

June 1, 2020

Via Email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

Ms. Vanessa Countryman  
*Secretary*  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: Release Nos. 33-10763; 34-88321; File No. S7-05-20  
Facilitating Capital Formation and Expanding Investment Opportunities by  
Improving Access to Capital in Private Markets

Dear Ms. Countryman,

OpenDeal Inc. (collectively with its subsidiaries, “Republic”) respectfully submits this letter in response to the request for comment by the Securities and Exchange Commission (the “Commission”), on its Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets rule proposals, File No. S7-05-20 (the “Proposals”). We thank the Commission for its efforts in publishing the Proposals and the opportunity to provide our comments.

We strongly support the Proposals and believe that, once adopted, the Proposals would harmonize and improve the exempt offering framework, promote more vibrant capital markets, whilst maintaining appropriate investor protections. We are, however, concerned by the proposed amendment to limit the types of securities issuable under Regulation Crowdfunding as well as certain recommendations that we believe do not provide sufficient reform to achieve the Commission’s goals. This letter addresses these concerns and suggests additional changes aimed to further streamline the capital formation process. We also wish to highlight the pressing need for the Proposals; with the current health pandemic (the “COVID-19 Pandemic”) and the economic uncertainty it has thrown the country (and world) in to, the need for small businesses to secure operating capital has never been greater.<sup>1</sup> A timely adoption of the Proposals would materially contribute to job creation and the U.S. economy, of which small and emerging businesses are the bedrock.

### **I. Republic’s business with respect to unregistered offerings**

As a family of companies that includes a registered crowdfunding portal, a registered broker-dealer, an exempt reporting adviser and a game development platform financing its ventures through Regulation A, Republic is in the business of servicing and facilitating a wide range of offerings exempted from registration under the Securities Act of 1933, as amended (the “Securities Act”). Exempt offerings play a pivotal role in the private capital markets and are central to Republic’s businesses. The Commission acknowledged the need for registration exemptions in the Proposals “[i]n recognition of the fact that registration is not always necessary or appropriate, the Securities Act contains a number of exemptions from its registration requirement and the Commission is authorized to adopt additional exemptions. . . . emerging companies— from early-stage start-ups seeking seed capital to companies that are on a path to become a public reporting company—may use the exempt offering rules to access critical capital needed to grow and scale.”<sup>2</sup> Further, recent studies have shown that private companies are “going public” later, and may never offer their

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<sup>1</sup> As the Commission recently acknowledged in the, “Temporary Amendments” - Release No. 33-10781 at 2, “. . . many small businesses are facing challenges accessing urgently needed capital in a timely and cost-effective manner.”

<sup>2</sup> Proposals at 6.

securities through a registered offering, resulting in the majority of Americans being excluded from possible substantial returns on investment, only open to those early stage investors that are generally accredited or company insiders. We believe providing access to private company investments as a means of diversifying main street investors' portfolios is necessary to level the playing field for investors of all backgrounds, and that many private companies in need of early-stage funding would rather secure that funding from their customers, who can become investor-evangelists, rather than institutional financiers. Regulation Crowdfunding and Regulation A+ are the two best tools to do this; however, the slow growth of Regulation Crowdfunding and Regulation A+, coupled with the high compliance costs of running our business means that without necessary action by the Commission to encourage the expansion of these registration exemptions, market participants like Republic may not be able to sustain operations and democratize private company investment opportunities. We believe that, in aggregate, the Proposals will provide essential access to capital for the business that need it most in the face of the current COVID-19 Pandemic. The COVID-19 Pandemic has slowed economies all over the world and small business, startups and early stage companies are facing an unexpected and unprecedented need for capital.<sup>3</sup> Due to that need, the ability to offer securities that do not require the payment, or accrual, of interest, and do not require the time and expense of providing a formal valuation to a venture, is critical; therefore we believe that restricting the offer and sale of simple agreements for future equity (SAFEs) and other alternative instruments during, or in the wake of, the COVID-19 Pandemic would unduly limit the ability of such businesses to access capital at a critical time and would generally be damaging to Regulation Crowdfunding's utility.<sup>4</sup>

## **II. General Solicitation and Offering Communications**

Issuers are currently prohibited from “testing the waters” for a prospective Regulation Crowdfunding offering before their Form C is filed. As a result, issuers cannot assess interest in their offerings before committing the time and incurring the expenses necessary to conduct a Regulation Crowdfunding offering and face the potential of such offering failing, which may negatively affect the way they are perceived by customers, employees and future financing sources. This is not the case under Regulation A, which allows issuers to “test the waters” both before and after their Form 1-A is filed.<sup>5</sup> The Commission has set forth a general testing the waters rule which will allow issuers to determine whether an offering under (i) Regulation A, (ii) Regulation Crowdfunding, (iii) Rules 147 or 147A, (iv) Rule 504(b) and/or (v) Rule 506(c), will best achieve their goals, without incurring cost or endangering investors. We are highly supportive of proposed Rule 241 and related Regulation Crowdfunding proposed rule 206.

