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"Panel Discussion Regarding Exempt Offerings under Regulation D, Rule 506"

Introduction

Thank you, Leslie, for inviting me to speak today. I am honored to talk a bit about Regulation D, Rule 506(b) offerings from the perspective of a state securities regulator.

My name is Amanda Senn. I am the Director of the Alabama Securities Commission (the "ASC"). Through a staff of approximately 65 people, we protect investors, promote responsible capital formation, and support inclusion and innovation in our markets and communities. As the Director, I am responsible for supervising the registration and auditing divisions, a robust investor education program, an enforcement division which consists of 12 law enforcement personnel responsible for investigating complaints from the public and referrals from our federal partners and industry, and a legal division which is responsible for prosecuting administrative, civil, and criminal actions on behalf of the State of Alabama. I share this organizational information with you because I think it will provide context for my unique perspective in discussing exempt offerings under Regulation D, Rule 506.[1]

At the ASC, we recognize the power of partnership. To that end, my ASC colleagues and I coordinate and collaborate with many federal partners, including the U.S. Securities and Exchange Commission ("SEC," "Commission," or "agency" as appropriate herein) and the U.S. Commodity Futures Trading Commission. In addition, we participate in various state and national organizations. Much of our efforts are through the North American Securities Administrators Association, or NASAA for short, where we work closely with our sister states to unify and streamline regulatory efforts, including registration processes, examination efforts, and enforcement actions.

Of note for today's panel, I presently serve as the Co-Chair of NASAA's Enforcement Section responsible for coordinating multi-state enforcement actions and initiatives. Each year, we release an enforcement report compiling data voluntarily submitted by almost every state securities regulator. During the last 15 years or so, private placements have ranked near or at the top of the list of investor threats. The benefit of the states' perspective is that it is most often from that of a retail investor, a small business, a member of our community, and the data

[1] To learn more, visit https://asc.alabama.gov/.

reflected in these enforcement reports is unfortunate because one of these investors was harmed in the process.

NASAA Has Four Modest, Urgent Proposals for Reform

As my fellow panelists have explained, in 1982, the Commission adopted SEC Regulation D and SEC Form D. At the time, the Commission believed that Regulation D would facilitate capital formation, while protecting investors, by simplifying and clarifying the existing exemptions for private or limited offerings, expanding their availability, and providing more uniformity between state and federal exemptions. Although Regulation D originated as an effort to assist small businesses, the Commission wrote Regulation D in a way that allowed companies of all sizes to rely on its exemptions.[2]

The means for measuring the size of the Regulation D market is inexact at best, due in large part to the meagre amount of data available to regulators. That said, recent studies have concluded that in the 40 years after the exemption was put in place, the Regulation D market in the United States is now significant, standing at approximately $2.5 trillion sold in 2021.[3] This amount is much greater than the $286 billion raised through initial public offerings in 2021.[4] To place these figures into context, Fiscal Year 2022 total expenditures across all U.S. states were $2.9 trillion, ranging from $5.6 billion in Wyoming, to $35.5 billion in Alabama, to $510.0 billion in California.[5]

Importantly, the present SEC is aware that the Regulation D market has grown well beyond the size and complexity envisioned by the SEC in the early 1980s. While the agency has yet to undertake a fulsome response to these developments, SEC leaders are beginning to encourage additional action. For example, in early 2023, SEC Commissioner Crenshaw again encouraged reconsideration of whether 'investor sophistication' is the safeguard that

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[2] *See* SEC, Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales, Rel. No. 33-6389 (Mar. 8, 1982) [47 FR 11251 (Mar. 16, 1982)].

[3] *See* Craig McCann, *et. al.*, Regulation D Offerings Summary Statistics (Aug. 2022).

[4] *See* Phil Mackintosh, A Record Year for IPOs in 2021 (Jan. 13, 2022).

[5] *See* Urban Institute, State Fiscal Briefs, Alabama (July 2023).

policymakers thought it would be.[6] In addition, the SEC published a resource to educate investors about investing in Regulation D offerings.[7]

Similarly, state securities regulators are very aware that the present Regulation D market is dramatically different from the private placement market the SEC envisioned. Of note, incomplete, inaccurate, and/or misleading Regulation D disclosures are commonplace in today's market. State regulators routinely encounter disclosures that fail to include material information regarding the value and risks associated with the investment. In such an environment, accredited investors and, in some cases, nonaccredited investors face an uphill battle to determine whether the investment makes sense in their portfolio. The widespread use of sloppy or check-the-box disclosures in this marketplace also makes it more difficult for regulators and investors alike to spot the truly fraudulent offerings from the ones with inadequate disclosures.

