets have eclipsed the public markets. Private offerings, which once comprised a small fraction of total securities issuances, now exceed registered offerings by approximately 2-to-1.[4] It is not coincidental that during this same period the number of companies conducting initial public offerings ("IPOs") has declined. As the Supreme Court explained in *Ralston Purina*, the private markets are for those investors who can fend for themselves,[5] which are not the typical "mom and pop" investors.

Accordingly, as explained below, the Commission should not take any regulatory steps that would further expand the scope of unregistered securities offerings.

II. NASAA's Perspective on the Public, Private, and "Quasi-Private" Securities Markets

The public securities marketplace consists of securities registered with the SEC under the Securities Act of 1933 (the "Securities Act") and/or subject to ongoing SEC reporting obligations under the Securities Exchange Act of 1934 (the "Exchange Act"). These laws, as well as others governing the public markets, require issuers to provide investors with full and fair disclosure of material information about a security at issuance and thereafter so investors are able to make informed investment and governance decisions. The result is a market that affords liquid investment opportunities for all individuals, households, and institutions. These benefits result in competitively determined prices, transparent valuations, and timely reporting of material information about the future prospects of a business.

The public markets thus allocate capital with an exceptionally high degree of efficiency and help guide decision-making in the real economy. The markets are not only a source of investment opportunity for purchasers and investment capital for businesses, they are a major contributor to the efficiency of our domestic economy and its capacity to spur and support innovation-based growth. Further, registration and transparency in the public markets provide important information for regulators, especially the SEC, to ensure a level playing field among all investors, while sustaining confidence in the marketplace. And finally, from the standpoint of "mom and pop" investors, the key feature of the public marketplace is that they are able, to a large degree, to invest on roughly equal terms as the most sophisticated investors.

In contrast, the private securities market consists of securities that are exempt from SEC registration and ongoing reporting obligations. In the private securities markets, offerings are not

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[4] *See Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2017*, Division of Economic and Risk Analysis, U.S. Securities and Exchange Commission (Aug. 2018), at 7 ("In 2017, registered offerings accounted for $1.5 trillion of new capital compared to more than $3.0 trillion reported raised through all private offering channels."), *available at* https://www.sec.gov/files/DERA%20white%20paper_Regulation%20D_082018.pdf.

[5] *SEC v. Ralston Purina*, 346 U.S. 119, 127 (1953) (stating the availability of registration exemptions should depend upon the "need of the offerees for the protections afforded by registration.").

open to all investors. Instead, an issuer may sell securities only or predominantly to "accredited investors," and may choose its buyers and the terms on which it offers securities.[6] Investors are not treated equally. Preferred investors may receive access to the highest quality deals on the most favorable terms, while others will not. Investors also are not protected by the ongoing reporting and disclosure obligations under federal securities laws and regulations.[7] And even the most basic information about an unregistered security – its price – may not be readily available and difficult to ascertain.[8] Furthermore, trading is often limited and even when trades do occur, they are not required to be reported publicly.

Unfortunately, the lack of transparency and liquidity in the private securities markets makes it ripe for bad actors. In fact, private offerings rank among the most common source of enforcement actions brought by NASAA's member state securities regulators.[9] For all these

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[6] SEC Rule 506 of Regulation D provides two distinct exemptions from registration for companies when they offer and sell securities. Under Rule 506(b), a "safe harbor" under Section 4(a)(2) of the Securities Act, an issuer may sell its securities to an unlimited number of "accredited investors" and up to 35 other purchasers. Under Rule 506(c), a company can broadly solicit and generally advertise its offering but may sell securities only to accredited investors.

[7] For example, the SEC recently entered into a settled enforcement action with a public company for selectively disclosing material, non-public information to two research analysts. Because the company was public, these selective disclosures violated the Exchange Act and Regulation FD. However, if the same situation occurred at a company that was a private company, the selective disclosure would have likely not violated any federal securities laws. *See In re Mosaic Capital, LLC*, SEC Release No. 34-86712 (Aug. 20, 2019), *available at* https://www.sec.gov/litigation/admin/2019/34-86712.pdf.