### **a. Testing the Waters**

We support the adoption of proposed Rules 206 and 241 and believe that issuers should be permitted to “test the waters” for any offering that permits general solicitation, and specifically for potential Regulation Crowdfunding offerings, subject to similar requirements. In addition, the existing Regulation

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<sup>3</sup> See New York Times (April 13, 2020, updated April 20, 2020), available at <https://www.nytimes.com/2020/04/13/business/coronavirus-economy.html>, and MetLife & U.S. Chamber of Commerce Special Report on Coronavirus and Small Business (April 3, 2020), available at [https://www.uschamber.com/sites/default/files/metlife\\_uscc\\_coronavirus\\_and\\_small\\_business\\_report\\_april\\_3.pdf](https://www.uschamber.com/sites/default/files/metlife_uscc_coronavirus_and_small_business_report_april_3.pdf) (“With high levels of concern about COVID-19 reported in every sector and region of the country, one in four small businesses (24 percent) report having already temporarily shut down. Among those who haven’t shut down yet, 40 percent report it is likely they will shut temporarily within the next two weeks. Forty-three percent believe they have less than six months until a permanent shutdown is unavoidable.”).

<sup>4</sup> See Temporary Amendments to Regulation Crowdfunding, Release No. 33-10781 (“Temporary Amendments”) and its focus on liberalizing the use of Regulation Crowdfunding to encourage expedited capital formation without restricting security types.

<sup>5</sup> See SEC Rule 255, such solicitations are subject to issuer compliance with rules on filing of solicitation materials and disclaimers.

Crowdfunding offering framework can easily be leveraged to provide adequate investor protection safeguards in connection therewith. For example, since issuers must conduct Regulation Crowdfunding offerings through registered crowdfunding portal and broker-dealer intermediaries, we previously suggested that the Commission impose a requirement that any “testing the waters” process also be conducted solely through an intermediary’s platform.<sup>6</sup> While the Proposals do not go that far, they do subject such solicitations to the antifraud protections under the federal securities laws and required such solicitations be filed with the Commission as an exhibit to the Form C. This requirement provides oversight and ensures that (i) the intermediary assess the issuer’s previous communications when determining the suitability of the offering and (ii) all prospective investors are able to review solicitations, prior to any sales. Any risk of investor harm resulting from such a process is thoroughly mitigated as intermediaries may not permit any sales to be affected until an issuer files its Form C and otherwise complies with the requirements of Regulation Crowdfunding. Such changes would enhance the utility of Regulation Crowdfunding by permitting the crowd to help companies decide whether or not to conduct a Regulation Crowdfunding offering in the first place and further align Regulation Crowdfunding more closely with Regulation A. Incidentally, the Commission’s conditional relief related to the COVID-19 Pandemic has liberalized certain issuers’ ability to solicit interests before completing an offering statement and conducting sales.<sup>7</sup>

#### **b. Regulation Crowdfunding Communications**

We are highly supportive of the proposed amendments to Regulation Crowdfunding Rule 204, which would provide clarity as to whether issuers may engage in oral, off platform, offers with prospective investors in compliance with Rule 204’s other requirements, however, we do not believe this clarity provides the necessary relief issuers utilizing Regulation Crowdfunding require.<sup>8</sup> Rule 204 of Regulation Crowdfunding provides that an issuer may not advertise the terms of its Regulation Crowdfunding offering except by way of a brief notice that directs investors to the relevant intermediary’s platform and includes no more than limited specified information regarding the offering. Rule 204 is the only instance of the Commission severely restricting advertisements an issuer may undertake during an offering that permits general solicitation, and its ambiguity has made issuers hesitant to discuss their offering off platform. Some issuers have gone as far as to carry an iPad so that prospective investors could review the offering through the portal in instances where a founder may be asked about the offering during normal social interactions.

We do not believe that issuers should be prohibited from engaging in broader marketing efforts once their Form C has been filed with the Commission and agree with the 2018 Small Business Forum that such rules are difficult to understand and “run counter to the intent of the law: to promote the democratization of investing.”<sup>9</sup> Our experience supports this assertion as we have encountered many Regulation Crowdfunding issuers (and investors) who find these restrictions confusing and counterintuitive. We do not believe that allowing issuers to engage in offering-related communications outside of the relevant platform’s channels after their Form C has been filed with the Commission would raise significant investor protection concerns, as all sales would remain restricted to the regulated intermediary’s platform. Such communications would also remain subject to the antifraud and other civil liability provisions of the federal securities laws. Accordingly, we recommend that the Commission permit Regulation Crowdfunding issuers to engage in unrestricted communications and therefore the Commission should eliminate Regulation Crowdfunding Rule 204(a-b), while leaving Regulation Crowdfunding Rule 204(c) or simply changing Regulation Crowdfunding Rule 204(c)’s language to reference or mirror Section 17(b) of the Securities Act. We also note that Commissioner Peirce has highlighted the need to consider liberalizing advertisement

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<sup>6</sup> See Proposals at 72-73 and proposed Rule 206.