It is within this context that I am here today to communicate four modest, urgent proposals for improving the Regulation D framework. However, I want to start by making a plug for more ambitious action. Specifically, as stated in NASAA's Federal Policy Agenda, we believe that the Commission should conduct a holistic study of its exemptive and registration pathways for raising capital and use the results of that study to inform a new, more efficient capital formation framework that disincentivizes the indefinite use of private or limited offerings.[8] This work is especially important given recent calls by some to increase retail investor exposure to this opaque, ill-liquid market.

Today, I want to focus on four modest changes to the Regulation D framework that require no study. They are well-supported by the significant investor harm that state securities regulators see regularly in the Regulation D market. Specifically, the Commission should:

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[6] *See* SEC Commissioner Caroline Crenshaw, Big "Issues" in the Small Business Safe Harbor: Remarks at the 50th Annual Securities Regulation Institute (Jan. 30, 2023) ("But, there are consequences to allowing issuers to grow so large without any of the requirements of registration….First, investors are simply not protected in the same ways in the private markets as they are in the public markets. The Rule 506 safe harbor provides insulation from state blue sky laws and, as I've mentioned, from the registration provisions of the federal securities laws. The current logic for that exemption, more or less, is that if investors are accredited, there is no need for any baseline regulatory disclosure obligations. Many would say, in fact, that large private issuers are backed by the most sophisticated investors in the world and don't need the SEC to impose disclosure or corporate governance protections. I am concerned, though, that sophistication is not quite the safeguard it's presumed to be. The relevant question perhaps should be, as the Fifth Circuit noted, whether investors have the information needed to bring "their sophisticated knowledge of business affairs to bear in deciding whether or not to invest." As private companies have gained increasingly large market power and as the pool of accredited investors has expanded – including venture capital, private equity funds, mutual funds, pension funds, and individuals that meet the requisite wealth thresholds – the de facto presumption that accredited investors need no disclosure isn't panning out.").

[7] *See* SEC, Private Placements under Regulation D – Investor Bulletin (Aug. 17, 2022).

[8] *See* NASAA, Federal Policy Agenda (last updated Jan. 5, 2023). *See also* Written Statement of Faith Anderson, Chief of Registration and Regulatory Affairs in the Securities Division of the Washington Department of Financial Institutions and Chair of the Small Business/Limited Offerings Project Group of NASAA, at the March 2, 2023 SEC Investor Advisory Committee "Panel Discussion Examining the Growth of Private Markets Relative to the Public Markets: Drivers and Implications" (Mar. 2, 2023); NASAA Report and Recommendations on Reinvigorating Our Capital Markets (Feb. 7, 2023); Prepared Remarks of Andrea Seidt for the SEC Small Business Capital Formation Advisory Committee Regarding Secondary Market Liquidity (Aug. 2, 2022).

1. Require issuers under Regulation D to submit Form D pre-issuance sales reports to the Commission.
2. Require issuers under Regulation D to submit Form D post-closing sales reports to the Commission.
3. Amend the definition of "accredited investor" to exclude assets accumulated or held in retirement plans from calculations of a natural person's net worth.
4. Amend the definition of "accredited investor" to adjust the net worth and income thresholds to account for inflation since 1982 and index those thresholds going forward.

The SEC Should Establish New Filing Requirements on Issuers Relying on Regulation D

In 2013, the Commission published proposed rules on several possible amendments to Regulation D under the Securities Act of 1933. The amendments were intended to enhance the Commission's ability to evaluate the development of market practices in Rule 506 offerings and address concerns that may arise in connection with permitting issuers to engage in general solicitation and general advertising under certain conditions. Notably for purposes of today's discussion, the proposed amendments to Regulation D would have required the filings of (1) a Form D in Rule 506(c) offerings before the issuer engaged in general solicitation (a so-called "Advance Form D"), (2) an amendment to the Advance Form D with the remaining information required by Form D within 15 calendar days after the date of the first sale of securities in the Rule 506(c) offering, and (3) the filing of a closing amendment to the Form D after the termination of any Rule 506 offering.[9]

Over the decades, NASAA has commented extensively about the need for private market reforms, including the need for these new filing requirements.[10] In short, the Commission never acted on the proposed amendments that would have established an Advance Form D or required the filing of a closing amendment. This inaction is notwithstanding past calls by the Investor Advisory Committee (the "committee") for SEC action. Indeed, in 2012, the committee recommended that the Commission require all issuers intending to rely on Rule 506(c) file with the Commission either a new "Form GS" or a revised version of Form D. The committee believed the form should request "simple information" such as the identity of the entity seeking to rely on the exemption and the control persons of that entity. In justifying the recommendation, the committee stated the data from the forms would be used both for (i) basic statistical purposes to help judge the effectiveness of the exemption and (ii) market monitoring purposes.[11]

NASAA continues to believe that the Commission should require the submission of Advance Form Ds along the lines outlined in the 2013 proposal. Under the 2013 proposal, the

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[9] *See* SEC, Amendments to Regulation D, Form D and Rule 156, SEC Rel. No. 33-9416 (July 10, 2013).

