



March 7, 2023

Submitted by Email

Erik F. Gerding
Director, Division of Corporation Finance
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Private Market Reforms

Dear Mr. Gerding:

On behalf of the North American Securities Administrators Association, Inc. (“NASAA”),¹ I am writing in response to an invitation made by Chair Gensler when he met with NASAA’s leadership team to share our perspectives on private market reforms. We also believe the time is ripe to reinvigorate this conversation given that improvements to Regulation D and Form D are on the Commission’s Agency Rule List for potential proposal. We are thankful for the opportunity to share our views.

As you may know, over the years NASAA has commented extensively about the need for private market reforms, including changes to the accredited investor definition and proposals related to Regulation D.² While we certainly look forward to commenting on any proposal that

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 See, e.g., *NASAA Report and Recommendations for Reinvigorating Our Capital Markets* (Feb. 7, 2023), <https://www.nasaa.org/wp-content/uploads/2023/02/NASAA-Report-and-Recommendations-on-Reinvigorating-Our-Capital-Markets-2.7.23-Final.pdf>; Letter from Christopher Gerold, NASAA President, to Vanessa Countryman, SEC Secretary, re: *Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets* (June 1, 2020), <https://www.nasaa.org/wp-content/uploads/2020/06/NASAA-Harmonization-Comment-Letter-060120.pdf>; Letter from Christopher Gerold to Vanessa Countryman re: *Amending the “Accredited Investor” Definition* (March 16, 2020), <https://www.nasaa.org/wp-content/uploads/2020/03/NASAA-Accredited-Investor-Comment-Letter.pdf>; Letter from Christopher Gerold to Vanessa Countryman re: *Concept Release on Harmonization of Securities Offering Exemptions* (Oct. 11, 2019), <https://www.nasaa.org/wp-content/uploads/2019/10/NASAA-Comment-Letter-re-SEC-Exempt-Offerings-Concept-Release-10-11-19-1.pdf>; Letter from Judith Shaw, NASAA President, to Brent Fields, SEC Secretary, re: *Report on the Review of the Definition of “Accredited Investor”* (May 25, 2016), <https://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Accredited-Investor-Comment-Letter-05252016.pdf>; and Letter from A. Heath Abshire, NASAA President, to Elizabeth Murphy, SEC Secretary, re: *Amendments to Regulation D, Form D and*

the Commission may put forward, we would like to take this opportunity, as a starting point, to focus on a subset of essential reforms that we believe would have the greatest impacts on investor protection and ultimately the efficient allocation of capital. To be clear, more can and must be done to reform the private market but, at a minimum, the Commission can make important incremental changes now that would greatly benefit investors and regulators. We highlight such changes below.

I. Form D Filing Requirements

As we advocated before when similar reforms were considered in 2013,³ NASAA asks the Commission to propose amendments that would require issuers who seek to offer securities without registration under the terms of Regulation D to file both Form D pre-sale and post-closing sales reports. We were recently encouraged by Commissioner Crenshaw's remarks regarding Regulation D,⁴ and we agree that reforms are necessary for greater transparency in the private market to ensure that investors make informed decisions. To advance these goals, and to make sound improvements to the private market in the future, we believe that regulators and policy makers need greater information about private offerings to determine under what circumstances offering exemptions are most effective.⁵

As the Commission recognized in its 2013 proposal, collecting data on private offerings has proved difficult without mandatory filings. Policy and rulemaking should be based on solid data, which is currently an impossibility. Adopting filing requirements would allow comprehensive analyses of the success of private offerings and private issuers.

Rule 156 under the Securities Act (Sept. 27, 2013) ("Abshire Letter"), <https://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Comment-Letter-re-Form-D.pdf>.

³ See *Amendments to Regulation D, Form D and Rule 156*, SEC Rel. No. 33-9416 (July 10, 2013) (the "2013 Proposal"), <https://www.sec.gov/rules/proposed/2013/33-9416.pdf>.