<sup>7</sup> See Temporary Amendments.

<sup>8</sup> Proposals at 84.

<sup>9</sup> See Final Report of the 2018 SEC Government-Business Forum on Small Business Capital Formation (Jun. 2019), at 20.

restrictions in the face of the COVID-19 Pandemic, stating “There may be more we can do to aid small businesses with urgent funding needs. What solutions might be hiding within our federal securities laws?”<sup>10</sup>

### **III. Proposed Changes to Offering, Investment and Instrument Limitations in Regulation A and Regulation Crowdfunding**

The Commission’s proposals to raise the maximum offering limits per 12-month period to \$75 million for Tier 2 of Regulation A and to \$5.0 million for Regulation Crowdfunding are of particular importance to us. We also believe aligning investment limits between the two registration exemptions, for unaccredited and accredited investors, is necessary to ensure their growth and to reduce investor and issuer confusion. However, we believe the Commission’s proposal to constrain which instruments can be used under Regulation Crowdfunding and remove such limitations from Regulation A would not provide any meaningful investor protection and may push issuers towards other offering types such as Regulation D and Regulation S, which will exclude main street investors from participating in these offerings.

#### **a. Offering Limits:**

In the summer of 2019, we recommended the Commission increase the offering cap of Regulation Crowdfunding to at least \$5.0 million “ . . . and preferably up to \$10.0 million.”<sup>11</sup> Currently, an issuer is permitted to raise a maximum aggregate amount of \$1.07 million in a 12-month period in reliance on Regulation Crowdfunding. In the Adopting Release for Regulation Crowdfunding, the Commission noted that while many commenters on the proposed rules believed that the offering limit was too low, it was “concerned about expanding the offering limit of the exemption beyond the level specified in Section 4(a)(6) at the outset of the adoption of final rules.”<sup>12</sup> After four years of experience, we believe that the \$1.07 million offering limit has and, unless raised significantly, will continue to severely impair the utility of Regulation Crowdfunding. Therefore we continue to believe \$10.0 million is the appropriate offering cap and are supportive of a \$5.0 million offering cap as a step toward expanding Regulation Crowdfunding.

In many cases, Republic has found that issuers conducting a Regulation Crowdfunding offering will need to spend additional time and incur additional expense pursuing other exempt offering types (either after or in conjunction with their Regulation Crowdfunding offering) to meet their funding requirements, as Regulation Crowdfunding cannot meet their needs. Given the nature of the exemptions utilized in these cases, such concurrent and subsequent offerings have typically not been open to the public nor provided the same levels of disclosure or oversight as a Regulation Crowdfunding offering. Similarly, Republic has encountered many potential issuers that are unwilling to expend the time and costs<sup>13</sup> associated with conducting a Regulation Crowdfunding offering when faced with the reality that the offering limit may

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<sup>10</sup> See Remarks at Meeting of the SEC Small Business Capital Formation Advisory Committee, May 8, 2020, Commissioner Hester M. Peirce, available at <https://www.sec.gov/news/public-statement/statement-peirce-sbcfac-2020-05-08>; while Commissioner Peirce was discussing Regulation A, we believe the sentiment is analogous to the frictions issuers utilizing Regulation Crowdfunding face.

<sup>11</sup> Republic’s response to the Concept Release can be found at <https://www.sec.gov/comments/s7-08-19/s70819-6189775-192417.pdf>.

<sup>12</sup> See Release No. 33-9974 (Oct. 30, 2015), at 17. Further, we note that we and other crowdfunding industry stakeholders are unaware of any instances of outright fraud by Regulation Crowdfunding issuers, which we believe underscores the effectiveness of the gatekeeper role that crowdfunding intermediaries have played, *see also* Report to the Commission, Regulation Crowdfunding (Jun. 18, 2019) at 42-44.

<sup>13</sup> In the Report to the Commission, Regulation Crowdfunding (Jun. 18, 2019) (the “Regulation Crowdfunding Report”), the Staff of the Commission found that the average issuer incurred \$22,479 in costs associated with conducting a Regulation Crowdfunding offering (before paying commissions to intermediaries and escrow agents) and expended 241 hours of human capital.

prevent them from fulfilling their capital needs without seeking other sources of funding. We believe that the adoption of the higher offering limits would “make these exemptions more cost-effective[.]”<sup>14</sup>

