



*Via Electronic Mail*

September 30, 2019

Vanessa A. Countryman  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

Re: SEC Concept Release on Harmonization of Securities Offering Exemptions  
File No. S7-08-19 (June 26, 2019)

Dear Ms. Countryman:

We appreciate this opportunity to comment on the Securities and Exchange Commission's ("Commission") Concept Release on Harmonization of Securities Offering Exemptions (the "Release"). The Release includes a request for comment on regulatory restrictions that we believe have had the effect of limiting retail investment in, and access to, promising private company securities. In light of the significant capital raised through the exempt offering process, especially in recent years, we support the Commission's efforts to consider rule changes, adjustments and updates that we believe would meaningfully benefit those that are currently unable to participate in exempt offerings.

Founded in 2013, EquityZen Inc. ("EquityZen") is an online marketplace for investors and shareholders in alternative assets. EquityZen is dedicated to democratizing access to investments that were previously out of reach for many. EquityZen's platform often links employees from private companies who seek some liquidity with investors who would not otherwise be able to invest in the private companies prior to their initial public offerings ("IPOs"). Over the past six years, EquityZen has allowed more than 8,000 qualified investors to access more than 140 private, pre-IPO companies. Given the current regulatory framework, EquityZen limits purchasers on its platform to those that qualify as accredited investors under Rule 501(a) of

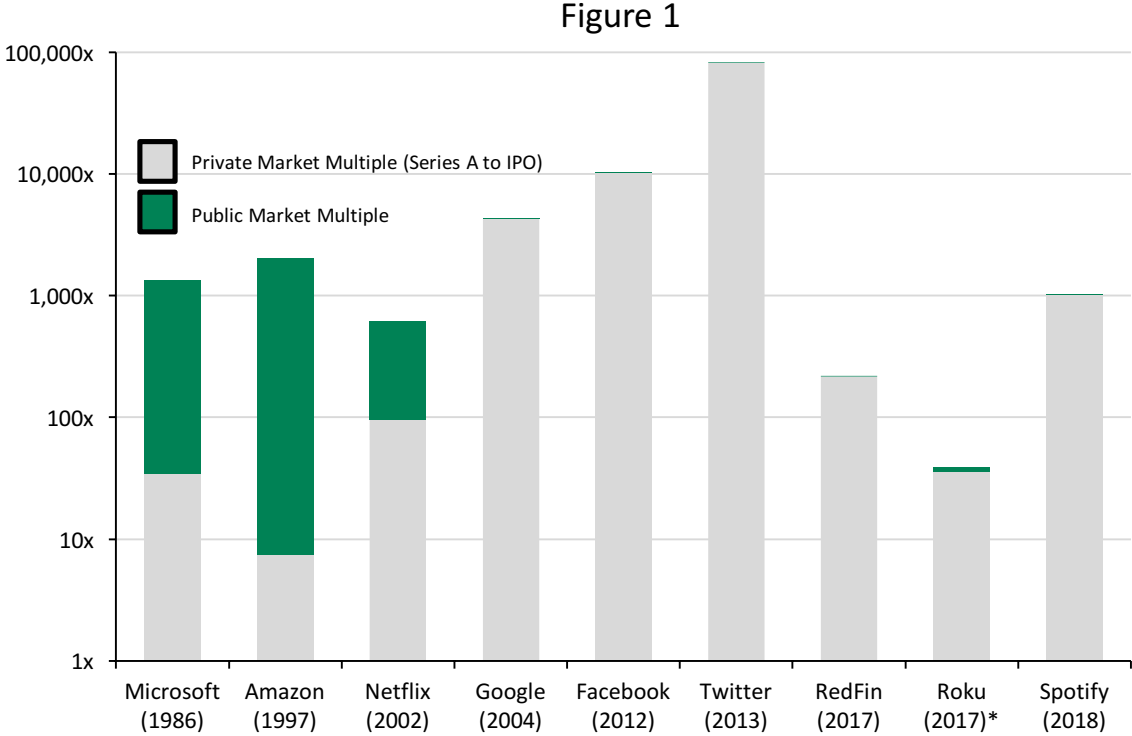
Regulation D of the Securities Act of 1933, as amended (the “1933 Act”). The issues raised by the Release are of particular interest to EquityZen as it seeks to provide a marketplace for all investors in a regulatory environment that does not preclude the retail investing community. Moreover, as the Commission and many Commissioners in individual remarks have recognized, there is a need to provide liquidity opportunities for employees and other stakeholders in private companies.