⁴ See Comm'r Caroline Crenshaw, *Big "Issues" in the Small Business Safe Harbor: Remarks at the 50th Annual Securities Regulation Institute* (Jan. 30, 2023) ("Crenshaw Remarks"), <https://www.sec.gov/news/speech/crenshaw-remarks-securities-regulation-institute-013023>.

⁵ Prior to 1989, the filing of a Form D was a condition to the Regulation D exemptions. See 2013 Proposal at 16 n.34. While the Commission has changed its stance over the years as to whether Forms D should be required in order to utilize the Regulation D exemptions, it has also recognized – as NASAA has advocated – that imposing more stringent filing requirements is necessary to give the staff better tools to "review and analyze [changes to the private market] more effectively, and to facilitate the assessment of the efforts of such changes on investor protection and capital formation." *Id.* at 10-11. While that was certainly true when the Commission proposed more stringent filing requirements in 2013, it is emphatically truer today now that private market offerings eclipse public offerings. As matters stand now, all regulators are left in the dark regarding the largest segment of the U.S. capital markets, a circumstance which should be regarded as unacceptable to the basic mission of securities regulation.

Pre-issuance Form D notice filings should be required for all offerings made pursuant to the terms of Regulation D both to alert regulators to forthcoming offerings and to provide opportunities to scrutinize such offerings should the information offered or omitted by the issuer raise concerns. Earlier notice of potential securities law violations – whether of fraudulent misconduct or lesser regulatory violations – would better protect investors, save state and federal regulatory resources, and help issuers avoid costly mistakes. Similarly, post-closing sales reports would provide state and federal regulators with crucial data on the efficacy of offerings made pursuant to Regulation D, which would improve oversight and inform future regulatory efforts to design offering exemptions properly.

For instance, such data would help policymakers identify what sort of exempt offerings truly create and maintain jobs. Commissioner Crenshaw noted the direct relationship between expansions to Regulation D and the proliferation of “unicorns” in the private market.⁶ As larger and more developed issuers remain private, they can siphon capital away from the smaller businesses for whom Regulation D was originally designed. Robust filing information would show in detail what many are observing anecdotally; namely, that the current scope of offering exemptions is being utilized most heavily by issuers that have the means to become public companies but choose not to do so. Such a circumstance undermines the ability of markets to efficiently allocate capital to the most promising small businesses. Robust data would reveal how far offering exemptions are diverging from their intended policy purposes, which in turn would inform an evidence-based recalibration of the need for and use of offering exemptions.

Separately, Form D filing requirements would help regulators identify which private issuers succeed and which fail. The ability to identify common characteristics of weak private issuers in turn could identify particular disclosures, including those identified by Commissioner Crenshaw,⁷ that should be required to effectively help investors to avoid problematic issuers. As it stands, the information asymmetry confronted by investors in private offerings means that they bear excessive and unnecessary investment risks. That is true for retail and sophisticated investors alike, and the solution is to narrow the gap. The best way to do so, however, requires solid data.

⁶ See *Crenshaw Remarks*, *supra* note 4.

⁷ See *id.* NASAA has also previously offered suggestions as to additional information that should be included in Forms D to capture data that is important to the Commission and investors. See *Abshire Letter*, *supra* note 2, at 4-5.

II. Natural Person Accredited Investor Thresholds

NASAA has repeatedly called for reforms to the accredited investor income and net worth thresholds for natural persons.⁸ Investor protection requires the strengthening of these thresholds, which have deteriorated in the 41 years since the rule was promulgated. In general, measures of wealth are poor proxies for determining which investors have both the sophistication to overcome information asymmetries and the ability to bear losses that make investing in private offerings an acceptable risk. Wealth measures are particularly inadequate with respect to persons who meet the current thresholds simply by accumulating retirement savings over time.⁹ Accordingly, NASAA believes the SEC should also make the following proposals.