Although to date, the majority of issuers have not exhausted the existing Regulation Crowdfunding offering limits and Regulation A Tier 2 offering limits, we believe there are compelling reasons to consider raising these limits. A higher offering limit will enhance capital formation for those Regulation Crowdfunding and Regulation A issuers that have exhausted existing offering limits. Further, as the commission acknowledged, “. . . a higher offering limit may make Regulation A offerings more attractive to Exchange Act reporting companies, which may be more established companies.”<sup>15</sup> We believe a similar affect will occur under Regulation Crowdfunding, with more established companies utilizing the registration exemption rather than raising capital from a select group of accredited and institutional investors. In its a recent report on private company financing trends, Wilson Sonsini found that the *median* amount raised for Series Seed financings in the second quarter of 2019 was \$2.7 million, while the *median* amount raised for Series A financings was \$10.6 million over the same period.<sup>16</sup> These findings illustrate the impact of offering limits on how viable Regulation Crowdfunding and Regulation A offerings are for early-stage issuers who need large amounts of capital to sustain and grow their operations. Adopting higher offering limits for Regulation Crowdfunding and Regulation A would also have the benefit of making both offering types more attractive to a diversified pool of issuers and, as a result, attract more financial intermediaries for whom the cost burden of hosting offerings will be better aligned to their compensation.<sup>17</sup>

If Regulation Crowdfunding maintains its unrealistically low offering limit, its intention and potential are both compromised by pushing more established issuers away from Regulation Crowdfunding and towards other exempt offering types not open to the general public, while impeding the capital formation efforts of founders who do not have access to the financing sources necessary to even avail themselves of such exemptions. One of the goals of the Jumpstart Our Business Startups Act was to help startups and small businesses lacking such access raise capital through investments from the “crowd”.<sup>18</sup> However, female, minority, veteran and immigrant entrepreneurs, as well as entrepreneurs based in middle America, often struggle to obtain exposure to and capital from traditional venture investors. The current \$1.07 million offering limited is reduced the utility and widespread acceptance of using Regulation Crowdfunding as a funding method. These concerns are amplified by the recent economic crises spurred by the COVID-19 Pandemic. We believe that increasing the offering limit to \$5.0 million or \$10.0 million would enable more companies and individuals to raise and invest under this framework, thereby directly contributing to diversifying and strengthening capital formation as the U.S. economy seeks to recover in the next 12-14 months, as a rising tide lifts all boats. Therefore, the current offering limits reduce the promise of Regulation Crowdfunding to provide the means for underserved entrepreneurs to obtain necessary funding from their customers, friends, family and other supporters. In addition, pushing issuers and investors away from Regulation Crowdfunding and towards exempt offering types with less rigorous (or no) substantive disclosure obligations or oversight is counterproductive to investor protection.

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<sup>14</sup> Proposals at 167-168.

<sup>15</sup> Proposals at 120.

<sup>16</sup> See The Entrepreneurs Report – Private Company Financing Trends 1H 2019, available at: <https://www.wsg.com/publications/PDFSearch/entreport/1H2019/private-company-financing-trends.htm>.

<sup>17</sup> Proposals at 167-168.

<sup>18</sup> See, e.g., congressional statements regarding crowdfunding bills that were precursors to the Jumpstart Our Business Startups Act: 157 CONG. REC. S8458-02 (daily ed. Dec. 8, 2011) (statement of Sen. Jeff Merkley) (“In recent years, small businesses and startup companies have struggled to raise capital. The traditional methods of raising capital have become increasingly out of reach for many startups and small businesses. There is another option, but Congress must act to authorize it and provide for appropriate safeguards. Low-dollar investments from ordinary Americans may help fill the void, providing a new avenue of funding to the small businesses that are the engine of job creation. The CROWDFUND Act would provide startup companies and other small businesses with a new way to raise capital from ordinary investors in a more transparent and regulated marketplace.”)

## b. Investment Limits

Currently, investors are limited in the amounts they are allowed to invest in all Regulation Crowdfunding offerings over the course of any 12-month period, as follows: (i) if either of an investor's annual income or net worth is less than \$107,000, then their 12-month investment limit is the greater of: \$2,200 or 5% of the *lesser* of their annual income or net worth; (ii) if both their annual income and net worth are equal to or more than \$107,000, then their 12-month investment limit is 10% of the *lesser* of their annual income or net worth and (iii) in no event shall the aggregate amount of securities sold to an investor through all Regulation Crowdfunding offerings in a 12-month period exceed \$107,000, regardless of the investor's annual income or net worth. In our experience, the application of this formula is very confusing for investors and issuers and can be difficult for intermediaries to track, especially when investors invest across multiple platforms. We have found that investors do not always provide reliable information about their Regulation Crowdfunding investment activity on other platforms because of confusion as to which of their investments were made pursuant to Regulation Crowdfunding versus Regulation A. The Commission has partially addressed this issue by proposing that investment limits for non-accredited investors be based on the *greater* of annual income or net worth but proposed retaining the 12-month look back period for calculating the maximum amount that can be invested. We think this is a half-step and recommend that the Commission adopt a simpler and more intuitive approach that would base investment limits for non-accredited investors on the *greater* of annual income or net worth and implement them on a *per offering* rather than a *cumulative 12-month* basis. By making both changes, the investment limits for non-accredited investors under Regulation Crowdfunding more closely align with those of Tier 2 of Regulation A, reducing investor confusion and making the tracking of investment limits consistent among intermediaries.