[8] *See* Jason Zweig, *How We Should Bust an Investing Myth*, Wall St. J. (Sept. 20, 2019) (stating that it is simply a "myth that private markets are superior to the public markets" while discussing WeWork's postponed initial public offering after it became apparent that the public securities markets would not value the company nearly as highly as the private marketplace had).

[9] *See*, *e.g.*, NASAA 2018 Enforcement Report at 7 (Sept. 2018), *available at* https://s30730.pcdn.co/wp-content/uploads/2018/10/2018-Enforcement-Report-Based-on-2017-Data-FINAL.pdf. Recent state securities enforcement actions involving private placements include: *In re Houston Energy Resources, LLC*, 2018 Ala. Sec. Lexis 12 (May 25, 2018); *In re Islam*, 2018 Ark. Sec. Lexis 6 (Feb. 23, 2018); *In re AZ Investment Property Experts, LLC*, 2018 Ariz. Sec. Lexis 2 (Mar. 27, 2018); *In re Maerki*, 2018 Ariz. Sec. Lexis 4 (Jan. 3, 2018); *In re USA Barcelona Realty Advisors, LLC*, 2018 Ariz. Sec. Lexis 3 (Jan. 3, 2018); *In re Cybrelabs*, 2018 Colo. Sec. Lexis 28 (Sept. 12, 2018); *In re AFT Logistics, LLC*, 2018 CT Banking Comr. Lexis 20 (May 2, 2018); *In re Endeavor Mgmt. Solutions, LLC*, 2018 Conn. Sec. Lexis 25 (May 21, 2018); *In re Rejda*, 2018 Conn. Sec. Lexis 24 (May 17, 2018); *In re Hauptman*, 2018 Ia. Sec. Lexis 22 (Apr. 6, 2018); *In re Advent Med Products Inc.*, 2018 Mass. Sec. Lexis 15 (Jul. 12, 2018); *In re ARO Equity, LLC*, 2018 Mass. Sec. Lexis 10 (Mar. 15, 2018); *In re Howse*, 2018 Maine Sec. Lexis 16 (Dec. 10, 2018); *In re Option Mint*, 2018 Maine Sec. Lexis 6 (Apr. 19, 2018); *In re 5A Holdings, LLC*, 2018 Mo. Sec. Lexis 23 (Jun. 4, 2018); *In re Akbar & Assocs.*, 2018 Mo. Sec. Lexis 6 (Feb. 1, 2018); *In re Glenridge Capital*, 2018 Mo. Sec. Lexis 29 (Jul. 25, 2018); *In re JK Janitorial Software*, 2018 Mo. Sec. Lexis 17 (May 4, 2018); *In re Morgan Finances*, 2018 Mo. Sec. Lexis 38 (Oct. 24, 2018); *In re Peregine*, 2018 Mo. Sec. Lexis 24 (Aug. 23, 2018); *In re Rumelia Capital*, 2018 Mo. Sec. Lexis 5 (Feb. 6, 2018); *In re Tropical Trade*, 2018 Mo. Sec. Lexis 37 (Oct. 24, 2018); *In re Unity Oil & Gas*, 2018 Mo. Sec. Lexis 4 (Jan. 31, 2018); *In re Wilkinson*, 2018 Mo. Sec. Lexis 19 (May 17, 2018); *In re Bitconnect*, 2018 N. Car. Sec. Lexis 15 (Jul. 12, 2018); *In re Calabro*, 2018 N. Car. Sec. Lexis 7 (Mar. 8, 2018); *In re Power Mining Pool*, 2018 N. Car. Sec. Lexis 10 (Apr. 19, 2018); *In re USI-Tech Ltd*, 2018 N. Car. Sec. Lexis 12 (Apr. 6, 2018); *In re Lucero*, 2018 N.H. Sec. Lexis 9 (Oct. 1, 2018); *In re Bellot*, 2018 N.J. Sec. Lexis 13 (Jun. 15, 2018); *In re Bruno*, 2018 N.J. Sec. Lexis 8 (May 23, 2018); *In re USI-Tech*, 2018 Oh. Sec. Lexis 25 (Aug. 23, 2018); *In re ACAP Fin. Inc.,* 2017 Okla. Sec. Lexis 23 (Nov. 9, 2017); *In re Becker Jackson & Reed LLC,* 2018 Ore. Sec. Lexis 1 (Jan. 2, 2018); *In re Woodbridge Inv. Fund 1, LLC*, 2018 Ore. Sec. Lexis 3 (May 7, 2018); *In re First Nationale Solutions, LLC,* 2018 S. Car. Sec. Lexis 11 (May 7, 2018); *In re Rosen*, 2018 S. Car. Sec. Lexis 13