### **Expanding Investor Access**

As acknowledged in the Release, in recent years U.S. companies have raised more equity through exempt offerings that are only available to institutional and high net worth accredited investors than through offerings that are available to retail investors. According to the Commission’s Division of Economic Research and Analysis, in 2017, the total raised in registered offerings was \$1.5 trillion, whereas the total raised through all private offerings was \$3.0 trillion (likely an understated estimate given unreported Section 4(a)(2) private offerings). As a result, the number of U.S. public companies has been declining while the valuations of privately-held companies has been increasing with retail investors unable to participate in this appreciation. From 1996 through 2016, the number of U.S. public companies declined by 50%, reducing the investment choices available to Main Street investors. In contrast, there are now at least 400 private companies valued by venture capital firms at \$1 billion or more, with a cumulative valuation of \$1.3 trillion.

The late stage private financing has become the new IPO. Many private companies are remaining private longer. From 1999 to 2018, the median time for a company that went public by an IPO increased from five years to more than ten years. Capital invested in private technology companies grew from \$11 billion in 2005 to \$75 billion in 2015 and almost tripled from 2013 to 2015. Six companies between 2004 and 2015 reached valuations upwards of \$10 billion before going public. The bottom line is the public markets are losing IPO candidates as promising companies choose to stay private longer.

One result is that, for many companies, more of their increase in value is taking place while the companies are still private, as illustrated in the figure below.



The graph above illustrates how value creation from 1986 through 2018 has shifted from public markets (green) to private markets (gray). \*Roku's private valuation multiple is based on Series B to IPO.

Source: EquityZen (March 2019).

In a speech to the Economic Club of New York in September 2019, Commission Chairman Jay Clayton said that “twenty-five years ago, the public markets dominated the private markets in virtually every measure. Today, in many measures, the private markets outpace the public markets, including in aggregate size.” Chairman Clayton described the lack of more public offerings and the inability of the Main Street investing public to access private markets as a “growing concern” and expressed a desire to expand opportunities for Main Street investors to participate in private markets. Chairman Clayton said he wants the Commission to take a “fresh look” at initiatives to expand access to the private markets, while at the same time providing “appropriate investor protections.”

We agree with the Chairman's remarks and believe equity issued by private companies has been, and can be, used in professionally managed multi-asset portfolios and other structures to minimize risk and maximize returns on behalf of retail investors. As an operator of an online marketplace for securities, we purposefully limit purchasers of securities in growth-stage private issuers to institutional and high net worth investors in accordance with current securities law restrictions. However, these restrictions have had the intended effect of eliminating retail investor participation in the growth of such private companies or delaying participation until the private company consummates an IPO later in its valuation cycle, if at all.

As a result of private companies delaying their IPOs as described above, companies (and their institutional and high net worth investors) are benefitting from the majority of the value creation during the company's private years, not within the company's public lifecycle. Because the private market has provided abundant late-stage private capital at robust valuations, companies have been able to achieve scale without retail investors and the related public disclosure and regulatory costs. Retail investors in the public markets are typically disadvantaged as a result.

For the past six years, EquityZen has been working to change that. At EquityZen, with few exceptions, qualified investors purchase interests in a pooled investment vehicle that acquires shares of a single pre-IPO company. In this way, EquityZen's marketplace of investment funds have helped thousands of investors gain access to pre-IPO technology company investments in more than 140 companies.

To be sure, not all private companies will go public or get acquired, and not all IPOs or acquisitions will result in successful investments. But for those investors with the time horizon, risk tolerance and willingness to hold illiquid private placement investments, the potential returns may substantially exceed what is available in public markets.

Over the past six years at EquityZen, for investors in numerous funds across 30 underlying companies, the funds have experienced exits (whether through IPO, acquisition or liquidation), so the results are known. On a time- and dollar-weighted basis, net of fees, the overall realized returns to investors in EquityZen's single-name marketplace funds have been positive.

