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October 16, 2019

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

Re: Concept Release on Harmonization of Securities Offering Exemptions File No. S7-08-19

Dear Ms. Countryman:

This letter is submitted on behalf of the Federal Regulation of Securities Committee (the "Committee") of the Business Law Section of the American Bar Association (the "ABA") with respect to the above-referenced concept release soliciting comment on various exemptions from the registration requirements under the Securities Act of 1933 (the "Securities Act") (the "Concept Release").[1]

The comments set forth in this letter represent the views of the Committee only and have not been approved by the ABA's House of Delegates or Board of Governors and should not be construed as representing the policy of the ABA. In addition, this letter does not represent the official position of the ABA Section of Business Law nor does it necessarily reflect the views of all members of the Committee.

The Committee commends the efforts of the Securities and Exchange Commission (the "Commission") to simplify, harmonize and improve the current exempt offering framework, which has evolved over time and may benefit from a comprehensive review, and we thank the Commission for this opportunity to comment. While the Commission may ultimately develop a comprehensive revision and harmonization of offering exemptions as a result of those efforts, the Committee believes that it can most usefully contribute at this stage by suggesting various incremental changes to the existing rules. We set forth, in Part I below, the contours of two possible new exemptions intended to combine the best aspects of various existing exemptions and a concept regarding "eligible issuers" that could be considered in fashioning conditions to offering exemptions; in Part II below, we set forth specific comments regarding

[1] The Committee also included and consulted with members of the Middle Market and Small Business Committee of the Business Law Section of the ABA.

a number of topics raised by the Commission in the Concept Release; and, in Part III below, we discuss pooled investment funds.

Part I: Developing New Offering Exemptions

We begin by explaining why we are proposing additional new offering exemptions. The Securities Act contains a number of exemptions from its registration requirements for primary offerings and resale transactions, and authorizes the Commission to adopt additional exemptions in the public interest. As noted in the Concept Release, the current legislative and regulatory exemptions were not adopted as part of a cohesive regulatory scheme, but rather evolved or were added from time to time in response to particular initiatives advanced by various constituencies. The more successful initiatives – for example, the Rule 506(b) safe harbor under Regulation D and Rule 144A – are heavily used. Other exemptions are less frequently used, but if used at all, have *some* utility and underlying rationale and may be very helpful in specific markets or circumstances. For example, Rule 504 under Regulation D represents federal delegation to the states to regulate smaller offerings, while Rules 147 and 147A similarly represent the absence of a federal interest in regulating purely intrastate offerings. Rule 506(c) under Regulation D was added at the direction of Congress under the Jumpstart Our Business Startups (JOBS) Act to permit general solicitation to facilitate the ability of issuers to locate suitable investors, so long as sales were only made to accredited investors whose status the issuer took reasonable steps to verify. In practice, the verification requirement has discouraged use of Rule 506(c). Congress also mandated crowdfunding as a way to permit issuers to raise small amounts of capital from any investors based upon the "wisdom of the crowd." However, the investor protection limitations built into the crowdfunding exemption have made it difficult for issuers to use. Retaining these and other less commonly used exemptions does not impose any real costs on the markets and market participants and provide benefits to certain market segments. Accordingly, we do not see any compelling or immediate need to harmonize them. However, certain suggested improvements to these exemptions, which may result in greater efficiencies, are discussed in Part II below.

Consistent with the Commission's objective of improving the exempt offering framework, the Committee suggests two new exemptions that would incorporate the best elements of the most successful existing exemptions, while honoring statutory and policy constraints reflected in the Securities Act, relatively recent legislative amendments and evolving rulemaking and administrative and market practices. We suggest that the existing offering exemptions available under Rule 506(b), Rule 506(c), Rule 504, Rule 144A, Rule 147, Rule 147A, Regulation A and Regulation Crowdfunding be retained, not replaced by these new exemptions, albeit with one exception for replacing Rule 506(b) and with some changes intended to address particular obstacles to capital formation without eroding investor protection, as discussed in Part II below. We also suggest for consideration the concept of "eligible issuer" to better fashion the conditions for offering exemptions.

A. Eligible Purchaser Exemption.

This exemption, which would be aimed primarily at the institutional market, would define a set of eligible purchasers deemed able to fend for themselves. Rule 144A presents a good starting point for the new exemption, but could be improved upon in several ways.[2]

The following are issues for the Commission to consider and resolve in designing such a new exemption.

A.1 *Eligible Sellers.*

If the new exemption, as intended, successfully defines a set of categories of investors that are able to fend for themselves and that do not require the protections afforded by the Securities Act registration requirements, there is no reason to limit who can rely on the new exemption. The Committee, therefore, proposes that the new exemption would be available for sales by issuers or their affiliates, by dealers or by any other security holders. The principle of Preliminary Note 7 to Rule 144A (that purchasing from the issuer with a view to reselling pursuant to the rule would not affect the availability of an exemption in respect of such transaction with the issuer) should also apply to the new exemption.

A.2 *Eligible Securities.*

The new exemption should be available in respect of sales of any securities issued by any issuers, other than registered investment companies. Securities sold pursuant to the new exemption would be "restricted securities," which could be resold in accordance with Rule 144, as and when available. In particular, the "fungibility" condition of Rule 144A should not be carried over to the new exemption; the restricted status of securities sold pursuant to the new exemption should afford sufficient incentive for issuers to continue to register offerings of their listed equity securities. Alternatively, if the fungibility condition is retained, it should relate only to the actual listed securities, not to derivatives thereof, such as convertible notes, which are commonly sold in the institutional market.

A.3 *Eligible Purchasers.*

The exemption would be available for sales to eligible purchasers consisting of categories of investors that the Commission determines can fend for themselves and can police their own resales, as discussed below. The categories of investors that would meet these criteria and be considered "eligible purchasers" might include institutional accredited investors, qualified institutional buyers ("QIBs"), qualified purchasers, and qualified clients. They could also include categories of investors from the QIB definition, but with a lower investment assets threshold (perhaps $10 million, in place of $100 million). The Commission should also consider formulating a new category of "eligible purchaser" that would include individuals and be based solely on the size of the actual investment. For example, any investor, individual or entity, that was investing (i.e., actually paying, on an unleveraged basis) $1 million (or some other amount)

[2] Rule 144A could eventually be replaced by the new exemption, to the extent it is or becomes duplicative.

would qualify as an eligible purchaser. The high minimum investment amount would evidence that such investors could fend for themselves.[3] Importantly, the eligible purchaser definition should incorporate the "reasonable belief" standard included in Regulation D and in Rule 144A so that eligible purchasers would be investors that meet, or that the seller reasonably believes meet, the specified criteria. The "reasonable belief" standard has worked well under Regulation D and Rule 144A and we believe there is no need to introduce a different standard (such as Rule 506(c)-type verification) in this regard. We expect this latter point would be key to market acceptance, and thus use, of the new exemption. There would be no limit on the number of eligible purchasers participating in an offering.