reasons, the private securities marketplace is ill-suited for retail investors.[10]

Since enactment of the JOBS Act and the FAST Act,[11] the U.S. securities marketplace has featured a greatly expanded third pathway for issuers to raise investment capital that blends elements of public and private offerings. Securities issued under Regulation A and Regulation Crowdfunding typify this "quasi-private" market. These regulations aim to create a means for small and mid-sized companies to raise investment capital from retail investors without the need for full registration under the Securities Act or compliance with the Exchange Act's ongoing reporting obligations. The size of the marketplace for quasi-private offerings remains small compared to the marketplace for private offerings under Regulation D.[12] But given the involvement of retail investors in this space, coupled with the risk of these offerings and the potential for growth in the marketplace, the SEC must not seek to expand the market without corresponding regulations that will increase protections for investors.

III. NASAA's Recommendations Regarding the Private Securities Marketplace

- ***The SEC should amend the accredited investor definition for natural persons to, at a minimum, raise the minimum net worth and annual income thresholds.***

In recent years, Regulation D has served as the single largest vehicle for capital raising in the private securities markets.[13] A key issue in private offerings under Regulation D is whether a potential investor qualifies as accredited. For instance, under SEC Rule 506(b), issuers can sell securities to an unlimited number of accredited investors and up to 35 non-accredited investors. And under SEC Rule 506(c), all investors must be accredited. The Commission first defined the term "accredited investor" for natural persons in 1982.[14] Since then, the thresholds have remained virtually static: a minimum net worth of at least $1 million exclusive of the person's primary residence or annual income of at least $200,000 ($300,000 with a spouse) for the past two years. The Commission should raise these thresholds to account for the effects of inflation and then index

(May 7, 2018); *In re Williams*, 2018 Tenn. Sec. Lexis 3 (Jun. 7, 2018); *In re Billington*, 2018 Wa. Sec. Lexis 32 (Dec. 4, 2018).

[10] NASAA agrees with the analysis set forth in the SEC Office of the Investor Advocate's July 11, 2019 letter to the Commission regarding the relative inability of most retail investors to meaningfully access private securities offerings and the unsuitability of private offerings for most Americans. *See* Letter from Rick A. Fleming to Vanessa Countryman, SEC Office of the Investor Advocate (July 11, 2019), *available at* https://www.sec.gov/comments/s7-08-19/s70819-5800855-187067.pdf.

[11] *See* the Jumpstarting Our Business Startups Act of 2012 ("JOBS Act"), Pub. L. No. 112-106, and the Fixing America's Surface Transportation Act ("FAST Act"), Pub. L. No. 114-94.

[12] *See Capital Raising in the U.S.*, *supra* note 4, at 8.