Specifically, EquityZen's marketplace funds that have experienced exits have returned an annual time- and dollar-weighted IRR (net of fees) of 36%.<sup>1</sup>

### **Accredited Investor Definition**

Given the importance of the accredited investor definition in the securities laws and particularly for exempt offerings, we believe that the definition should maintain the current net worth and net income thresholds because these provide objective criteria.

However, we believe that the definition should be expanded to allow retail investors to qualify as accredited investors based upon a new financial sophistication category. This new category might include individuals (i) with certain licenses or professional designations (including any individual that has passed the Series 7, Series 65, Series 66, or Series 82 examination, is a certified public accountant (CPA), certified financial analyst (CFA), certified management accountant (CMA), a control person of a registered investment adviser (RIA), a registered representative (RR), or has a certified investment management analyst (CIMA) certification), (ii) advised by such professionals in connection with the investment; (iii) with professional credentials (including those with an MBA from an accredited institution); (iv) who are knowledgeable employees of a private fund or a manager of a private fund; and (v) who have a certain minimum amount of investable capital and can, therefore, bear the risk of loss.

We also support permitting spousal equivalents to pool their finances for the purpose of qualifying as accredited investors as it would expand opportunities to invest in securities offerings to more households.

With respect to entities, we believe that the accredited investor definition should be expanded to allow all entities with investments in excess of \$5 million to qualify as accredited investors. We support this change because entities, regardless of form, with such investments are already extremely likely to be sophisticated enough to protect themselves from the risks of the investment and presumably able to withstand the potential loss of a particular investment.

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<sup>1</sup> Investor experiences in individual funds necessarily vary. Past performance does not guarantee future results and the investments are risky. Aggregate net of fees IRR is as of June 30, 2019.

We also strongly support prospectively indexing any financial thresholds included in the definition to inflation. Periodic adjustments of this type going forward avoid any unnecessary uncertainty associated with an abrupt and sizeable adjustment to compensate for many years of inflation. In that regard, if this particular aspect of the definition is adopted, we strongly believe that adjustments to the financial thresholds should take place on a fixed schedule so that both issuers and investors alike can properly prepare for each adjustment.

We also encourage the Commission to similarly expand the definition of qualified purchaser under the Investment Company Act of 1940, as amended (the “1940 Act”), as most private equity funds rely on Section 3(c)(7), which requires that all of the fund’s investors be qualified purchasers. We recommend revising the definition to include any investor that invested in a private equity fund upon the advice of a registered or exempt reporting investment adviser. The Commission should consider similarly expanding the definition to other types of funds, such as venture capital and hedge funds. Nonetheless, without expanding the definition of qualified purchaser under the 1940 Act, any changes that are made to expand the definition of accredited investor will have lesser impact for retail investors that desire to participate in such funds.

### **Harmonization: Rule 506**

The information requirements that are set forth in Rule 506(b) in the case of private placements involving non-accredited investors have a negative impact on the willingness of issuers and placement agents to allow non-accredited investors to participate in such placements. The current information requirements for private placements involving non-accredited investors are a particular barrier to secondary market transactions. We recommend scaling the type and amount of information required to be disclosed to non-accredited investors based upon the specific characteristics of the investors and the offering. In order to appropriately scale the applicable information requirements, the Commission might consider identifying relevant investor characteristics; these might include the inclusion of a proposed investment limit or cap for a non-accredited investor or the inclusion of a proposed per investment limit. The Commission also might consider scaling the applicable investment requirements to the extent that a non-accredited investor is advised by a broker-dealer or a registered or exempt reporting investment adviser in connection with the investment.

Rule 506(c) permits issuers to engage in general solicitation provided that all purchasers in the offering are accredited investors and the issuer takes reasonable steps to verify each purchaser's accredited investor status. Rule 506(c) provides a principles-based method for verification of accredited investor status as well as a non-exclusive list of verification methods. However, notwithstanding the ability to use the principles-based method, the vast majority of market participants insist on verifying an accredited investor's status based on the non-exclusive list of verification methods. Compliance with the verification requirement has in part limited the utility of the Rule 506(c) exemption. We recommend removing the verification requirement for private placements that otherwise comply with Rule 506(c) and involve a placement agent, investment adviser or other regulated institution.