A.4 ***The Regulation of Offers.***

Although the Securities Act regulates offers and sales, true damage rarely occurs unless there is an actual sale, and yet a disproportionate part of the compliance problems associated with exempt offerings has nonetheless related to offers. This imbalance has improved somewhat over time, most notably following the JOBS Act-mandated amendments to Rule 144A and Rule 506(c). Offers have been truly deregulated in the Rule 144A market. On the other hand, the verification requirement of Rule 506(c) has to be understood as reflecting at least Congressional concern that offers entice retail investors into inappropriate purchases. This concern should not be carried over to the new exemption: an exemption limited to institutional investors and other large purchasers, defined by reference to their ability to fend for themselves, could reasonably not have any conditions relating to offers – in other words, just as with Rule 144A, general solicitation should be permitted.

A.5 ***Information Requirement.***

Rule 506(b) permits unlimited funding to be raised from an unlimited number of accredited investors and imposes no information requirement as a condition of the exemption in offerings limited to accredited investors. *A fortiori* (and notwithstanding the information requirement of Rule 144A), the new exemption, limited to the newly defined category of eligible investors, should not be conditioned on availability or delivery of specified information to purchasers. Rather, it can be left to market participants, acting against the backdrop of the antifraud provisions, to work out the information that is delivered. One reason Rule 144A works as well as it does for reporting companies is because there is efficient private ordering with respect to these matters.

A.6 ***Restricted Periods and Permissible Sales.***

Securities purchased under the new exemptive rule would be 'restricted securities' from the time they are last purchased from the issuer (or an affiliate of the issuer) until the expiration of the Rule 144 restricted period (which we recommend be reduced to three months in the case of securities of a reporting issuer and six months in the case of securities of a non-reporting

[3] The "accredited investor" definition originally included a category based on the amount invested ($150,000), which was later dropped. We submit that with a substantially higher minimum investment amount, this approach would be conceptually sound.

issuer). During the restricted period for a security, the security could be resold in accordance with the new rule or, consistent with current practice, in reliance on Rule 144A, in transactions registered under the Securities Act or in sales outside the United States under Regulation S. Thereafter, except in the case of securities owned by an affiliate of the issuer, the security could be resold without registration or compliance with any other exemption from registration.

A.7 *Purchasers' Ability to Police Their Own Resales.*

Key to the success of Rule 144A was the Commission's determination, at the outset, that QIBs could be trusted to police their own resales. This permitted very efficient use of the rule to support large-scale capital raising. As noted above, the eligible investor definition in the proposed new exemption should be designed so as to permit the Commission to reach the same conclusion, which should be publicized in a similar manner (e.g., in an adopting release). This would be key to optimizing efficiency in the use of the new exemption. Note that the availability of the new exemption, which would facilitate resales to an expanded universe of eligible purchasers, should itself facilitate the Commission's conclusion as to eligible purchasers' ability to police their own resales.

A.8 *Integration.*

The integration doctrine may serve a purpose where it is being applied to protect a numerical or quantitative limit in an exemption (e.g., Rule 506(b)'s limit of 35 non-accredited investors), or where an exemption's limits on offers would be undermined by the existence of other offers purporting to relate to a separate offering. But since sales under this proposed new exemption could be made to any number of eligible purchasers and, as discussed above, there would be no need to restrict offers as a condition to the exemption, there will be no need to apply integration analysis to the new exemption. Where the exemption is premised entirely on the qualifications of the purchasers, the scope of the offering is really not significant. Rather, the principle of Rule 144A(e) (that offers and sales pursuant to the new exemption would not affect the availability of any exemption relating to any previous or subsequent offer or sale) should be applied equally to the new exemption. Note that this aspect of Rule 144A was crucial to the market's acceptance of that rule.

A.9 *Federal Preemption.*

We would also suggest that the new rule provide that securities sold pursuant to the new exemption be considered "covered securities" under Section 18 of the Securities Act for blue sky purposes.

B. Broader Exemption Based on Rule 506(b)

Overview

We propose that the Commission also consider adopting a new exemption from registration based on, and in place of, Rule 506(b) that does not contain the limitations found in Rule 506(b) that appear to have arisen from its creation as a safe harbor for private offerings

under Section 4(a)(2) of the Securities Act. Instead, the new exemption, freed of these constraints, would contain only those conditions necessary for appropriate investor protection.

This new exemption would accommodate inclusion of retail investors and be in addition to our proposal for the eligible purchaser exemption discussed above. This new exemption also would be in addition to our proposals to expand opportunities for retail investors to participate through pooled investment vehicles, such as registered and private funds, discussed in Part III below. Another way to increase opportunities for retail investors to participate in private offerings is to expand in justified ways the definition of accredited investors, as discussed in Part II below. The following are key features of this new exemption.

B.1 ***Manner of Offering.***

We believe it is appropriate when non-accredited investors are permitted to participate in an exempt offering like the one we propose that the restriction on the manner of offering (namely, the absence of general solicitation) remain so as to protect against abuses. The Commission Staff has provided helpful guidance on what constitutes general solicitation.[4] We believe it would be useful for the Commission to codify and expand on that guidance.

B.2 ***Number of Purchasers.***

If the manner of offering is restricted by prohibiting general solicitation, we would not see a need to limit the number of non-accredited purchasers. The absence of general solicitation sufficiently distinguishes the exempt offering from a public offering and would itself constrain the number of purchasers. Alternatively, a reasonable limit on the number of non-accredited investors above the current 35 limit could be considered.

B.3 ***Sophistication Requirement and Other Limitations.***

We believe the separate sophistication requirement for non-accredited investors was derived from treating Rule 506(b) as a private offering safe harbor and may not be necessary for the new exemption adopted under the Commission's general exemptive authority. Instead, the limitation on the manner of offering by prohibiting general solicitation may be sufficient to circumscribe the universe of non-accredited investors. If, however, the Commission concludes that there should be a limitation on eligible non-accredited investors, we would suggest that, in addition to the existing sophistication test, the exemption permit sales to non-accredited investors with whom the issuer (or a person acting on its behalf) has a pre-existing, substantive relationship, defined (similar to C&DI 256.31) as follows: "a 'pre-existing, substantive relationship' means that the issuer (or person acting on its behalf) before making an offer to an offeree has sufficient information to evaluate, and in fact has evaluated, whether the offeree has the financial circumstances and experience to make the type of investment proposed to be made." This would broaden the pool of eligible non-accredited investors and allow for avoiding a determination based upon the more subjective criterion of sophistication alone, while sensibly limiting who may invest in the interest of investor protection. Adding this test as an alternative

[4] Securities Act Rules Compliance and Disclosure Interpretations ("C&DIs") 256.23-256.34.

also would build upon existing concepts and therefore be workable. In developing any test for eligible investors, we would not include any limitation on the amount or percentage of assets invested because this would be a complexity not justified by the benefit and would be an impediment to use of the exemption.