[13] *See* 17 C.F.R. § 230.500 *et seq.* Amounts raised through Regulation D dwarf other means. *See Capital Raising in the U.S.*, *supra* note 4, at 8. Rule 506 of Regulation D is by far the most common tool used, representing 97% of all Regulation D offerings. *See id.* at 13; *see also* Concept Release at 19

[14] *See Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers and Sales*, SEC Release No. 33-6389, 47 Fed. Reg. 11251 (Mar. 16, 1982).

the adjusted amounts to inflation going forward. (NASAA has long advocated for such a change to bring these wealth and income standards into the 21st century.[15])

In addition, NASAA strongly urges the Commission to consider additional reforms to the accredited investor definition that would more accurately tie it to investor sophistication and the potential ability to withstand economic loss. For example, NASAA has advocated for: (1) use of an "investments owned" test;[16] (2) qualitative improvement of net-worth standards through reference in the definition to the type and liquidity of the asset counted for purposes of determining accredited status (for example, retail assets vs. retirement assets vs. real property assets other than a primary residence); and (3) elimination and replacement of income and net-worth standards on the grounds that such standards are inherently flawed proxies for sophistication.[17]

- ***Amend Regulation D to impose a pre-issuance and post-closing Form D filing requirement.***

As a starting point, NASAA encourages the Commission to implement amendments to Regulation D the SEC proposed in July 2013 but never adopted that would impose a pre-issuance and post-closing Form D filing requirement on issuers.[18] Pre-issuance Form D notice filing should be required for all Regulation D offerings to alert regulators that the offering is forthcoming and to provide an opportunity for regulators to investigate the offering if any information in the Form D raises concern. (One obvious area of concern is offerings involving statutorily disqualified persons or known "bad actors" in the industry.) In addition, the Commission should add a requirement that issuers file a final post-closing sales report or other closing amendment to their Form D that summarizes the actual results of the offering. This would provide the SEC with much needed data on Regulation D offerings, improve the oversight of this very large segment of the U.S. capital markets, and help inform future potential regulatory efforts.

- ***Rule 504 should be preserved in its current form.***

NASAA recommends the SEC retain Rule 504 of Regulation D in its current form. In light of its use and regulatory coordination between Rule 504 and state securities laws, Rule 504 provides a helpful capital raising tool for many small businesses. Rule 504 also is not duplicative of Regulation A, as in 2018 there were over six hundred Rule 504 offerings.

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[15] *E.g.*, Letter from NASAA President Joseph Borg to Nancy M. Morris, *Re: File No. S7-25-06* (Apr. 2, 2007), *available at* https://s30730.pcdn.co/wp-content/uploads/2011/07/42-CorpFinHFCommentLetter.pdf.

[16] NASAA has suggested an additional investments owned test of $1,000,000 in investments. *E.g.*, Letter from NASAA President Karen Tyler to Nancy M. Morris, *Re: Revisions of Limited Offering Exemptions in Regulation D*, (Oct. 26, 2007), at 12, *available at* https://www.sec.gov/comments/s7-18-07/s71807-57.pdf.

[17] *See* Written Testimony of Michael S. Pieciak to U.S. House of Representatives Committee on Financial Services (Sept. 11, 2019), *available at* https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-wstate-pieciakm-20190911.pdf.

[18] *See* Amendments to Regulation D, Form D and Rule 156, SEC Release No. 33-9416 (July 10, 2013), *available at* https://www.sec.gov/rules/proposed/2013/33-9416.pdf.

Issuers commonly use Rule 504 in combination with various exemption and registration provisions under state law. NASAA members recently approved updates to the SCOR Form and SCOR Statement of Policy to further simplify these offerings[19] and NASAA intends to develop a national coordinated review process for these filings.[20] The SCOR program facilitates direct public offerings by entrepreneurs and small business owners seeking to raise capital without incurring significant legal expenses. Entrepreneurs and small business owners can prepare the form themselves without the necessity of hiring experienced securities counsel. This is accomplished through the completion of a fill-in-the-blank disclosure document that includes instructions to the user about its completion.