In line with the Proposals, we believe that the Regulation Crowdfunding investment limits for accredited investors should be eliminated.<sup>19</sup> In discussing this topic in the Adopting Release for Regulation Crowdfunding, the Commission expressed its view that “crowdfunding transactions were intended under Section 4(a)(6) to be available equally to all types of investors” and noted that “issuers can rely on other exemptions to offer and sell securities to accredited investors and institutional investors.”<sup>20</sup> However, as noted above, forcing startups and small businesses to spend additional time and expense pursuing other exempt offering types after or in conjunction with a Regulation Crowdfunding offering is not only inefficient, but reduces the viability of a Regulation Crowdfunding offering for many issuers.<sup>21</sup> Further, limiting accredited investors' participation in an offering that requires robust disclosure and a registered intermediary, when they are otherwise unrestricted in less regulated offerings, is counterintuitive to the intent of accredited investor status, *i.e.* a status that is “intended to encompass those persons whose financial sophistication and ability to sustain the risk of loss of investment or fend for themselves render the protections of the Securities Act's registration process unnecessary.”<sup>22</sup> Accordingly, we recommend that the Commission eliminate Regulation Crowdfunding investment limits for accredited investors, which would also align Regulation Crowdfunding with Regulation A and Regulation D.<sup>23</sup>

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<sup>19</sup> Proposals at 132.

<sup>20</sup> See Release No. 33-9974 (Oct. 30, 2015), at 28.

<sup>21</sup> Proposals at 167-168.

<sup>22</sup> Regulation D Revisions; Exemption for Certain Employee Benefit Plans, Release No. 33-6683 (Jan. 16, 1987) [52 FR 3015 (Jan. 30, 1987)].

<sup>23</sup> Proposals at 134 (“[t]he proposed amendment would conform Regulation Crowdfunding with Tier 2 of Regulation A and use a consistent approach to mitigate concerns regarding the ability of investors to absorb losses incurred in offerings conducted in reliance on the two exemptions”).

### c. Instrument Limitations

While Regulation Crowdfunding does not restrict the types of securities eligible to be sold under the exemption, the types of securities eligible for sale under Regulation A are limited to equity securities, debt securities, and securities convertible or exchangeable to equity interests, including any guarantees of such securities. Regulation A also specifically excludes asset-backed securities.<sup>24</sup> The Commission is now proposing to impose Regulation A's current instrument limits on to Regulation Crowdfunding, while removing them from Regulation A, and also considering banning the offer and sale of specific securities such as the SAFE under Regulation Crowdfunding. While the Proposals suggest that the changes to eligible instruments under Regulation Crowdfunding would restrict the use of SAFE instruments, we do not agree that this would be the effect.

Under Rule 405 of the Securities Act an "equity security" is defined as "any stock or similar security, certificate of interest or participation in any profit sharing agreement, preorganization certificate or subscription, transferable share, voting trust certificate or certificate of deposit for an equity security, limited partnership interest, interest in a joint venture, or certificate of interest in a business trust; any security future on any such security; or any security convertible, with or without consideration into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any put, call, straddle, or other option or privilege of buying such a security from or selling such a security to another without being bound to do so." Under the definition above, SAFEs are both equity securities as well as securities convertible or exchangeable into equity securities, therefore SAFEs would remain eligible instruments under Regulation Crowdfunding.<sup>25</sup>

Furthermore, modifying Regulation Crowdfunding only to exclude the SAFE<sup>26</sup> would (i) unduly restrict a company's business discretion to balance the pros and cons of the different form of securities (stock verses debt verses SAFE), (ii) contradict the purpose behind the disclosure requirements of Regulation Crowdfunding, which we believe are appropriately protective of investors both in terms of risk disclosure and ongoing information rights, (iii) arbitrarily subjugate the SAFE as being disadvantageous to investors without empirical evidence; (iv) discourage companies in sectors where the use of SAFE is prevalent from raising capital from the crowd; and (v) stifle the growth and innovative spirit of Regulation Crowdfunding. We believe that the Commission should not deviate from its longstanding approach of basing exemptions on the characteristics of the securities themselves or the transactions in which they are offered or sold and therefore should remove all restrictions on security type for Regulation A and Regulation Crowdfunding due to the issuer eligibility requirements act as the effective gate to prevent highly speculative issuers from utilizing the exemptions.<sup>27</sup>

The Commission has expressed concern that retail investors may "face challenges in analyzing and valuing such securities" or be confused by the descriptions of such securities on an intermediary's portal.<sup>28</sup> However, in practice, the SAFE is not any more or less complex or difficult to analyze than convertible notes or different classes of stock. For example, there is no material difference between a standard SAFE and a standard convertible note, except that with the SAFE, investors need not account for accrued but unpaid interest (and the related tax reporting consequences). Similarly, an inexperienced investor assessing

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<sup>24</sup> Proposals at 138. We note that despite disallowing asset-backed securities, real estate investments, held through single or series limited liability companies owned by the issuer are prevalent in Regulation A+ offerings.