B.4 ***Information Requirements.***

Even with non-accredited investors, we do not think it necessary to include any specific information requirement, but instead would leave the information provided to market practice and antifraud compliance. The information that could be required would be the place where available information generally could be found, the restricted nature of the securities and, possibly, equal opportunity to obtain information shared with others investors (other than where confidentiality considerations require otherwise). An alternative might be to exclude a general information requirement for investors who, alone or with a representative, are sophisticated (but, as noted, without sophistication as a condition to investing). Another approach could be to eliminate the information requirement when there is co-investment with sufficient institutional accredited or other qualified investor participation (for example, 25% of the offering on the same terms), on the basis that co-investment by those investors validates the offering.

Should the Commission nevertheless conclude that mandating specific substantive disclosure is necessary, it could require more limited information about the company and the securities essential for a purchaser to receive than Rule 506(b) now requires for non-accredited investors, with appropriate distinction between reporting and non-reporting issuers. The current extensive information requirement of Rule 506(b) has effectively foreclosed non-accredited investors from participating as investors in these offerings.

B.5 ***Resales.***

In order to separate exempt offerings from public offerings and mitigate abuse, a six-month (or possibly 90-day) restriction on public resales should apply. This restricted period would sufficiently separate the initial sales and the resales.

B.6 ***Availability.***

We do not see a reason for this exemption (or indeed any of the other exemptions) to be limited to issuers. Instead, the exemptions should be available to affiliates and holders of restricted securities, as well. Rule 144 would remain in place to address public resale of control and restricted securities.

B.7 ***Federal Preemption.***

Like current Rule 506(b), securities sold under this exemption should be considered "covered securities" under Section 18 of the Securities Act for blue sky purposes.

B.8 ***Consequence of Violation.***

In order to avoid drastic consequences for a failure to comply with an exemption requirement, a violation should result in a private remedy (e.g., rescission rights) only to the investors to whom the violation applies and not to all investors in the offering.[5]

B.9 ***Integration.***

If there are limitations on investors who can participate in an offering, the integration doctrine should apply in order to avoid abuses. However, as we address in Part II below under "Integration," integration should be applied narrowly to address those abuses and not as a free-standing concept.

We believe that rethinking Rule 506(b) as we have suggested without the conditions originally included to make it a section 4(a)(2) private offering safe harbor will allow creation of an exemption from registration that will broaden the pool of available investors, including providing greater opportunities for retail investors, while maintaining the necessary level of investor protection.

C. Harmonization of Exemptions Through an "Eligible Issuer" Framework.

A common thread running through the most commonly used exemptions is the focus on the offeree or purchaser of the security, with only a minimal focus on the quality of, and risk associated with, the securities being sold by the issuer. However, in the public registration context, the quality of and risk associated with, the securities being sold, demonstrated by factors such as market capitalization of the issuer, timely reporting, financial condition (e.g., revenues), and governance features (with respect to exchange-listed securities), are often taken into account in determining the ability of the registrant to conduct a particular offering or list its securities on a national securities exchange.[6] As a result, the Committee encourages the Commission to consider whether certain offering and investment restrictions found in commonly used exemptions could be removed for an issuer that qualifies as an "eligible issuer," as defined by the Commission in a new rule.

By way of example, an "eligible issuer" could include requirements such as revenues and net income in the last three years in excess of a certain dollar threshold, governance features, including a minimum number of independent directors, "bad actor" disqualifications, or other characteristics that the Commission's Division of Economic and Risk Analysis determine are indicia of higher quality (less risky) securities. The new rule could specify that if the issuer qualifies as an "eligible issuer" as defined by the rule, then certain restrictive provisions within the various commonly used exemptions would no longer apply. Examples of restrictions that could be removed include (i) prohibitions on general solicitation, (ii) limitations on the

[5] Rule 508 of Regulation D could be viewed as a precedent for this approach.

[6] For example, a public company that seeks to list its securities on a national securities exchange must meet the quantitative and qualitative listing standards of the exchange. Other examples of scaled accommodations include those available to well-known seasoned issuers, filer status scaled disclosure rules and shelf eligibility rules.

participation of non-accredited investor purchasers, (iii) investment limitations, (iv) investor verification requirements, and (v) requirements to include audited financial statements.

Part II: Addressing the Current Exempt Offering Framework

We have the following specific comments on other topics raised in the Concept Release.

A. Accredited Investor Definition.

Overall, the Committee encourages the Commission to maintain in the definition of accredited investor clear, objective standards based on the income and net worth of an investor. These objective standards provide certainty to issuers that lead to an efficient process for identifying qualified investors and reduce regulatory costs. These objective standards also are necessary to provide certainty to an issuer that an individual is an accredited investor, and, consequently, that a private offering will be conducted in compliance with Rule 506(b) and 506(c) of Regulation D. In adopting Regulation D, the Commission carefully reviewed the existing regulatory framework and appropriately determined that issuers need to be able to rely on objective standards in conducting private offerings. As a result of such bright-line standards, Regulation D has been successful in promoting capital formation and protecting investors, and private issuers continue to depend on the legal certainty of quantitative, objective standards based on financial thresholds.

We also strongly support the existing aspects of the definition that an accredited investor includes a person who meets one of the listed qualification methods, or who an issuer reasonably believes meets one of the qualification methods, at the time of the sale of the securities to the person. Under these standards, if an issuer has an objectively reasonable belief that a person is an accredited investor at the time of investment in a private offering, it is provided with additional legal certainty, even if for some reason the person was not in fact an accredited investor.

Offerings under Regulation D have proven to be important to investors and issuers, and account for significant amounts of the capital raised by issuers. As such, who qualifies as an accredited investor, and may easily participate in those offerings, is of paramount importance to the investor and issuer community.

We have the following specific comments in respect of particular ideas raised in the Concept Release.

A.1 *Leaving the current income and net worth requirements in place, but adding investment limitations based on a percentage of income or net worth, and adding new inflation adjusted thresholds not subject to investment limits.*

We are concerned that creating a type of accredited investor that has investment limitations, and others that do not, would further complicate the process of making an offering under Regulation D. We also think such an approach would tend to be self-defeating as offering

participants would seek to avoid dealing with investors subject to such limitations, and thus exclude them from offerings whenever possible.

A.2 ***Permit spousal equivalents to pool their finances for the purpose of qualifying as accredited investors.***

We support this change as it would expand opportunities to invest in securities offerings to more households and reflect current social norms.

A.3 ***Permit all entities with investments in excess of $5 million to qualify as accredited investors.***

We support this change because entities, regardless of form, with investment in excess of $5 million are already quite likely to be sophisticated enough to protect themselves from the risks of the investment and are also presumably able to withstand the potential loss of a particular investment. We believe changing the standard to "investments" from "total assets" is sensible. We would apply this investments test as well to individuals.