- ***The Commission should not open the private securities marketplace to additional retail investors even in limited ways.***

With respect to other aspects of Regulation D, the Concept Release questions whether the Commission should consider rule changes that would allow non-accredited investors to participate in exempt offerings (subject to potential conditions such as a limit on the amount size non-accredited investors could invest in an offering or across multiple offerings).[21] NASAA opposes the idea of further opening the private securities market to non-accredited investors even with safeguards such as investment limits. Investment limits have no bearing on investors' financial sophistication, their ability to evaluate the merits of an offering, or their ability to withstand economic loss and thus simply do not protect retail investors.

IV. NASAA's Recommendations Regarding the Quasi-Private Securities Marketplace

- ***The SEC should amend Regulation A Tier 2 to rescind the preemption of state securities regulators in this area.***

NASAA has previously questioned the necessity and viability of a marketplace for quasi-private securities offerings, especially on the scale allowed by Regulation A Tier 2, and we reiterate that concern. The quasi-private marketplace is difficult to police and has the potential to enable fraud. By functioning as a means for non-accredited investors to invest in early-stage companies that are not subject to the review process applicable to other public offerings, Regulation A Tier 2 entails substantively increased investment risk. Retail investors are put into a position of essentially competing with far more sophisticated investors for access to pre-IPO companies. Retail investors are at a steep structural disadvantage: they assume significant risk

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[19] The updates to the SCOR Statement of Policy increased the offering limit from $1 million to $5 million and incorporated many of the investor protections that have been put in place under state and federal crowdfunding laws, including investment limits, sales report requirements, and ongoing reporting requirements. The new SCOR Form includes updates drawn from intrastate crowdfunding forms, federal Form C, word processing features, and changes in federal law. The amendments were adopted in May 2019. More information is available at https://s30730.pcdn.co/wp-content/uploads/2019/05/Amended-SCOR-Statement-of-Policy.pdf.

[20] The SCOR Form is considered when an issuer is seeking to undertake a multi-state registration of its securities or franchise offering. *See* https://www.nasaa.org/industry-resources/securities-issuers/coordinated-review/.

[21] *See* Concept Release at 30.

without gaining access to the most attractive deals or the favorable terms and prices made available to venture capital funds or professional investors.

NASAA members have seen many problems in Regulation A offerings. Many of these offerings are made using offering documents with minimal or problematic disclosures. Additionally, the majority of Regulation A Tier 2 equity offerings involve securities that do not afford their holders customary voting rights. In some offerings, investors are offered equity securities with absolutely no voting rights. In others, investors are offered securities with voting rights but those voting rights are significantly curtailed.[22] NASAA is concerned with these inequitable voting structures found in many Regulation A offerings.

Another area of concern is the composition of boards of directors or similar governing bodies. In some Regulation A Tier 2 offerings, the issuers simply do not have a board of directors or similar independent governing body. Equally concerning is the presence of conflicts of interest and a lack of limits on conflicts of interest. Many Regulation A offerings involve issuers that have engaged in material related-party transactions. As an example, in one of these offerings, the issuer licensed its intellectual property to its co-founder and chief executive officer for minimum royalties. In another example, an issuer subleased multiple facilities owned by a corporate insider. Unfortunately, these offerings typically do not include any limits on the ability of the issuer to engage in these types of conflicted transactions.

Other common problems NASAA members see in Regulation A offerings include: no minimum offering amount (creating risk that investors funds will be expended without raising enough capital to advance the issuer's business plan), no escrow of offering proceeds, broad indemnification of directors, disclaimer of a fiduciary duty by management, mandatory arbitration of disputes and forum selection clauses that limit investor lawsuits. For some quasi-private offerings that have become exchange listed, the press has reported on losses incurred by investors.[23]

Notably, although we are just a few years into the experiment of expanded Regulation A offerings, both NYSE and NASDAQ have already significantly decreased their appetites for listing these offerings. In June 2019, the SEC approved NASDAQ's proposal to heighten its listing

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[22] For example, in one deal, investors were offered equity securities that limited their ability to remove the manager even for cause. In another deal, voting rights were limited to just a few issues, such as approving a potential merger or joint venture.