[10] *See* SEC Chair Mary Jo White, Statement at the SEC Open Meeting (July 10, 2013).

[11] Recommendations of the Investor Advisory Committee Regarding SEC Rulemaking to Lift the Ban on General Solicitation and Advertising in Rule 506 Offerings: Efficiently Balancing Investor Protection, Capital Formation and Market Integrity

agency would have required issuers to disclose only the following Form D items in their Advance Form Ds:

- 1. Basic identifying information on the issuer
- 2. Information on the issuer's principal place of business and contact information
- 3. Information on related persons
- 4. Information on the issuer's industry group
- 6. Identification of the exemption or exemptions being claimed for the offering
- 7. Indication of whether the filing is a new filing or an amendment
- 9. Information on the type(s) of security to be offered
- 10. Indication of whether the offering is related to a business combination
- 12. Information on persons receiving sales compensation
- 16. Information on the use of proceeds from the offering[12]

Advance Form Ds along these lines would empower state and federal securities regulators to make smarter decisions when they see advertised offerings. Absent Advance Form Ds, regulators who see an advertised offering have no easy way of knowing whether the issuer is engaged in a compliant Rule 506 offering or an unregistered, non-exempt public offering. Providing information in advance of a general solicitation would allow us to quickly assess questions relating to an investment solicitation and allow us to use our limited resources more efficiently.

In addition to supporting an Advance Form D, NASAA continues to believe the Commission should require that issuers file a final post-closing sales report or other closing amendment to their Form D. In 2013, the Commission proposed that issuers be required to file a final amendment to Form D within 30 calendar days after the termination of any offering conducted in reliance on Rule 506.[13]

Requiring a closing filing would provide more complete information of the total amounts of capital raised in these offerings and the methods used to verify accredited investor status. By way of illustration, in 2010, issuers sought to raise $1.2 trillion in reported Regulation D offerings but only $905 billion was reported as sold at the time of the initial Form D filing. Thus, based on the available information, regulators were unable to determine the actual amount raised. A requirement to file a closing amendment that confirms the actual amount raised in the offering could provide more complete information about the offering and a more accurate assessment of the overall size and quality of this market.[14]

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[12] *See generally* NASAA President Andrew Hartnett, Letter to SEC Director Erik Gerding, SEC Division of Corporation Finance Regarding Private Market Reforms (Mar. 7, 2023); NASAA President Lisa Hopkins, Letter to SEC Chair Jay Clayton in Follow Up to October 8 Meeting and Request for Recommendations from NASAA (Oct. 21, 2020); SEC, Amendments to Regulation D, Form D and Rule 156, SEC Rel. No. 33-9416 (July 10, 2013).

[13] *See* SEC, Amendments to Regulation D, Form D and Rule 156, SEC Rel. No. 33-9416 (July 10, 2013).

[14] *See* SEC, Amendments to Regulation D, Form D and Rule 156, SEC Rel. No. 33-9416 (July 10, 2013).

Of note, requiring a closing filing for Rule 506 offerings would likely come at a nominal cost to issuers. In many cases, the filing would be substantially similar to the initial Form D filing or prior Form D amendments for the offering.[15]

The SEC Should Strengthen the SEC's Definition of an Accredited Investor

As my fellow panelists have explained, the present versions of Regulation D, Rule 506 and related rules have changed very little in the last 40 years notwithstanding major changes in our securities markets. This is true for the SEC's definition of an accredited investor as well. In my opinion, the only two changes of note in 40 years have been with respect to primary residences and professional licenses.[16]

Specifically, in 2011, the Commission adopted amendments to the accredited investor standards in its rules under the Securities Act of 1933 to implement the requirements of Section 413(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, commonly referred to as the Dodd-Frank Act. Section 413(a) required that the value of a person's primary residence be excluded when determining whether the person qualifies as an "accredited investor" on the basis of having a net worth in excess of $1 million.[17]

In 2020, the Commission adopted amendments to permit natural persons to qualify as an accredited investor if they hold a Series 7, 65, or 82 license in good standing. The General Securities Representative license (Series 7), the Private Securities Offering Representative license (Series 82), and the Licensed Investment Adviser Representatives (Series 65) are professional certifications and designations for financial professionals. To obtain and qualify for these licenses, an individual must pass the related exam.