<sup>25</sup> We are aware that in the past the Commission has characterized SAFEs as debentures, however, they do not meet the basic requirements of a debt instrument and even if they did, debt remains an eligible instrument under the Proposals amendments to Regulation Crowdfunding's instrument eligibility.

<sup>26</sup> Proposals at 158.

<sup>27</sup> Id. at 10.

<sup>28</sup> Id. at 156-157.



an offering of common stock or preferred stock may draw an inaccurate assumption with respect to their ownership percentage in the issuer, given that the issuer may have other classes of stock with different rights and privileges and an issuer has the ability to dilute investors through the issuance of additional shares, something that SAFEs can protect against. Private investing is inherently complex, and different types of businesses and financing terms call for different instruments<sup>29</sup>, but absent clear and pervasive evidence of fraud and abuse, there is no basis to mandate which businesses must use which type of instrument. Disclosure is the means to ensure that investors understand the risk and rights of the securities being offered.

As one of the most active registered funding portals since 2016, we believe that Regulation Crowdfunding adequately and appropriately addresses investor protection concerns by prescribing disclosure requirements for both issuers and intermediaries. Not only must the issuer disclose “[t]he terms of the securities being offered and each other class of security of the issuer, including the number of securities being offered and/or outstanding, whether or not such securities have voting rights, any limitations on such voting rights, how the terms of the securities being offered may be modified and a summary of the differences between such securities and each other class of security of the issuer, and how the rights of the securities being offered may be materially limited, diluted or qualified by the rights of any other class of security of the issuer,”<sup>30</sup> but the intermediary is *also* required to provide investors with educational materials, including information about the types of securities offered and sold on the intermediary’s platform and the risks associated with each type of security.<sup>31</sup> In addition, SAFEs are one of the most popular securities offered in Regulation Crowdfunding offerings,<sup>32</sup> which has resulted in a wealth of literature and guidance regarding their use, conversion mechanics, risks and common terms.<sup>33</sup> Both FINRA and the Commission itself has issued educational materials regarding SAFEs.<sup>34</sup> Relatedly, members of the Commission and public have called in to question the fairness of SAFEs due to provisions such as a “[ ] redemption feature by which a company can call its SAFEs from all non-accredited investors”<sup>35</sup> Such provisions are typically not included in SAFEs and can be featured in other security instruments, including common stock and convertible note. When an offering on Republic’s crowdfunding portal provides for investment terms with such provisions, we require the issuer make these provisions clear to investors (and apply to all investors, regardless of their accreditation status), in a prominent manner, both to meet the portal and the issuer’s disclosure requirements, as well as in the interest of fairness.<sup>36</sup> Due to the many investor protections centered on educating investors about SAFEs and other securities that may be offered and sold under Regulation Crowdfunding on each intermediary’s platform, investors are able to make informed choices and can choose to not invest in an offering with terms they believe are not in their best interest or not marketable.

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<sup>29</sup> For an overview of the advantages and disadvantages of various financing instruments, please see: [https://content.next.westlaw.com/Document/If79627a5428311e598dc8b09b4f043e0/View/FullText.html?contextData=\(sc.Default\)&transitionType=Default&firstPage=true&bhcp=1](https://content.next.westlaw.com/Document/If79627a5428311e598dc8b09b4f043e0/View/FullText.html?contextData=(sc.Default)&transitionType=Default&firstPage=true&bhcp=1).

<sup>30</sup> See 17 CFR 227.201(m)(1).

<sup>31</sup> See 17 CFR 227.302(b).

<sup>32</sup> See Proposals at 262 “SAFES accounted for 21 percent of the number of offerings and 24 percent of the aggregate target amount sought.”

<sup>33</sup> See <https://republic.co/crowdsafe>, <https://www.nextseed.com/education-center/investor/nextseed-safe>, and <https://medium.com/@josephraim/complete-guide-to-understanding-safes-how-we-invest-at-dorm-room-fund-bbb37855ec4e>, among numerous other resources.

<sup>34</sup> See SEC Office of Investor Education and Advocacy, Investor Bulletin: Be Cautious of SAFEs in Crowdfunding (May 9, 2017), available at [https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib\\_safes](https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_safes).

<sup>35</sup> Crowdfunding and the Not-So-Safe SAFE, *Posted by Joseph Green, Thomson Reuters Practical Law, and John Coyle, University of North Carolina, on Thursday, September 15, 2016, accessible at https://corpgov.law.harvard.edu/2016/09/15/crowdfunding-and-the-not-so-safe-safe/*

<sup>36</sup> In the rare event a repurchase provision has been allowed, Republic has also required the issuer provide for, in the instrument, a minimum return and an independent third party valuation of the instrument before repurchasing to ensure investors are paid fair-market-value of greater in the event a repurchase is affected.