[23] In early 2018, Barron's conducted a study of these offerings. There were two notable points from that study. First, because the final rule required so little information about the securities after the initial offerings, the study was unable to examine who invested in the majority of these offerings or their performance. Second, of the Regulation A Tier 2 offerings that elected to list on the New York Stock Exchange or the Nasdaq, investor returns were abysmal. Excluding one wildly over-performing stock (which is currently the subject of an SEC enforcement action), the study found that "the average Reg A+ stock fell 40% in the six months after its mini-IPO and has underperformed the raging bull market surrounding them by nearly 50 percentage points." *See* Bill Alpert, Brett Arends, and Ben Walsh, *Most Mini-IPOs Fail the Market Test*, Barron's (Feb. 13, 2018), *available at* https://www.barrons.com/articles/most-mini-ipos-fail-the-market-test-1518526753)

standards for Regulation A securities in part due to concerns with the quality of past listings.[24] Increasingly, as securities exchanges and investors lose confidence in the companies that use Regulation A Tier 2, the premise of these hybrid offerings seems dubious and unlikely to succeed.[25] At a minimum, Regulation A Tier 2 should be amended to cede primary oversight of these offerings to state securities regulators.

Given all these concerns, it is unfortunate that states are preempted from imposing registration or qualification requirements on Tier 2 offerings.[26] The Commission's previous decision to preempt state regulation of these offerings enables abuse by eliminating a potentially effective layer of oversight and substantive regulation. For example, but for their preemption, many state regulators would require issuers to appoint and maintain at least two independent directors in the event the issuer has previously engaged in related party transactions or require the issuer to limit conflicts of interest. As another example, states might require an issuer to provide investors with the same voting rights as prior shareholders or require that investors have certain minimum voting powers. Preemption of state regulation precludes these potential investor protection measures.[27] Furthermore, state regulation would not be overly burdensome. Under NASAA's existing coordinated review program for Regulation A Tier 1 offerings, issuers can register an offering in multiple jurisdictions in a streamlined process. This ensures these offerings are subjected to regulatory review. The Tier 2 offering framework could be amended to provide similar state oversight.

- ***Business development companies should not be eligible Regulation A issuers.***[28]

Business development companies ("BDCs") were created to provide capital to small and mid-size businesses that might not otherwise be able to access financing. The Commission did not include BDCs as eligible issuers when enacting amendments to Regulation A in 2015. At the time, the Commission wanted the opportunity to observe the use of the amended Regulation A exemption and assess any new market practices as they developed. Since then, there have not been any new practices that would warrant including BDCs as eligible Regulation A issuers. Due to the specialized nature of capital formation and investment strategies by BDCs, BDCs today – like in 2015 – continue to warrant more specialized disclosures than Regulation A requires.[29] As such,

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[24] *See* SEC Order Granting Approval of a Proposed Rule Change to Adopt Additional Requirements for Listings in Connection with an Offering Under Regulation A of the Securities Act, The Nasdaq Stock Market LLC, SEC Release No. 34-86246 (Jun. 28, 2019), *available at* https://www.sec.gov/rules/sro/nasdaq/2019/34-86246.pdf.

[25] Alexander Osipovich, *Exchanges Shy Away From Mini-IPOs After Fraud Concerns*, Wall St. J. (Jun. 10, 2019), *available at* https://www.wsj.com/articles/exchanges-shy-away-from-mini-ipos-after-fraud-concerns-11560177205.

[26] *See* Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), SEC Release No. 33-9741 (Mar. 25, 2015) at 206-220, *available at* https://www.sec.gov/rules/final/2015/33-9741.pdf.

[27] The Commission questions whether state notice filing requirements should be preempted in Tier 2 offerings. *See* Concept Release at 111. Under no circumstances should the Commission undertake this change.