A.4 ***The Commission should revise the accredited investor definition to allow individuals to qualify as accredited investors based on other measures of sophistication.***

Generally, we are in favor of expanding the "accredited investor" definition to encompass more of those parties who possess the sophistication to responsibly invest in Regulation D offerings. In that regard, using objective tests that result in certainty for an issuer and its advisers, either a new one created for this purpose or existing tests, to determine the sophistication of investors would be a step forward, and could expand overall access to capital from investors. Additionally, expanding the definition to encompass those investors with relevant experience in respect of the particular investment or who work closely with the particular investment also expands the potential pool of investors and allows them to reasonably and responsibly invest in the securities in question. We think this would increase investment opportunities with little to no impact on investor safety. We would stress, however, that unless a new category has objective certainty, issuers are unlikely to find it useful.

B. **Private Placement Exemption and Rule 506 of Regulation D.**

B.1 ***Offers and General Solicitation.***

As noted above, we suggest that the Commission consider the manner in which the current exempt offering framework continues to regulate "offers." The Committee suggests that the Commission consider defining "offer," solely for purposes of one or more (or all) of the offering exemptions, in a way that focuses on actual or potential transactions in securities, as opposed to vague "conditioning-the-market" concerns. For example, the Commission could usefully adopt a rule providing that a communication made more than 30 days before a sale of securities that does not refer to a securities offering, a particular security, or the terms or other provisions of a security does not constitute an "offer."

B.2 ***Section 4(a)(2).***

The Concept Release asks how frequently issuers use the Section 4(a)(2) exemption when no Form D is required. While the Committee has no hard data, we believe that the practice of lawyers representing smaller issuers in non-registered offerings may shed some light on the use of Rule 506(b) and how the capital-raising process for such issuers might be improved. Many practitioners in this area are reluctant to rely on Section 4(a)(2), even for initial rounds of financing. This reluctance is driven primarily by the absence in some states of an applicable exemption that does not require the filing of a copy of the federally filed Form D. This may hold true even when there are only one or two investors in a particular state. Many lawyers also consider it prudent to rely on Rule 506(b) at a federal level and to file a copy of the Form D in every state in which a purchaser is located, even if Section 4(a)(2) would be available, and another exemption could be found at the state level. It is thought that this creates a better record going forward and provides assurance to later investors that all prior offerings were exempt.

Notwithstanding frequent reliance on Rule 506(b), it is our own experience that Section 4(a)(2) is regularly relied on as an exemption in appropriate circumstances.

B.3 ***Rule 506.***

Having a more flexible standard for the adequacy of information in Rule 502(b), particularly for early stage issuers, might make it easier to comply with the information requirement for non-accredited investors. It can be particularly onerous for early stage companies to obtain an audited balance sheet that is no more than 120 days old when the offering is commenced. For this reason, many companies exclude non-accredited investors from their offerings. It would be consistent with the Commission's stated intention of broadening access to exempt offerings if the Commission were to review and revise the information requirements in connection with Regulation D. The Commission might consider scaling the information requirements based upon the amount sought to be raised in the proposed exempt offering, as the Commission has done in connection with other offering exemptions, such as pursuant to Regulation Crowdfunding. Alternatively, the Commission might consider scaling the information requirements to the extent that a regulated financial intermediary, such as a registered broker-dealer or a registered investment adviser, is involved in the exempt offering. Such an entity would serve as a gatekeeper that should provide necessary investor protection safeguards if there were individual investors that could not fend for themselves.

C. **Regulation A.**

C.1 ***Eligible Issuers.***

Regulation A allows issuers to address the retail market before they are ready to engage in a registered offering. It provides a system of disclosure that is scaled to the size of the issuers that typically engage in Regulation A offerings, but is sufficiently robust to meet the needs of retail investors. Regulation A at least potentially opens up new markets to retail investors, by making it easier for them to invest in companies that are not ready to engage in registered offerings and that are not actively traded. This benefit is limited to the extent that Regulation A unnecessarily restricts the type of issuer that is eligible to use Regulation A. There would seem

to be no compelling reason to prevent issuers from countries other than the United States and Canada to offer their securities under Regulation A. Issuers from countries outside the United States and Canada sometimes express an interest in Regulation A, because they wish to access the U.S. retail investor market, but are not yet ready to go through a complex registration and continuous reporting process. The modifications to current rules that would be required to make Regulation A available to non-Canadian foreign issuers would seem relatively modest.

Making Regulation A available to "business development companies," or BDCs, as defined in Section 2(a)(48) of the Investment Company Act, as amended (the "Investment Company Act"), would also be beneficial, as it might provide an easier path to market for such companies and encourage the formation of more BDCs. Like Regulation A, the rules governing BDCs are designed to facilitate retail investment in smaller companies. BDCs also provide diversification and professional management, which a retail investor in the Regulation A market might not otherwise get or even be able to achieve. Again, it would seem that relatively modest changes to Regulation A could be made to permit its use by BDCs. As noted in the Concept Release, participants in the Commission's Small Business Forum in 2014, 2015 and 2016 recommended that BDCs be made eligible to use Regulation A. The Commission might then rescind outdated Regulation E. For similar reasons, it would make sense to extend eligibility to small business investment companies and rural business investment companies.

C.2 *Variable Pricing and At the Market Offerings.*

Many issuers using Regulation A do not begin the offering process until the offering circular is qualified, with a best efforts marketing process that begins after the price range and offering amount have been set in the offering circular. Thus, the price range and size of the offering that are reflected in the offering circular may be set without much input from market participants. A lack of accurate pricing in the initial offering of Regulation A companies may adversely affect their marketability.

As provided in Rule 253(b)(2), issuers under Regulation A have the flexibility to set a price range (the greater of $2 or 20% of the upper range of price) and to decrease the size of the offering, so long as the final price and volume are disclosed in an offering supplement. Issuers often experience difficulty in setting a reasonable price range, and are often reluctant to lower the price outside of the range to the extent required by the market because it will require an amendment to their offering circular. Issuers are expressly precluded from engaging in "at the market offerings" as defined in Rule 251(d)(3)(ii).

It would be helpful to Regulation A issuers to have either greater flexibility in setting the price range, and for issuers that are Exchange Act-reporting issuers to have the ability to engage in at the market offerings pursuant to Regulation A, provided that information regarding sales is publicly reported quarterly.

C.3 *State Advance Notice and Filing Fee Requirements.*

State advance notice and filing fee requirements for Tier 2 offerings impose a substantial burden on the issuers without any corresponding benefit. The fees are high and the process is complex and expensive. Issuers generally file in most states, because they do not know in which

states their potential investors will be located. The burden of making these filings may discourage issuers from using Regulation A when they have other options. Even when issuers plan to list their securities on an exchange, they may conclude that they need to make the state filings because of the uncertainty as to whether they will be accepted for listing upon qualification of the offering. In addition, a small number of states require the issuers to register as issuer-dealers if they are not using a broker in the offering.

