

United States Senate

WASHINGTON, DC 20510

July 1, 2020

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets [File Number S7-05-20]

Dear Ms. Countryman:

I write to applaud the Securities and Exchange Commission (SEC) for the proposed rulemaking, “Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets.” Increasing offering limits for private offerings, helping issuers communicate with investors at demo days, and improving crowdfunding will improve access to private capital without undermining investor protection.

Expanding access to private capital through this rulemaking will help the U.S. economy recover from the COVID-19 crisis. To transform ideas into new businesses and sustain operations, entrepreneurs and existing small businesses need private capital because public markets are often prohibitively expensive. Improving access to private capital also helps public markets over time as many new private companies evolve into public companies.

Suggestions to consider for improvement

While private companies would greatly benefit from a fundamental simplification of how they raise capital, these suggestions focus on incremental ideas that could improve this rulemaking.

- *Micro-offering safe harbor* - The SEC should consider including a micro-offering safe harbor for offerings under \$1 million. This can help startups raise money from relational networks; 38% of startups raise money from friends and family.¹ The definition of non-public offering is confusing and constricting, particularly for non-lawyers. Entrepreneurs should be able to smoothly transition from personally financing their company to raising

¹ Laura Entis, “Where Startup Funding Really Comes From (Infographic)”, Entrepreneur, November 2013, available at <https://www.entrepreneur.com/article/230011>.

money from their local sphere of influence – without hiring a lawyer or fear of a lawsuit. Unfortunately, a strict interpretation of current securities laws could punish entrepreneurs who announce their raise at the local chamber of commerce or in their local paper.²

- *Improve the crowdfunding statute* – Crowdfunding has not lived up to its potential, raising just \$170 million through 2019 at an average offering size of \$210,000. Even the SEC’s 2019 crowdfunding study characterized crowdfunding’s uptake as “relatively modest.”³ The proposed rulemaking would help, but the SEC could go farther.
 - Increase the crowdfunding offering limit. Increasing the crowdfunding limit to \$5 million from \$1 million will dramatically improve crowdfunding. However, the SEC should consider increasing the limit to as high as \$10 million, and annually adjust this amount for inflation.⁴ If necessary, raises above \$5 million could require greater investor protections, such as discussed immediately below.

Tailoring auditing requirements. Crowdfunding’s accounting requirements are overly costly and likely contribute to its underuse.⁵ Pre-revenue and early stage companies may not be able to afford GAAP accounting or reviewed financials, and such statements may not provide much useful data.⁶ Under one approach, the SEC could allow for cash accounting for raises up to \$500,000 and require GAAP

² David Burton, Letter to SEC Re: File No. S7-08-19, September 2014, available at <https://www.sec.gov/comments/s7-08-19/s70819-6193328-192495.pdf> at p. 51.

³ SEC, “Regulation Crowdfunding Study 2019” June 2019, available at https://cdn.crowdfundinsider.com/wp-content/uploads/2019/06/SEC-regulation-crowdfunding-2019_0.pdf at p. 4.

⁴ Association of Online Investment Platforms, “Policy Position Paper”, available at <https://static1.squarespace.com/static/5b8dd688cc8fedec3a482ce8/t/5d152294390e000118b6d3/1561666196448/AOIP+Policy+Position+Paper++%28June+2019%29.pdf> at p.1; *see also* <https://www.sec.gov/comments/s7-08-19/s70819-6189775-192417.pdf> at p. 3.

⁵ Republic, “Letter to SEC re Concept Release on Harmonization of Securities Offering Exemptions” September 2019, available at <https://www.sec.gov/comments/s7-08-19/s70819-6189775-192417.pdf> at p. 3-5.

⁶ Wefunder, “Letter e: Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets; File Number S7-05-20” available at <https://www.sec.gov/comments/s7-05-20/s70520-7246786-217248.pdf> at p. 14 (“It often takes several thousand dollars and a few weeks to convert those financials into GAAP format. Yet GAAP financials are often not useful to evaluate the potential of the earliest stage investments... [W]ith an equity investment in an early-stage company just getting off the ground, financials matter less, as the investor is making a bet on the future value of the company in the next 5+ years. That decision is more weighted on if they believe the vision of the founder can be made into a reality – there often is no market traction yet. For an equity investment in an early-stage growth startup, financials are generally only useful for an investment decision at the Series A, when the unit economics of the traction must be more carefully evaluated); Mainvest, “Letter to SEC Re: Securities and Exchange Commission Proposed Rules Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets; File No. S7-05-20”, May 2020, available at <https://www.sec.gov/comments/s7-05-20/s70520-7166858-216574.pdf> at p. 4 (“For companies that are pre-revenue or otherwise have a limited operating history, investors are generally unable to rely on historical financials because they do not exist or else do not have enough information to be of any use. For these new businesses, MainVest has seen that the most important factor is the businesses’ projections, which are not included in a CPA Review.”).