[28] *See* Concept Release at 108.

[29] *See* Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), *supra* note 26, at 24 ("we believe it prudent to defer expanding the categories of eligible issuers (for example, by including non-Canadian foreign issuers, BDCs, or Exchange Act reporting companies) until the Commission has had the opportunity to observe the use of the amended Regulation A exemption and assess any new market practices as they develop").

funds that operate as BDCs should remain subject to meaningful regulation through the relevant provisions of the Investment Company Act of 1940 to which they are currently subject.

- ***Crowdfunding could be expanded through the use of pooled investment vehicles, though stringent regulations should be applied.***

Another form of quasi-private offerings that Congress and the SEC have established in recent years is Regulation Crowdfunding, which provides opportunities for small businesses to raise comparatively small amounts of capital directly from retail investors. Unlike Regulation A Tier 2, which allows issuers to raise as much as $50 million, Regulation Crowdfunding permits an issuer to raise a maximum of $1 million. As of March 2019, thirty-five states (including the District of Columbia) have enacted state crowdfunding exemptions tied to the federal intrastate exemption. NASAA members' experiences have been that crowdfunding generally is unappealing to issuers that might otherwise be contemplating a public offering. Furthermore, the parties who avail themselves of it – both issuers and investors – are often motivated at least in part by considerations other than simply return-on-investment or profit.

Currently, investors cannot pool their investments through special purpose vehicles or funds to facilitate crowdfunding investments.[30] NASAA has suggested that Congress amend the federal crowdfunding provision, Section 4A of the Securities Act, to authorize such special purpose vehicles. Of course, any such change would require corresponding investor protections. But if done appropriately, crowdfunding funds could open the door to greater use of crowdfunding by issuers and investors. Those corresponding investor protections should require that any such funds be managed by a registered investment adviser, issue a single class of securities, be limited to investing in only a single crowdfunding offering, and maintain certain mandatory disclosure obligations.[31]

- ***Adoption of a new micro-offering exemption is unnecessary.***

The Concept Release discusses the potential creation of a micro-offering exemption – *i.e.*, a broad exemption from registration for securities issued up to a specified dollar threshold.[32] Such an exemption is unnecessary. The Concept Release quotes statistics on the large number of smaller offerings conducted under Rule 506[33] in addition to offerings conducted under Regulation A, Regulation Crowdfunding and Rule 504. Small businesses already have numerous ways to conduct small capital raises and adding a new exemption would only further complicate the existing framework.[34]

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[30] *See* Concept Release at 129.

[31] Recent federal legislation in this regard has included the Crowdfunding Amendments Act, H.R.6380 (115th Cong.), *available at* https://www.congress.gov/bill/115th-congress/house-bill/6380/text.

[32] *See* Concept Release at 154-158.

[33] *See* Concept Release at 155 ("in 2018, approximately 3,080 issuers each reported raising $250,000 or less in reliance on Regulation D").

[34] Question 101 of the Concept Release also queries whether micro-offerings should be treated as covered securities. *See* Concept Release at 157. The Commission's ability to craft regulations that preempt state securities registration is

V. NASAA's Recommendations Regarding Other Issues Raised in the Concept Release

- ***Securities offers should not be deregulated.***

The Concept Release poses the question, "If our exemptions focused on investor protections at the time of sale rather than at the time of offer, should offers be deregulated altogether?"[35] NASAA opposes the suggestion that the SEC should (or even could) deregulate offers altogether. The regulation of securities offers is codified within Section 5(c) of the Securities Act, which requires registration of an "offer to sell or offer to buy." Further, even if it were within the Commission's authority to do so, deregulation of offers would remove a powerful enforcement tool to stop fraudulent offerings.