### **Investment Limits and Diversification Requirements**

The current regulatory framework does not limit the amount that can be invested by any investor or impose a diversification requirement on any investor's portfolio. We view this as an important feature of Regulation D that helps promote operational efficiency and investor access in the secondary markets, and a feature that certainly should not be altered for accredited investors. Further, imposing a deal size limitation on offerings that include non-accredited investors is unlikely to promote the inclusion of such investors in private placements. Instead, non-accredited investors will be left out of larger offerings that are conducted by more established issuers and placement agents and instead be permitted to partake in smaller offerings made by more speculative issuers that may be undertaking the offerings without the involvement of a reputable placement agent. We are also not in favor of imposing a diversification requirement on any investor's portfolio (either accredited or non-accredited). Based upon our experience, we do not believe it is beneficial to require an investor to purchase less desirable private company securities in order to satisfy an arbitrary diversification requirement when such investor wants a targeted exposure to a specific private company.

Instead, we propose applying an investment limit for non-accredited investors so that they may participate when an issuer is making use of a securities offering exemption. In lieu of a limitation on the number of non-accredited investors in an exempt offering, we are in favor of limiting the total investment by each non-accredited investor in an exempt offering to the greater

of 5% of his or her net worth and 10% of his or her annual income. We are not in favor of imposing any investment limit on accredited investors consistent with the current standard.

### **Integration Safe Harbor**

Rule 502(a) of Regulation D provides for a safe harbor from integration for all offers and sales that take place at least six months before the start of, or six months after the termination of, the Regulation D offering, so long as there are no offers and sales of the same securities within either of these six-month periods. Under Rule 502(a), issuers have comfort that if they cease offerings for at least six months, then there would be no integration between their separate private offerings. The use of a six month cooling off period does not differentiate between intentional general solicitation activity, such as that under Rule 506(c) and inadvertent or narrow activity.

We agree with prior Commission releases that have proposed a shorter integration safe harbor period in part to offer issuers greater flexibility. The long six-month delay has had the effect of inhibiting and imposing an unnecessary restriction on the ability of companies, especially smaller and mid-sized companies, from efficiently raising capital. We recommend that the Commission shorten the six-month period to 90 days and allow companies to raise capital at least once every fiscal quarter without fear of integration. Shortening the integration safe harbor period will also have the added benefit of promoting investor access and aiding the development of private markets, especially secondary markets.

We also ask that the Commission's Staff confirm that there is no integration of offers made by separate pooled investment vehicles, with the same manager or control person, each of which invests in the same underlying company and in the same class of securities, but at different times and on different prices or terms.

Coupled with the proposed modifications to the five-factor integration test under Regulation D, we believe that a shorter cooling off period would facilitate capital formation and enhance investor transparency. Smaller and larger issuers may have different financing needs at different times, and will need the flexibility to adjust their offerings in response to the market. In addition to issuer flexibility, we believe that a shorter cooling period is also warranted in order to distinguish between inadvertent general solicitation activity and intentional general solicitation



activity. We urge the Commission, or its Staff, to permit issuers to rely on a shorter cooling off period, such as 30 days, under the following circumstances:

- statements to the media (or at investor conferences) that correct or otherwise clarify information about the issuer’s business in response to, or in connection with, a news or similar publication;
- statements made by certain agents of the issuer, such as service providers, to trade publications or similar media, that were not precleared by the issuer; and
- statements made to the general public that were inadvertent (e.g., fat finger errors where an internal memorandum is instead issued as a press release).

We believe that a more flexible approach is warranted in light of the broad concept of what constitutes an “offering” under the securities laws. The current approach may put issuers in the difficult position of choosing between silence and withdrawing from the market for up to six months to avail themselves of the certainty of the safe harbor, when there was no intent to engage in a public offering.

### **Pooled Investment Vehicles**

We believe that investing through a pooled investment fund (such as a private fund exempt from registration pursuant to Section 3(c)(1) of the 1940 Act) would provide retail investors with the opportunity to gain exposure to a diversified portfolio of private company investments that have historically increased an investor’s total return. Facilitating the use of pooled investment vehicles with retail investor participation is an important aspect of providing broader access at smaller investment sizes than is currently available for traditional private market venture capital investing. Retail participation in such private funds could be limited to those funds that have engaged an investment adviser and are acting as a pooled investment vehicle in order to aggregate capital to make a long-term investment.