accounting after that.⁷ The SEC could then require reviewed financials for raises at \$1 million and audited financials at \$5 million.⁸

- Encouraging secondary markets. The SEC should consider pre-empting state blue-sky laws under certain conditions. If necessary, secondary market sales could still have to comply with the blue-sky laws of the issuer’s domiciled state, but not those of other states.
- *Improve Regulation A and D.*
 - Verifying accredited investor status. The SEC’s implementation of the JOBS Act’s allowance for Reg. D issuers to generally solicit has been unworkable for too many.⁹ Potential investors may be uncomfortable sharing their confidential information with issuers, and issuers may not be able to spend time and money verifying such status. While the SEC’s proposed treatment of this requirement is positive, improvements could be made. The SEC could allow issuers to verify an accredited investor’s status through an investor’s voluntary certification that they are an accredited investor, which mirrors treatment of this issue in the U.K.¹⁰ This certification could be upon penalty of perjury, if necessary.¹¹
 - Secondary market for trading. Current regulations governing the resale of Reg. D securities are so overly complex that they discourage the formation of a robust secondary market.¹² The SEC should allow accredited investors to freely trade Reg. D securities with other accredited investors on an online portal, provided that only accredited investors can access the portal. If necessary, the SEC could require that secondary market investors have reasonable documentation on their investment and establish a holding period prior to any trade on the secondary market.¹³

⁷ Republic, “Letter to SEC Re: File Number S7-08-19 Concept Release on Harmonization of Securities Offering Exemptions” September 2019, available at <https://www.sec.gov/comments/s7-08-19/s70819-6189775-192417.pdf> at p. 3.

⁸ *Id.*

⁹ The SEC itself has at least acknowledged this possibility. SEC, “Amending the “Accredited Investor” Definition” March available at <https://www.sec.gov/rules/proposed/2019/33-10734.pdf> at p. 117-118.

¹⁰ David Burton, “Letter to the SEC Re: File No. S7-08-19” September 2019, available at <https://www.sec.gov/comments/s7-08-19/s70819-6193328-192495.pdf> at p. 35.

¹¹ David Burton, “Letter to the SEC Re: File No. S7-08-19” September 2019, available at <https://www.sec.gov/comments/s7-08-19/s70819-6193328-192495.pdf> at p. 35-36.

¹² AngelList “Letter Re: Concept Release on Harmonization of Securities Offering, File No. S7-08-19” <https://www.sec.gov/comments/s7-08-19/s70819-6203757-192567.pdf> at page 4-5; SIFMA “Re: Concept Release on Harmonization of Securities Offering Exemptions (File No. S7-08-19)” September 2019, available at <https://www.sec.gov/comments/s7-08-19/s70819-6193329-192494.pdf> at p. 4.

¹³ AngelList “Letter Re: Concept Release on Harmonization of Securities Offering, File No. S7-08-19” <https://www.sec.gov/comments/s7-08-19/s70819-6203757-192567.pdf> at p. 5-7.

- Improving Reg A. The SEC itself admits that Reg. A’s “financing levels remain modest relative to registered offerings or Regulation D offerings.”¹⁴ I welcome the SEC’s proposal to raise Reg. A’s Tier 2 offering limit to \$75 million which could help address this problem. However, the SEC should consider raising the threshold to as much as \$100 million and adjusting the threshold annually for inflation. As with crowdfunding, the SEC should consider pre-empting state blue-sky laws for secondary market trading to help address the “lack [of] a liquid secondary trading market for [the] securities”¹⁵ of Reg. A issuers. If necessary, the SEC could require that secondary market trades comply with the blue-sky laws of the issuer’s domiciled state securities regulator.

I thank the Commission for consideration of these suggestions and for its important work in this area.

Sincerely,



Pat Toomey
U.S. Senator
Chairman, Subcommittee on Securities, Insurance, and Investment
U.S. Senate Committee on Banking, Housing, and Urban Affairs

¹⁴ SEC, “Report to the Commission” Report to the Commission Regulation A Lookback Study and Offering Limit Review Analysis, March 2020, available at <https://www.sec.gov/files/regulationa-2020.pdf> at p. 5.

¹⁵ SEC, “Report to the Commission” Report to the Commission Regulation A Lookback Study and Offering Limit Review Analysis, March 2020, available at <https://www.sec.gov/files/regulationa-2020.pdf> at p. 15.