It is not difficult to imagine the negative consequences of allowing unfettered offerings. Under current law, securities regulators, including the staff of the SEC, can quickly bring enforcement actions to stop an offering that is unlawfully made in the absence of registration. In these situations, regulators do not have to additionally establish that the offering is fraudulent although fraud may very well be suspected. Fraud is common in offerings that are unlawfully made in the absence of registration. With the entry of an enforcement action, the public is notified that the offering is unlawful which can prevent investor losses. If offerings are deregulated, an important enforcement tool would be lost. Regulators would have to prove that a sale had already occurred in violation of Section 5 or alternatively prove that the offer or sale was in fact fraudulent. If this were the case, regulators would be sidelined until sufficient evidence of a sale or proof of fraud was gathered to halt the offering. In the meantime, these issuers would be able to continue to take unsuspecting investors' money. Congress appropriately limited unregistered offerings under the Securities Act, and this bedrock of securities regulation should not be upended.

- ***Integration standards should not be loosened.***

The SEC's integration safe harbors have developed over many years. These safe harbors should not now be loosened. Doing so would increase the likelihood of regulatory arbitrage or create gaps in the investor protection landscape. In particular, shortening the time periods during which integration will be considered would represent a dangerous loosening of SEC regulations. As NASAA has asserted previously, this would further encourage companies to use private securities transactions and avoid going public.[36]

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of course limited by Congress's definition of "covered security" in Section 18(b) of the Securities Act. *See* 15 U.S.C. § 77r(b).

[35] *See* Concept Release at 25.

[36] *See*, *e.g.*, Letter from Karen Tyler to Nancy Morris, *Re: Revisions of Limited Offering Exemptions in Regulation D*, (Oct. 26, 2007), *available at* https://s30730.pcdn.co/wp-content/uploads/2011/07/34-NASAACommentLetter_Revisions_of_Limited_Offering_Exemptions_in_Regulation_D.pdf.

- ***Existing secondary trading exemptions are sufficient.***

Secondary trading of unregistered private or quasi-private securities should be permissible only when accompanied by clear and specific disclosures for investor protection. In 2015, Congress provided a new opportunity for resale of restricted securities by broadly permitting resales to accredited investors.[37] The effects of this legislative change are not yet clear. The Commission accordingly should proceed cautiously before opening additional routes for secondary trading. For example, holding periods in Rule 144 transactions should not be shortened. States also should not be preempted from regulating secondary trading of exempt securities taking place within their jurisdictions. States have taken steps to permit secondary trading in certain circumstances. For instance, NASAA recently adopted a new model rule to help facilitate secondary trading in Regulation A Tier 2 securities.[38]

VI. Conclusion

For the foregoing reasons, NASAA supports a reexamination of the private offering framework with a goal towards strengthening and growing our public securities markets and rejects the view that modernizing the securities regulatory framework requires expanding the availability of private offerings.[39] Instead, NASAA recommends that the SEC adopt regulations that will promote the expansion of the public markets for the benefit of all investors.

Thank you for considering our views on this important issue and we look forward to working with you in our shared mission to protect investors. Should you have questions, please contact either the undersigned or NASAA's Executive Director, Joseph Brady, at 202-737-0900.

Sincerely,

Christopher Gerold
NASAA President
Chief, New Jersey Bureau of Securities

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[37] *See* Fixing America's Surface Transportation Act of 2015, Pub. L. No. 114-94, 129 Stat. 1312 (2015) (enacting new Section 4(a)(7) of the Securities Act, 15 U.S.C. § 77d(a)(7)).

[38] *See* Model Rule to Provide a Transactional Exemption from Registration for Transactions in Securities of Issuers That Comply with Ongoing Reporting Requirements Under Tier 2 of Regulation A (adopted May 19, 2019), *available at* https://s30730.pcdn.co/wp-content/uploads/2019/05/Reg-A-Tier-2-Secondary-Trading-Model-Rule-Adopted-05192019.pdf.

[39] *See NASAA's Legislative Agenda for the 116th Congress*, *supra* note 3.