NASAA continues to believe that it is long overdue for the Commission to make two additional adjustments to the SEC's accredited investor income and net worth thresholds for natural persons. First, we believe that the Commission should exclude assets accumulated or held in retirement plans from inclusion in natural person accredited investor net worth calculations. Second, we believe the Commission should adjust the income and net worth thresholds to account for inflation since 1982 and then index those thresholds going forward.

As background, around the same time the natural person accredited investor thresholds were established in 1982, there was a marked shift in the benefits employers offered to

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[15] Presently, an issuer must file a new notice with the SEC for each new offering of securities no later than 15 calendar days after the "date of first sale" of securities in the offering as explained in the Instruction to Item 7. An issuer must file an amendment to a previously filed notice for an offering (i) to correct a material mistake of fact or error in the previously filed notice, as soon as practicable after discovery of the mistake or error; (ii) to reflect a change in the information provided in the previously filed notice, except as enumerated in the form instructions, as soon as practicable after the change; or (iii) annually, on or before the first anniversary of the most recent previously filed notice, if the offering is continuing at that time. Access the Instructions for Submitting a Form D Notice. To be clear, NASAA believes the Commission should maintain the periodic amendment requirement as well.

[16] To learn about additional changes, see SEC, Amendments to Accredited Investor Definition (last updated Mar. 29, 2021).

[17] SEC, Accredited Investors – Updated Investor Bulletin (Apr. 14, 2021).

employees. Now, the increased use of defined contribution plans over defined benefit plans leaves most workers responsible for providing the bulk of their own retirement savings. While it arguably would have been appropriate in the early 1980s to exclude retirement plans from these calculations, it is even more appropriate now. In particular, older investors can be vulnerable to losses that they simply cannot recoup over time. Protecting them from speculative private investing is essential.

As further background, 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—applied in 1982 to 1.6 percent of American households. Although a poor proxy for investor sophistication and the ability of the investor to bear financial losses, the thresholds seemed designed at the time to restrict the risks of private market investing to a group of investors who are more likely to withstand those losses. Today, the thresholds qualify approximately 13 percent of American households to engage in speculative private investing.[18]

NASAA Urges the Commission to Prioritize Trust in Our Markets

Generally, NASAA's perspective on the private markets, including the issues outlined in this statement, derives from our work to promote responsible capital formation and protect investors of all kinds. Speaking for myself, I have seen firsthand, time and again, the benefit of effectively regulated markets to the issuers who do act in good faith, the accredited and nonaccredited investors operating in or adjacent to our private markets, and the investment professionals who serve these issuers or investors.

As a prosecutor with the ASC, I have spent many long hours with investor victims of Regulation D frauds. In my experience, these fraudsters often use the Form D filing to give their scheme an appearance of legitimacy. The fraudster may have filed the disclosure on a timely basis. Alternatively, he may have learned of the government's investigation and then filed the Form D in order to "prove" to investors that the scheme is legitimate. Many investors have confidence in government documents generally, and these filings tend to serve the fraudster's goals.

In follow-up to these victim interviews, my office in Alabama has sent numerous letters to the SEC regarding issuer violations of Regulation D, Rule 506. Broadly, our letters since 2005 have documented cold calling activity, disclosure omissions, and significant conflicts of interest.

Sadly, these cases just keep coming. Right now, my office is reviewing several matters. The evidence strongly suggests the issuers were flat out stealing investor funds. Currently, I expect to bring civil or criminal charges, or both. While I am not at liberty to share all the details, I can give you a sense of the types of cases we see. Recently, I became aware of a matter in which the self-dealing and incestuous business relationships resulted in millions of dollars in undisclosed compensation to the issuer and related affiliates. Here, a fund, which the issuers owned, paid the issuers and related parties to invest on the fund's behalf. The companies in

[18] SEC Proposed Rule, Amending the "Accredited Investor" Definition, Rel. Nos. 33-10734 and 34-87784 (Dec. 18, 2019), at 77, 134.

which the fund invested not only paid fees to the issuers for arranging the financing, but also signed agreements that unknowingly obligated them to pay companies affiliated with the issuers for ongoing business services.

Conclusion

Thank you again for the opportunity to speak. I hope the SEC will take more ambitious actions around Regulation D than the four proposals we are asking for today. However, we appreciate that modest, but impactful, reforms may be all that is possible in the short term. Should you decide to incorporate some or all of my comments into a recommendation to the SEC, I would be delighted to engage with you further. In the meantime, I look forward to any questions you might have for me.