

September 24, 2019

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0213

Re: Concept Release on Harmonization of Securities Offerings
(Release Nos. 33-10649; 34-86129; IA-5256; IC-33512; File No. S7-08-19)
(the “Concept Release”)¹

Ladies and Gentlemen:

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We thank the Commission for the opportunity to provide comment in connection with the above-referenced Concept Release. As noted in the Concept Release, the framework for exempt offerings has changed significantly since the passage of the Jumpstart Our Business Startups Act of 2012, providing startup and emerging growth companies with greater access to capital and democratizing the investment opportunities available to retail and smaller private investors. We agree with the Commission that these laudable changes can be made more effective by making the framework more consistent and by addressing gaps and complexities. Based on our experience, we believe the framework would benefit from (i) expanding the definition of “accredited investor” under Rule 501 of Regulation D to include a new class of sophisticated investors to provide issuers with additional access to capital formation; and (ii) technical reforms to better coordinate certain of these exempt offerings with the various securities registration requirements of the state blue sky laws.

These comments are rooted in the recurring concerns faced by our clients as issuers in raising capital by way of exempt offerings and our experience with our client investors when seeking secondary sale opportunities for the debt and equity purchased in these exempt offerings. The Concept Release speaks to some of the best thinking of the Staff. By continuing to evolve aspects of the current registration exemption framework and harmonizing the regulatory landscape under federal and state law, special opportunities are revealed that can simultaneously expand the overall benefits associated with capital formations for smaller issuers, streamline ongoing administrative burdens for both issuers and investors while allowing the Securities and Exchange Commission to maintain meaningful investor protections.

Revising and Regionally *Right-Sizing* the Definition of “Accredited Investor”

A popular existing exemption from the federal securities registration requirements under Rule 506(b) of Regulation D, permits a private company to sell its securities to no more than 35 non-accredited investors, provided such investors (either alone or with their purchaser representatives) have sufficient knowledge and experience in financial and business matters to evaluate the merits and risks of the prospective investment. The exemption imposes significant disclosure requirements for issuances made to such non-accredited investors,

¹ The views expressed in this letter are solely those of the authors, and do not constitute the official position of McCarter & English, LLP or its clients.

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which, when combined with the relatively low number of permitted non-accredited investors, makes this particular facet of the Rule 506(b) exemption impracticable in the vast majority of private placement transactions and therefore little-used.²

Issuers relying on the exemption under Rule 506 are therefore effectively limited to raising capital from accredited investors, who only make up an estimated 13 percent of households in the United States.³ We further note the disparities between household incomes and net worth between Northeast and West regions, and Midwest and South regions (as reproduced from the Concept Release below),⁴ which have the effect of excluding certain households from investments in smaller issuers based upon their state of residence.

While the overall makeup of accredited investors as a proportion of the U.S. population is small, the data collected by the Commission shows a high degree of concentration amongst high income / high net worth households specifically located in the Northeast and West regions, which account for the vast majority of accredited investors. Further, the disparity between the mean and the median income and net worth in different regions seems to indicate a highly skilled / sophisticated pool of potential investors in certain regions who may be able to tolerate and may be interested in greater exposure to privately placed securities, but who are currently limited or prevented from investing because they are not as well compensated or have not accumulated as much wealth as persons of comparable skill / sophistication in other parts of the country.

(\$ thousands)	Northeast	Midwest	South	West
Mean household income (before-tax)	136.5	102.0	100.0	108.5
Median household income (before-tax)	64.4	54.7	51.5	57.5
Mean household net worth	851.3	658.8	636.9	873.7
Median household net worth	154.5	103.2	87.0	114.3

In order to expand the private offering framework so that it “works for investors and entrepreneurs alike, no matter where they are located in the United States,”⁵ we propose including a certain sophisticated investors in the definition of “accredited investor” under Rule 501. While not a bright line rule, our proposed definition would provide clearer guidance than what exists under the current framework. Specifically, balancing an investor’s demonstrated experience in financial and business matters with such investor’s ability to withstand some financial loss, would allow issuers to avoid the burdensome disclosure requirements that have historically prevented issuers from seeking to expand their offerings to non-accredited investors under the current Rules 506(b).

Our proposal would permit persons with income and/or net worth lower than the thresholds currently required under Rules 501(a)(5) and 501(a)(6) to be included in the definition of “accredited investor” based upon their demonstrable knowledge and experience in financial and business matters. Issuers would be able to obtain a reasonable belief of such experience based on an analysis of a number of relevant factors, including:

² Concept Release at note 47.