We understand that the Commission might not be able to provide a solution without legislative change, but thought that the problems were worth highlighting to help the Commission better understand some practical impediments to small business capital formation.

C.4 _Periodic Review of Regulation A_.

The Commission should consider in connection with a periodic review of Regulation A whether the exemption remains available for evolving financings and financial instruments. For example, the Commission might consider reviewing the definition of "eligible securities," set out in Rule 261(c) and which reflects the language of Section 3(b)(3) of the Securities Act. This definition should be revised to clarify that "debt security" should be read broadly, to encompass not just notes and debentures, but also digital assets and other investment contracts that are sold to raise capital and that give the purchasers a financial interest in the company doing the offering or its business.

D. Regulation Crowdfunding.

While most small issuers choose to engage in private funding transactions under Regulation D, some prefer to engage in crowdfunding transactions or wish to supplement their private fundraising with public crowdfunding. Regulation Crowdfunding enables these companies to engage in public fundraising when they are still in the very early stages of development and before they are ready to undertake an offering under Regulation A.

Companies often have difficulty with the follow-on annual reporting that is required under Regulation Crowdfunding. They may lack the administrative staff and focus required to report in a timely and compliant manner. They also may find that it was easier to provide the initial disclosures, when they had little or no operations, than it is to provide follow-on disclosures in subsequent years. Efforts to ease the burden of disclosure would make sense in light of the paucity of secondary trading in crowdfunded securities. Possible ways to ease the burden might include limiting the narrative disclosures that are required, providing a longer time period in which to make the disclosure (150 days after the fiscal year end, rather than 120 days) or eliminating the need for filing the reports on the Commission website, so long as the report is posted on the issuer's website.

The Concept Release asks whether it would be useful to permit companies to offer their securities through a special purpose vehicle under Regulation Crowdfunding, as recommended by prior Small Business Forums. The Committee believes this would be useful to help retail investors obtain diversification and select and monitor their crowdfunding investments.

E. **Integration.**

The Commission's integration doctrine, initially announced in Commission guidance applicable to Section 4(a)(2) and subsequently codified in Regulation D, generally serves to prevent an artificial division of an otherwise single private offering into separate offerings. The doctrine also has been applied to successive or concurrent private and public offerings. As a doctrine, we believe integration should be limited to its basic purpose, which is to prevent abuse, and should not be applied as an independent condition to be met to preserve an exemption for concurrent or successive offerings. As described below, the Commission has in recent years followed this approach in its JOBS Act and related rulemakings by providing that the exemption for an offering will not be lost as a result of integration with other offerings if that offering satisfies the requirements for its exemption. Certain Commission Staff interpretations also have been helpful. We believe it would be useful for the Commission to address the concept of integration of offerings both in a general way and with specific clarifications.

E.1 *General Approach of a Consolidated Rule.*

We recommend that the approach to integration in the more recently adopted or amended exemptions be made generally applicable to all exemptions and that its application be explained, either in the rule, through notes to the rule or through accompanying interpretive guidance. This harmonization would permit the integration doctrine to serve its original purpose and avoid unduly encumbering legitimate capital raising activities. We also make some recommendations below regarding the historic "five-factor test," which is an integral part of the integration doctrine.

The approach to a new general rule is best illustrated by the actions the Commission and the Staff have previously taken. These are described as follows, along with some suggestions for changes to those actions:

- Rule 152, which addresses successive private and public offerings, preserves the private offering exemption under Section 4(a)(2), presumably including an offering under the Rules 506(b) and (c) safe harbors, even though the issuer subsequently engages in a public offering or files a registration statement. The Commission should make clear that Rule 152 applies to offerings under Rules 506(b) and (c). In this regard, a Rule 506(c) offering can be a private offering for purposes of Rule 152 and a public offering for other purposes, including as the subsequent offering under Rule 152 (see the comment below regarding C&DI 256.34). In addition, the Commission should make clear that the Rule's protection covers both completed or abandoned exempt offerings, including under Rule 504 and whether or not the offering involves general solicitation, that are followed by a public offering or the filing of a registration statement. In this way, exempt offerings that satisfy their own requirements will not lose their exemption if followed by a public offering or such filing. Broadening Rule 152 also would have the benefit of encouraging registered public offerings. Also, when the Commission is addressing Rule 152, it should

eliminate the subjective "decides to" reference made inapplicable in the *Verticom* no action letter.[7]

- Rule 502(a) provides a safe harbor under Regulation D for offerings that are six months apart. The Commission should consider shortening this period, for example, to 90 days as it previously proposed, on the basis that such period ensures sufficient separateness. In addition the Commission should make this safe harbor generally available beyond Regulation D.

- Rule 155 provides a safe harbor for certain abandoned private and public offerings if there is a 30-day separation. The Commission should consider whether all the conditions, including the 30-day separation period, are necessary in light of experience under the Rule. We see no potential abuse in switching from a private offering to a registered offering that justifies imposing any delay period. In addition, the requirement in Rule 155(b) that the preliminary and final prospectus in the registered offering contain detailed disclosures about the abandoned private offering should be eliminated on the basis that it serves no useful purpose but rather imposes an impediment to undertaking the registered offering by creating a possibly unjustified negative perception about the issuer. Eliminating these conditions will only increase the likelihood that investors get the benefits of registration.

- Regulation A, Regulation Crowdfunding and the intrastate offering exemptions under Rules 147 and 147A each have specific safe harbors from integration with other specified offerings, as does Rule 701. These safe harbors reflect the Commission's more current approach to integration and can form the basis for the more comprehensive, general integration rule that we recommend the Commission adopt.

E.2 ***Revisiting Purpose of Five-Factor Test.***

The five-factor test historically has been used to determine whether ostensibly separate offerings are part of the same offering. Consistent with the position in C&DI 139.25 that the five-factor test does not have to be satisfied in order to rely on the 2007 Guidance referred to below and the approach to integration we recommend, the Commission should make clear that the five-factor test does not compel the integration of offerings but rather is a predicate for there to be integration if other factors require integration. In other words, the failure to meet the five-factor test would itself negate integration by establishing that the two offerings are separate. This approach to the five-factor test also would alleviate some of the concerns over the test's imprecision.

[7] Verticom, Inc. (avail. Feb. 12, 1986).