Currently, Section 3(c)(1) of the 1940 Act is limited to not more than 100 beneficial owners with respect to the number of such owners allowed in an exempt investment vehicle. In order to expand opportunities for investors to access and benefit from such investment vehicles, we

recommend increasing the beneficial owner threshold to at least 250 beneficial owners. Without a sizeable increase to the number of beneficial owners, fund managers are more likely to rely on the Section 3(c)(7) exemption for more attractive investment opportunities because it has no limitation on the number of investors in the vehicle, but instead restricts investment to “qualified purchasers.” As a result, Section 3(c)(7) investment vehicles will inherently be in a position to raise more capital than a Section 3(c)(1) investment vehicle as their beneficial owners have more access to capital and the vehicle is not limited in the number of owners that may provide capital to it. Increasing the beneficial ownership limit will allow non-qualified purchasers to pool their capital together in an effort to more effectively compete with those funds that are limited to qualified purchasers. Alternatively, in lieu of a limit on the number of beneficial owners in the Section 3(c)(1) investment vehicle, the Commission may impose an investment limit similar to the limit we proposed for an exempt offering above (greater of 5% of his or her net worth and 10% of his or her annual income) and allow an unlimited number of non-qualified purchasers to pool their capital together as is presently allowed for qualified purchasers.

Without a diversification requirement or an investment limit mandated by the Commission, the securities laws currently allow retail investors to (i) purchase a single company’s securities in the public market; (ii) invest in a registered fund that is actively managed by a registered investment adviser; and/or (iii) invest in a passively-managed exchange traded fund that tracks a given index of public companies. We strongly caution against imposing a diversification requirement that would limit investor choice. In our experience, many investors prefer being able to understand and invest in a pooled investment vehicle that invests in the securities of a single underlying private company. As a result, we recommend giving retail investors the same choice and the same opportunity to pool capital into an investment vehicle that can hold securities in a single private company or in a diversified portfolio of private companies depending upon the given investor’s investment preferences. Allowing this regulatory flexibility may also help protect retail investors to the extent popular private companies are included in a fund with other, less desirable private company investments.

Finally, we also encourage the Commission to revise the definition of “qualified client” under the Investment Advisers Act of 1940, as amended (the “Advisers Act”), to include accredited investors. Private fund managers typically are compensated with a management fee based on a

percentage of the assets under management (often 2%) and an incentive or performance fee based on the capital appreciation of the value of the fund’s holdings (often 20% of the appreciation). However, private fund managers that are registered with the Commission are prohibited from charging incentive or performance-based fees under the Advisers Act to investors who are not “qualified clients” as defined in Rule 205-3 of the Advisers Act. A typical private fund will make a private offering of its securities under Regulation D, charge incentive or performance-based fees and qualify as exempt under the 1940 Act. As such, these private funds will already need to limit their securities offerings to accredited investors. Limiting the same fund to qualified clients (after it is already limited to accredited investors) does not appear to serve a practical purpose and results in unnecessary administrative costs for the fund and its adviser. The vast majority of American investors will either qualify as both an accredited investor and a qualified client under the current definitions or not qualify as either. Requiring private funds to identify the few American investors that would qualify as an accredited investor (net worth of \$1 million) but not as a qualified client (\$1 million of assets under management of the investment adviser) does not appear to serve a significant public policy purpose. We suggest either eliminating the incentive/performance fee limitation under the Advisers Act entirely as it is inconsistent with certain existing retail investment vehicles (such as business development companies) or at least conforming the accredited investor and qualified client definitions.

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If you have any questions regarding the foregoing, please contact Chris Giampapa at (██████████). Thank you.

Sincerely,

EquityZen Inc.

By:   
Atish Davda, Co-Founder  
& CEO

By: *Phil Haslett*  
Phil Haslett, Co-Founder  
& Chief Revenue Officer

By:   
Chris Giampapa,  
General Counsel

cc: Anna Pinedo, Mayer Brown LLP