³ Concept Release, “Table 3: Households qualifying under existing accredited investor criteria” at p. 36.

⁴ Concept Release, “Table 4: U.S. household income and net worth, by region” at p. 37.

⁵ “SEC Seeks Public Comment on Ways to Harmonize Private Securities Offering Exemptions” available at <https://www.sec.gov/news/press-release/2019-97>.

- a) the investor's investment experience, including prior experience investing in unregistered offerings;
- b) the investor's educational background, including degrees in relevant fields (*e.g.*, MBA);
- c) professional certifications held by the investor, *e.g.*, FINRA Series 65 and Series 7 licenses;
- d) the investor's work experience in the securities industry (*e.g.*, broker-dealers, investment advisors, attorneys and accountants); and
- e) whether the investor is being advised by a registered investment advisor in connection with the investment.

The combination of significantly reducing the financial thresholds at which investors are considered accredited and formalizing the requirements with respect to an investor's level of financial sophistication, will promote efficient access to capital for smaller issuers while ensuring adequate investor protection. Such a definition would also likely significantly improve the access to investment opportunities for persons with either a Bachelor's Degree or MBA/MS/MA⁶ and for households in the Midwest and South regions.⁷

We note that our proposal echoes the recommendations of the Commission's Advisory Committee on Small and Emerging Companies, which noted, among other things, that small businesses are key drivers of U.S. economic activity, innovation and job creation, that their ability to raise capital in the unregistered securities markets is critical, and that the Advisory Committee was not aware of any evidence suggesting that fraud in the private markets is driven or affected by the income and net worth levels at which the accredited investor definition is set.⁸

Improve Coordination Between Exemptions Under Federal Securities Laws and State Blue Sky Laws.

Identified below are areas where we routinely confront duplicative federal and state regulation, which seems to provide little incremental protection to investors, yet imposes unnecessary expense and administrative burden on smaller issuers. We propose that the following reforms be implemented in order remove this unnecessary and costly duplication:

⁶ See, Concept Release, "Figure 4: Education profile of the accredited investor pool" at p. 38.

⁷ See, Concept Release, "Table 4: U.S. household income and net worth, by region" at p. 37.

⁸ Letter from Advisory Committee on Small and Emerging Companies to the Hon. Mary Jo White, Chair, dated July 20, 2016, available at: <https://www.sec.gov/info/smallbus/acsec/acsec-recommendations-accredited-investor.pdf> (last accessed September 20, 2019).

- The definition of “qualified purchasers” under Regulation A+ should be revised to include offerees and purchasers under Tier 1 of Regulation A+ (in addition to Tier 2) such that Regulation A+, Tier 1 securities also become “covered securities”;⁹
- Securities issued by an issuer to its employees, consultants and advisors under Rule 701 should be deemed “covered securities” such that they preempt state “blue sky” laws;
- Federal preemption should be extended to secondary sales of securities under Rule 144 (akin to the old Rule 144(k))¹⁰, and if the issuer is a Tier 2 Regulation A+ issuer and is current in its reporting requirements under Rule 257 of Regulation A+, such reports should be deemed to constitute adequate current public information for purposes of Rule 144(c); and
- States should not be permitted to require issuers (or their officers and directors) to register as brokers or dealers (or impose similar registration requirements) in connection with offers and sales of the issuer’s own securities where such securities are “covered securities.”¹¹

We believe that the above recommendations will help to harmonize capital raising exemptions and expand investment opportunities in smaller issuers, while maintaining meaningful investor protections. We hope that these suggestions, in light of the request for comments, will be helpful to the Staff and the Commission in connection with their efforts to continue modernizing the registration requirements of the federal securities laws as suggested by the Concept Release.

Sincerely,

/s/ Theodore M. Grannatt

/s/ Benjamin M. Hron

/s/ Bernard C. Devieux

/s/ Stephen M. Fox

⁹ See Letter to the Commission Re: SEC Regulatory initiative Under the JOBS Act Title IV Small Company Capital Formation by Jonathan C. Guest, dated July 10, 2012.

¹⁰ See Release No. 33-8869 pg. 14

¹¹ For example, Arizona, Florida, North Dakota, and Texas appear to require issuers to register as dealers in connection with certain unregistered offerings. Other states (Alabama and Nevada) may require directors and officers of the issuer to register with the state.