E.3 *Specific Integration Clarifications.*

The following are specific areas where additional clarification or broadened application under a new integration rule would be helpful without sacrificing investor protection:[8]

- Offerings that comply with the Rules 506(b) and (c) exemptions should be treated as separate offerings, with each able to stand on its own if its conditions are met. Although both are based upon the Section 4(a)(2) private offering exemption, Congress chose to treat Rule 506(c) as different in the manner of offering as long as the accredited investor limitations are met. Thus, if an issuer completes a Rule 506(b) or Section 4(a)(2) offering, it should be able to undertake a Rule 506(c) offering with general solicitation without having to test the two offering together, applying the five-factor test, but instead testing each separately to determine if it satisfied its conditions. Although the Staff in C&DI §256.34 applied Rule 152 to permit the 506(c) offering as a subsequent "public offering," we believe it would be more consistent with the broader integration principle to permit the consecutive offerings on the basis of testing them as separate offerings. Under this approach, the Rule 506(b) or Section 4(a)(2) offering also would be exempt because it would have been completed before any general solicitation took place and thus would have satisfied the conditions for its own exemption. Integration in the context of Rule 506(b) has focused on compliance with the 35 non-accredited investor limitation, but that is irrelevant with a subsequent Rule 506(c) offering because purchasers in that offering are limited to accredited investors, an unlimited number of which could have purchased shares in the 506(b) offering. This result also is consistent with the Commission's guidance in the 2007 Regulation D Proposing Release (the "2007 Guidance") that general solicitation in a registered public offering does not necessarily foreclose a concurrent exempt private offering in which general solicitation is not permitted if the issuer establishes that the investors in the exempt offering were not obtained through the general solicitation (for example, because the issuer can establish that the investor was introduced to the offering as a result of a pre-existing, substantive relationship and not through the general solicitation). Again, we see no reason why the foregoing should not apply equally to abandoned offerings.

- The 2007 Guidance should be codified and expanded so that it is broadly applicable as an overriding principle. There is precedent for the Commission taking this position, notwithstanding the more limited view of the 2007 Guidance expressed as dicta in the *KCD Financial Inc.* Commission decision.[9] Thus, if an issuer completes a Rule 506(c) offering with general solicitation, it should be able to undertake a Rule 506(b) or a Section 4(a)(2) exempt offering if it can establish that the investors were not introduced to the offering through the general solicitation. Correspondingly, sales to non-accredited

[8] The discussion is based on the existing exemptive framework. We address integration as it applies to our proposals for new exemptions in connection with those exemptions in Part I above.

[9] KCD Financial Inc., SEC Opinion 34-80340 (Mar. 29, 2017).

investors in the exempt subsequent offering should not affect the completed Rule 506(c) offering exemption.

- As noted above, a Rule 506(c) offering, even with general solicitation and thus a subsequent "public offering" for purposes of Rule 152, also can be a private offering under Section 4(a)(2) whose exemption is unaffected by a subsequent registered offering, whether a new registered offering after completion of the Rule 506(c) offering or a conversion of an abandoned Rule 506(c) offering. It would be helpful for the Commission to make this clear. In view of the nature of eligible investors in the Rule 506(c) offering, there should be little concern about abuse, and such clarification would encourage registered offerings. In addition, it should be possible for an issuer to undertake a side-by-side Rule 506(c) offering and a registered offering because even if the marketing activities for the registered offering were considered to be a general solicitation for the Rule 506(c) offering that activity is consistent with the Rule 506(c) exemption. An issuer should also be able to treat the Rule 506(c) offering separately and conclude that the Rule 506(c) offering activity did not involve impermissible gun-jumping. Thus, investors in the Rule 506(c) offering should be able to purchase in the registered offering. There are legitimate reasons for an issuer to undertake an exempt Rule 506(c) offering during the pendency of a registered offering – for example, the issuer may be in immediate need of funds while the registration statement is pending (which was the motivation for the 2007 Guidance) or may be issuing a different security (such as a note or preferred stock convertible into the underlying common stock that is the subject of the registered offering) – and we see no compelling policy reason to deny issuers this flexibility in view of the nature of the eligible investors in the Rule 506(c) offering. If there is concern about gun-jumping abuses by using general solicitation in the Rule 506(c) offering preceding or concurrently with a registered offering, the Commission could provide, as it does under Rule 500(f) of Regulation D, that the exemption cannot be used as part of a plan or scheme to avoid the registration requirements of the Securities Act. Alternatively, the Commission could require a separation period (e.g., 30 days as under Rule 163A) before the filing of the registration statement after completion of an offering under the Rule 506(c) exemption using general solicitation.

- A new rule also could address the relationship of test-the-waters activity with exempt offerings. This would be particularly useful in view of the Commission's recent expansion of the ability of issuers to test-the-waters and would reflect and codify the guidance provided by the Commission in connection with the adoption of Rule 163B. Thus, permitted test-the-waters communications, before or during the pendency of a registered offering, should not foreclose the ability of an issuer to decide to rely on Section 4(a)(2) or Rule 506 for offerings to the same investors, either under Rule 506(b) or Rule 506(c), assuming the other requirements of these exemptions are met, because the test-the-waters communications would not have been gun-jumping. Similarly, QIBs and institutional investors with which testing the waters took place, whether or not they participate in an exempt offering, should not be foreclosed from purchasing in the registered public offering.

Part III: Pooled Investment Funds

In the Concept Release, the Commission noted that for issuers, particularly issuers seeking to raise growth-stage capital, pooled investment funds[10] can serve as an important source of funding, and for retail investors seeking exposure to growth-stage issuers, there are potential advantages to investing through a pooled investment fund, including the ability to have an interest in a professionally managed diversified portfolio that can reduce risk relative to the risk of holding a security of a single issuer. The Commission acknowledged that while retail investors can obtain some exposure to exempt offerings indirectly through investment companies registered under the Investment Company Act and BDCs, those opportunities may be limited.

The Commission is soliciting comment on whether it should take steps to expand companies' ability to raise capital through pooled investment funds, such as target date funds, BDCs, interval funds, tender offer funds and other closed-end funds, and whether investors should be allowed greater exposure to exempt offerings through pooled investment funds. Although the Concept Release poses a number of important policy questions that the Committee does not have a position on, to the extent the Commission decides to pursue some of the ideas raised in the Concept Release, the Committee has suggestions of a technical nature with respect to their implementation.

Regulatory limitations that discourage participation by registered investment companies and BDCs in exempt offerings

For target date funds, the 15% limit on illiquid investments under Rule 22e-4 of the Investment Company Act

In the Concept Release, the Commission requests comment on whether there are "any regulatory provisions or practices, including those promulgated or engaged in by the Commission, that discourage or have the effect of discouraging participation by registered investment companies and BDCs in exempt offerings."[11] One potential area of review concerns the 15% limit on illiquid investments in Rule 22e-4 under the Investment Company Act. The Commission may consider providing certain categories of funds that have more stable investor bases, such as target date funds, with additional flexibility to hold securities purchased in exempt offerings in their portfolios by increasing the 15% limit for such funds. As noted in the Concept Release, for "funds with target dates significantly far into the future, the intended holding period may be better aligned with the limited liquidity of securities from exempt offerings relative to other types of open-end funds where the intended investor holding period may be shorter."[12]

Since target date funds are open-end funds, and therefore subject to unlimited redemptions on any business day, the 15% limit on illiquid securities applies to such funds. The

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[10] The Concept Release defines pooled investment funds as investment companies, such as a mutual fund or exchange-traded fund ("ETF"), registered under the Investment Company Act, "BDC," or a private fund that operates pursuant to an exemption or exclusion from the Investment Company Act.