Critics of the SAFE place unreasonable weight on the fact that, compared to traditional equity security, it grants the holder no voting rights. To date, not a single Republic investor has complained about not having voting right or wishing that she had secured voting rights at the time of investment. A micro-investor deploying \$400 into a company typically would not want to vote or otherwise participate in corporate governance; they simply expect a return if the company does well and realizes a liquidity event. However, if voting rights are mandated, we strongly believe that credible companies with established operations and robust revenue (*i.e.*, the more attractive investment opportunities) will avoid raising under Regulation Crowdfunding altogether, thereby leaving the most high-risk companies with no other financing option turning to the crowd to raise capital. That would fulfill the negative assumption of "adverse selection" faced by Regulation Crowdfunding issuers - something Republic has been working very hard in the past years to overcome for the benefits of our issuers and the industry at large.

The SAFE also provides issuers organized as limited liability companies ("LLCs"), and their investors, material advantages over other financing instruments. LLCs typically pass through both liability and income to their underlying owners. As such, many investors do not wish to have equity ownership in companies organized as LLCs, and instead opt to invest via a SAFE or a convertible note with a requirement that there can be no conversion unless and until the company has been restructured and incorporated as a corporation. The main difference between the SAFE and convertible note is that the former does not accrue ongoing interest. Interests accrued under a convertible note is often *de minimis* and not paid out in cash, but it results in complex accounting obligations and added expenses for the issuer as well as the investors (primarily in the form of Form K-1 issuance and IRS reporting). Because of that, from our experience, small businesses organized as LLCs and their investors prefer the SAFE over other financing instruments.

The Proposal further suggests that restrictions on the SAFE would be a fair tradeoff with the creation of "a crowdfunding vehicle that meets conditions designed to require that it function as a conduit for investors to invest in a business that seeks to raise capital through a crowdfunding vehicle" from the definition of "investment company" under the Investment Company Act of 1940.<sup>37</sup> Such special purpose vehicles are referred to herein as "SPVs" and are themselves typically limited liability companies. SPVs cannot adequately alleviate the harms created by restricting the offer and sale of SAFEs, and the net effect of these changes would be to reduce the desirability of fundraising under Regulation Crowdfunding. Under the Proposals, the SPVs would be limited in utility and, as such, expensive and cost prohibitive for many issuers because (1) the proposals require that they be organized and operated for the sole purpose of acquiring, holding, and disposing of securities by a single issuer, (2) they preclude SPVs from borrowing money or from using the proceeds of sales to do anything but purchase a single class of securities from a single crowdfunding issuer, and (3) SPVs would be permitted to issue only one class of security.<sup>38</sup> Additionally, the proposed changes would increase the cost of offerings under Regulation Crowdfunding by (1) requiring issuers to provide an undertaking upfront in order to fund the expenses of the creation and operation of SPVs, (2) requiring the SPVs to vote the crowdfunding issuer securities and to participate in tender or exchange offers, (3) forcing SPVs to deliver all disclosures directly to investors and potential investors<sup>39</sup> and (4) due to the tax code, requiring the delivery of K-1s to potentially thousands of investors every year, regardless of profits earned by such investors, which could cost an issuer thousands of dollars per year.<sup>40</sup> As proposed, SPVs should not be considered a viable alternative for many issuers due to the hardships imposed and the limited benefits provided to investors, and would therefore not alleviate the

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<sup>37</sup> Proposals at 144.

<sup>38</sup> Proposals at 147. We note this could prevent SPVs from being used in offerings with early-bird or instruments that provide different terms for larger investors as well as prevent them from realizing economies of scale by being re-usable for subsequent or follow on offerings.

<sup>39</sup> *Id.* at 149.

<sup>40</sup> SAFE instruments and common stock do not create annual tax document delivery obligations to investors unless and until distributions are made to holders, a boon to issuers looking to reduce operational and ongoing costs.

harms caused by restricting the offer and sale of SAFEs and other alternative instruments. We believe the Commission's proposal to discontinue the use of SAFEs or limit its use to certain types of businesses would deter issuers from fundraising under Regulation Crowdfunding and would not strengthen investor protection beyond the existing robust disclosure framework.

#### **d. Regulation Crowdfunding Financial Reporting Requirements**

While the Proposals aim to increase access to capital markets in a comprehensive manner, we entreat the Commission to also consider adopting adjustments to the financial reporting requirements of Regulation Crowdfunding.<sup>41</sup> In conjunction with raising the offering limit, we recommend that the Commission impose a requirement that issuers seeking to raise more than \$2.5 million must provide reviewed financial statements, but any offering of less than a maximum amount of \$2.5 million should be allowed to proceed solely with financial statements prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") statements and a self-certification. Similarly, we believe that repeat Regulation Crowdfunding issuers should not be required to provide audited financial statements until the aggregate amount of securities that they have sold and are currently offering pursuant to Regulation Crowdfunding exceeds \$2.5 million. In our experience the financial statement disclosure requirements are the most burdensome aspect of conducting a Regulation Crowdfunding offering; however, we believe that the ability to raise amounts greater than \$2.5 million would justify the time and expense involved in undertaking a review or an audit for many issuers. We believe that these thresholds better reflect both the stage of development at which issuers raising such amounts would be, as well as the needs of their investors, and that the adoption thereof would not increase the risk of fraud or investor harm when considered in the totality of Regulation Crowdfunding's safeguards. We note that the Commission has already provided conditional relief toward the financial statement reporting requirements for certain issuers through August of 2021<sup>42</sup> and encourage the Commission to consider extending this exercise, indefinitely, when adjusting these requirements as the economic harm caused by the COVID-19 Pandemic is likely to be far reaching, well beyond August of 2021.