1. **Exclude assets accumulated or held in defined contribution plans from inclusion in natural person accredited investor net worth calculations.**

Around the same time the natural person accredited investor thresholds were established, there was a marked shift in the benefits employers offered to employees. The increased use of defined contribution plans over defined benefit plans now leaves most workers responsible for providing the bulk of their own retirement savings. It should be a priority for the Commission to guard these assets from exposure to the riskiest offerings in our markets. Elderly investors in particular are vulnerable to losses that they cannot recoup over time. It should be recognized that like a primary residence, which is excluded from accredited investor net worth calculations, these are assets that as a class and given their defining purpose are not appropriate for speculative private investing.

⁸ See *supra* note 2.

⁹ See, e.g., Michael S. Finke and Tao Guo, *The Unsophisticated Sophisticated: Old Age and the Accredited Investors Definition* (Working Paper, Sept. 22, 2019) (finding “strong evidence that older households are at risk of meeting the accredited investor definition without having the sophistication needed to avoid high agency costs in a largely unregulated securities market”), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2634818&download=yes; John E. Girouard, *The Sophisticated Investor Farce*, *Forbes* (Mar. 24, 2009) (stating that “often people whose net worth puts them in the accredited category ... may be smart and successful in their fields, but most are confused about the basics of investing and managing money”), <https://www.forbes.com/2009/03/24/accredited-investor-sec-personal-financefinancial-advisor-network-net-worth.html#30630526184b>.

2. Adjust the income and net worth thresholds to account for inflation since 1982, and index those thresholds going forward.

The natural person accredited investor thresholds – namely \$1 million in net worth, an individual annual income of \$200,000, or a combined income of \$300,000 – have not changed since 1982, except for the exclusion of primary residences from net worth calculations. In 1982, these thresholds applied to 1.6% of American households. Although a poor proxy for sophistication and the ability to bear losses, the number of qualifying households in 1982 kept the risks of private market investing within a rung of investors most likely to be able to bear speculative losses. That is no longer true; today these thresholds qualify approximately 13% of American households to engage in private market investments.¹⁰

NASAA asks the Commission to propose to raise the current thresholds to account for inflation, and to index those thresholds to inflation going forward. Doing so would maintain the rulemaking judgment originally reached through notice and comment when the thresholds were first adopted. Given that there has been no indication that the Commission is inclined to discontinue the use of financial thresholds to define accredited investors, the Commission should at least adjust these standards for inflation to retain the original investor protection goal embodied in them. Any adjustment to the income and net worth thresholds must take into account the role inflation has played in eroding their protective aims. The Commission previously acknowledged that in failing to adjust the “dollar-amount thresholds upward for inflation, we’ve effectively lowered the thresholds in term of real purchasing power.”¹¹ Without adjustment, the protective barrier that these thresholds are meant to represent will become further eroded, exposing more vulnerable investors to unnecessary risks.

¹⁰ See Amending the “Accredited Investor” Definition, SEC Rel. No. 33-10734 at 16 (Dec. 18, 2019), <https://www.sec.gov/rules/proposed/2019/33-10734.pdf>.

¹¹ Revisions to Limited Offering Exemption in Regulation D, SEC Rel. No. 33-8828 at 42 (Aug. 3, 2007), <https://www.sec.gov/rules/proposed/2007/33-8828.pdf>.

I. Conclusion

Again, NASAA is thankful for any opportunity to share its views on these extremely important topics, and we look forward to contributing to the record surrounding any proposal. We hope that, as the Commission is considering what changes are appropriate to bring needed investor protection reforms to the private market, it will consider these basic steps as the bedrock necessary reforms. Should you have any questions about this letter, please contact either the undersigned or NASAA's General Counsel, Vince Martinez, at (202) 737-0900.

Sincerely,

A handwritten signature in cursive script that reads "Andrew Hartnett".

Andrew Hartnett
NASAA President and
Deputy Commissioner,
Iowa Insurance Division

cc: Hon. Gary Gensler