[11] Concept Release at 188.

[12] *Id.* at 184.

Commission could consider amending Rule 22e-4 to permit the liquidity risk management program of funds with relatively stable investor bases to provide for a limit on illiquid investments that is higher than 15% in appropriate situations, including where the liquidity profile of the fund is consistent with such higher limits, in recognition of the relatively stable investor bases of certain funds such as target date funds with target dates that are sufficiently distant. The amended rule might contemplate that the maximum percentage in a particular target date fund could vary with the extent of the period of time to its target date, if such an approach is indicated by the redemption profile of the fund. In addition, the Commission also could consider adopting an exemptive rule that would permit such funds a longer period than the seven days specified for the payment of redemption proceeds in Section 22(e) of the Investment Company Act, or to limit redemptions, in each case in a very narrow range of circumstances, such as when a target date fund is faced with an extraordinarily high level of redemptions calculated by reference to the higher illiquid securities limit set forth in the exemptive rule.

The Committee recognizes that the Commission may be of the view that the adoption of such an exemptive rule is not necessary because investors are sufficiently protected by the existing regulatory framework, including the ability of the Commission to waive the prohibition on suspending redemptions for more than seven days and the potential ability of target date funds to access other sources of liquidity than sales of portfolio assets. The Committee notes, however, that the requirement to seek a Commission order pursuant to Section 22(e)(3) in an emergency situation may cause even funds with highly stable investor bases to be reluctant to exceed the 15% limit, and urges consideration of an exemptive rule, which would be subject to appropriately restrictive conditions, to address unexpected situations that may arise.

If the Commission were to take steps to enable target date funds to seek greater exposure to exempt offerings, participation in such offerings may become more accessible to a broader group of investors. In addition, because target date funds are often available through defined contribution plans, such steps by the Commission to provide target date funds with flexibility to invest in exempt offerings could also address growing market concern about the increased participation in, and relatively poor performance of, defined contribution plans as compared to defined benefit plans. Chairman Jay Clayton, the U.S. Department of Labor and others have observed the marked shift over the past few decades away from participation by private-sector employees in defined benefit plans and towards participation in defined contribution plans.[13] This shift could be limiting U.S. retiree access to better performing investments, since defined contribution plans, unlike defined benefit plans, generally do not provide participants with options to invest in private equity funds, hedge funds or other private offerings.[14] It is also

[13] Chairman Jay Clayton, Statement Announcing SEC Staff Roundtable on Short-Term / Long-Term Management of Public Companies, Our Periodic Reporting System and Regulatory Requirements (May 20, 2019), available at: https://www.sec.gov/news/public-statement/clayton-announcement-short-long-term-management-roundtable; U.S. Department of Labor, Employee Benefits Security Admin., Private Pension Plan Bulletin Historical Tables and Graphs, 1975-2016 at 5 (Dec. 2018), available at: https://www.dol.gov/sites/dolgov/files/EBSA/researchers/statistics/retirement-bulletins/private-pension-plan-bulletin-historical-tables-and-graphs.pdf.

[14] Committee on Capital Markets Regulation, Expanding Opportunities for Investors and Retirees: Private Equity (Nov. 2018), at 49-52, available at: https://www.capmktsreg.org/wp-content/uploads/2018/10/Private-Equity-Report-FINAL-1.pdf.

possible that exposure to exempt offerings is contributing to the outperformance of defined benefit plans compared to defined contribution plans.[15]

With respect to investor protection concerns, as noted in the Concept Release, nearly all target date funds are registered open-end funds, which are subject to extensive disclosure requirements under the Securities Act and the Investment Company Act, and such funds are subject to additional regulations that protect investors such as daily pricing requirements and leverage restrictions. Such funds are also subject to stringent reporting and governance provisions. In addition, a target date fund's intent to exceed the 15% limit, and potentially its ability to delay payment of redemption proceeds, would need to be appropriately disclosed to investors under the existing regulatory framework and would be done under the oversight of its board, including independent directors.

For interval funds, liquidity and other restrictions of Rule 23c-3 under the Investment Company Act

The Commission also requests comments on whether to consider making any changes to the rules regarding interval funds and tender offer funds.[16] For the reasons discussed below, and consistent with the recommendation in the U.S. Treasury Department report dated October 2017, the Commission should consider revising Rule 23c-3 under the Investment Company Act ("Rule 23c-3" or the "Rule") to promote increased formation of such funds. More flexible provisions governing interval funds, akin to some of the flexibility that "tender offer" funds have pursuant to Rule 13e-4 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), might encourage the formation of more interval funds that invest in exempt offerings by smaller public companies and private companies, including private funds, in a manner that would promote capital formation and expand investor access to such offerings and the potential advantages of such investments.

Interval funds comprise a small but growing segment of the registered closed-end fund market. In the adopting release for Rule 23c-3, the Commission noted that the adoption of the Rule "should attract greater investment in closed-end companies."[17] Despite a slow start initially, interval funds have experienced recent growth due, at least in part, to a growing number of investors seeking to diversify their portfolios beyond traditional equity or fixed income mutual funds. Like other closed-end funds, interval funds can invest in illiquid securities beyond the 15% limit that applies to open-end funds and can more easily invest in less liquid securities, including those issued by private companies in exempt offerings.

The Committee believes that the strict provisions of Rule 23c-3, including the requirement to obtain stockholder approval to change repurchase offer practices (timing and amount of each offer to repurchase) and the liquidity requirement described below, has discouraged the formation of such funds. With respect to the liquidity requirement, although limited by the Rule to the repurchase offer period, as a practical matter, many closed-end funds

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[15] *Id.*

[16] *See* Concept Release at 188; *see also* Concept Release at 191.

[17] Repurchase Offers by Closed-End Management Investment Companies, Inv. Co. Act Rel. No. IC-19399 (1993).

that seek to invest all or substantially all of their assets in illiquid securities cannot rely on Rule 23c-3 unless a portion of their assets remains invested in liquid securities, which affects these funds' ability to meet their investment objectives. As a result, the Committee believes that many funds that would otherwise be formed as interval funds are instead formed as "tender offer funds," which, as the Commission observed in the Concept Release, enjoy more operating flexibility than interval funds, but lack some of the advantages that come with relying on Rule 23c-3, as discussed below.[18]

Specifically, interval funds are required to adopt a fundamental policy, changeable only by a majority vote of the outstanding voting securities of the fund, stating, among other things, the periodic intervals between repurchase request deadlines, the dates of repurchase request deadlines or the means of determining the repurchase request deadlines and the maximum number of days between each repurchase request deadline and the next repurchase pricing date. In addition, interval funds must conduct their periodic repurchase offers every three, six, or twelve months.