### **IV. Integration**

The Proposals' discussion of integration, specifically the proposed new Rule 152, which we believe will provide substantial relief and certainty to companies utilizing numerous registration exemptions in a specific period of time, because new Rule 152 provides clarity on avoiding the integration of several offering types. The principles-based approach to integration is the proper and necessary standard by which to determine whether two, or more, offerings should be considered one for the purposes of perfecting a registration exemption.<sup>43</sup> Similar to Rule 506(c)'s focus on the ultimate purchaser, rather than those who may have been inadvertently or purposefully solicited, the new Rule 152 would allow issuers which are in the middle of closing private rounds, or who renew negotiations with a prospective investor they previously solicited and have a substantive relationship with, to accept their investment without needing to fold such investor into a general solicitation offering. We are also highly supportive of the thirty (30) day "cooling off" safe harbor put forward by the new Rule 152, along with the serial 506(b) offerings proposals with respect to unaccredited investors, which we believe will make issuers seeking capital from unaccredited

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<sup>41</sup> Proposals at 132.

<sup>42</sup> See Temporary Amendments and see Regulation Crowdfunding Rule 201(t).

<sup>43</sup> Proposals at 28, "Our proposed integration framework provides a general principle of integration that looks to the particular facts and circumstances of the offering, and focuses the analysis on whether the issuer can establish that each offering either complies with the registration requirements of the Securities Act, or that an exemption from registration is available for the particular offering."

investors more likely to utilize Regulation Crowdfunding and Regulation A. Further, we agree with the necessity of the proposed rule's blocking of reverse integration and amendments to Regulation S.<sup>44</sup>

#### **V. Proposed Technical Amendments to Regulation A**

We endorse amending Item 17 of Form 1-A option to file redacted material contracts and plans of acquisition, reorganization, arrangement, liquidation, or succession consistent with recent amendments to 601(b)(2) and (b)(10) of Regulation S-K, as this will allow issuers with sensitive business plans to make the necessary disclosure to the Commission to qualify their offering without exposing themselves unnecessarily during the offering.<sup>45</sup> Further, amending the abandonment provisions of Rule 259(b) to permit the Commission to declare a post-qualification amendment to an offering statement abandoned, consistent with Rule 479, is necessary in our experience. The current rule only permits the Commission to declare the whole offering statement abandoned, and we believe there are situations where it would be appropriate for the Commission to have the ability to declare a specific post-qualification amendment abandoned, instead of the entire offering statement, such as if the Commission was unable to qualify an expansion of the offering, but had no concerns with the offering as currently qualified. In addition, the Proposal's amendment to Form 1-A Item 17.17(a), which would allow documents previously submitted for non-public review by the staff and related non-public correspondences to be filed as exhibits to a publicly filed offering statement via EDGAR to comply with the requirements of Securities Act Rule 252(d), would reduce costs for issuers. Similarly, allowing incorporation by reference to previously filed financial statements will again reduce the cost of preparing and filing a Form 1-A without any loss of disclosure.

#### **VI. Encouraging Liquidity and Federal Preemption**

On a final note, the Commission asked if federal preemption should be applied to secondary sales of Regulation A or Regulation Crowdfunding securities, for example, by expanding the definition of "qualified purchaser". We believe the answer must be "yes", as the uncertainty of purchasing securities that are federally preempted at purchase but are not, generally, at resale, creates a liquidity problem that severely reduces the value of the investments made in Regulation Crowdfunding and Regulation A offerings, solely to the detriment of the investor.

\* \* \*

Thank you for the opportunity to comment on the Concept Proposals. We are available to discuss our comments or any questions the Commission or its Staff may have.

Sincerely,



Maxwell R. Rich

Deputy General Counsel

cc: Kendrick Nguyen  
Chuck Pettid

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<sup>44</sup> Proposals at 48 " . . . would permit an issuer that is conducting an exempt offering that allows general solicitation, such as under Rule 506(c), and uses widely accessible internet or similar communications, to continue to be able to rely on Regulation S for a concurrent offshore offering even though the general solicitation activity would likely be deemed "directed selling efforts" under current Rule 902(c)."

<sup>45</sup> Proposals at 105 and see "Companies would still have the option to file such exhibits pursuant to the existing confidential treatment application process, which would remain unchanged".