In addition to the fundamental policy requirement and the timing limitations, interval funds are limited in the percentage of their shares that they may repurchase and may face, from time to time, repurchase offers that are oversubscribed. Because Rule 23c-3 limits an interval fund's repurchase offers to an amount between 5% and 25% of the fund's outstanding shares, to the extent that an interval fund's repurchase offer is oversubscribed, the fund will, generally, be required to repurchase shares on a *pro rata* basis.[19]

Interval funds also must comply with certain liquidity requirements during the repurchase period pursuant to Rule 23c-3. In particular, during the repurchase offer period (from the date of notice to the pricing date), an interval fund must hold assets equal to the full repurchase offer amount that mature by the repurchase payment deadline or can be sold in the ordinary course between the repurchase request deadline and the repurchase payment deadline (i.e., within a maximum of 21 days), even if such amount is not ultimately repurchased. As a result, interval funds must have sufficient liquidity to cover all offered shares, regardless of the number of shares investors tender during the repurchase offer period. In practice, an interval fund may need to adjust a portion of the fund's portfolio to hold more liquid assets during the repurchase offer period, or otherwise maintain a portion of its assets in liquid assets, which could make it more challenging for the interval fund to pursue its investment objective or to invest in many types of illiquid underlying assets, as many types of assets may not be saleable or redeemable in the prescribed period.[20]

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[18] Concept Release at 177.

[19] Interval funds are permitted to increase the offer by only 2% of the fund's assets.

[20] During this repurchase offer period, pursuant to Rule 23c-3(b)(10)(i), at least 100 percent of the repurchase offer amount has to consist of assets that can be sold or disposed of in the ordinary course of business, at approximately the price at which the company has valued the investment, within a period equal to the period between a repurchase request deadline and the repurchase payment deadline, or of assets that mature by the next repurchase payment deadline. Because, under Rule 23c-3(a)(5), a repurchase pricing date has to occur no later than the fourteenth day after a repurchase request deadline and, under Rule 23c-3(a)(4), a repurchase payment deadline has to occur seven days after the repurchase pricing date, as a practical matter interval funds must maintain the assets must be liquid

By contrast, tender offer funds, although subject to the tender offer rules under the Exchange Act, operate in very similar ways to interval funds, but "have greater flexibility with respect to the amount and timing of the repurchase offers, relative to interval funds, as there is no requirement for a tender offer fund to conduct such offers at specific intervals or any minimum or maximum repurchase amount."[21] Tender offer funds conduct repurchase offers subject to the discretion of the tender offer fund's board of directors, which may consider numerous factors, including: the recommendation of the adviser, shareholder requests to tender shares, liquidity of the fund's assets, the fund's repurchase history and the economic condition of the securities markets. Tender offer funds are not subject to the portfolio liquidity requirements to which interval funds are subject to under Rule 23c-3, which is one reason why closed-end funds that invest in many illiquid privately placed securities, such as private funds, are typically structured as tender offer funds. Instead of adjusting the liquidity of their portfolio during each repurchase offer period, or otherwise maintaining a portion of their assets in more liquid securities, tender offer funds can liquidate assets based on participation levels at the expiration of a particular repurchase offer. In addition, unlike interval funds, tender offer funds do not automatically face oversubscription issues, as repurchases are conducted at amounts approved by the fund's board of directors, and the board could amend the repurchase offer and approve an increased repurchase amount. Further, tender offer funds may also pay out the proceeds of a repurchase, or a portion thereof, over a longer period of time.

Although tender offer funds have greater flexibility with respect to repurchase offers than interval funds, they do not enjoy certain regulatory benefits that apply to interval funds. For example, to register additional shares, tender offer funds require a declaration of effectiveness from the Commission staff. By contrast, interval funds that are publicly offered can register shares in an immediately effective amendment to the registration statement pursuant to Rule 486(b) under the Securities Act. In addition, interval funds have no required Financial Industry Regulatory Authority, Inc. ("FINRA") filing fees, while offerings of securities by tender offer funds are subject to the FINRA filing requirements, an initial filing fee, and regulation pursuant to FINRA Rule 5110, which imposes fixed lifetime caps on sales compensation and distribution fees. By contrast, interval funds are exempt from FINRA Rule 5110 and are subject to FINRA Rule 2341, which imposes varying caps on sales compensation and distribution fee levels, similar to open-end funds.

The Committee suggests that the Commission consider amending Rule 23c-3 to provide interval funds some of the flexibility already available to tender offer funds while imposing conditions that address the Commission's investor protection concerns. These changes could result in increased formation of interval funds (i.e., by funds that would otherwise be structured as tender offer funds) without the need to extend the benefits of the Rule to tender offer funds. Although the Committee appreciates the investor protection rationale for the restrictions in Rule 23c-3, it believes that greater reliance on disclosure (such as a requirement to provide ample advance notice of a board-approved change in a fund's repurchase policy (with no shareholder approval requirement)) would better balance the investor protection considerations and the

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within a maximum of 21 days. This requirement presents a challenge for interval funds that invest in assets that do not provide liquidity within 21 days, including many private funds.

[21] Concept Release at 177.

increased flexibility that could promote product development and broaden the investment options available to investors. Moreover, the increased flexibility that would be provided under a revised Rule would merely mirror the flexibility that currently exists for closed-end funds structured as tender offer funds, which have been in operation for decades.

The affiliated transaction restrictions of the Investment Company Act

The Commission should consider proposing an exemptive rule or amending existing exemptive rules to provide exemptive relief from Sections 17(a) and 57(a) of the Investment Company Act in order for a registered fund to pursue a private equity or venture capital strategy that may result in the control of a portfolio company

Question 120 of the Concept Release asks what types of relief may be needed in order for a registered fund to pursue a private equity or venture capital strategy whereby the fund's investments may result in control of a portfolio company. In order for a registered fund to pursue a direct private equity-type strategy, for most sponsors narrow relief from the provisions of Sections 17(a) and 57(a) of the Investment Company Act would be required. Section 17(a) restricts the ability of a registered fund to engage in principal transactions with an affiliated person of the registered fund or an affiliated person of such a person. Section 57(a) applies similar restrictions to BDCs. Private equity investments generally involve the acquisition of a significant portion of the voting securities of an issuer in the form of majority or minority stake positions. Both majority and minority stake positions typically exceed 5% of the issuer's voting securities (resulting in an affiliation that implicates Section 17(a)) and many exceed 25% of the issuer's voting securities (resulting in an affiliation that implicates Section 57(a)). While the Commission has adopted exemptive rules that can help a registered fund or BDC in certain circumstances, such as Rules 17a-6 and 57b-1, these exemptive rules do not account for side by side investing between regulated funds and private funds in the initial investment. Rule 17a-6, for example, allows a registered fund (or a series of a registered fund) to rely on the rule if it had co-invested with another registered fund (or series of a registered fund), but not a private fund. It is not clear that investor interests are served by this distinction, and we suggest that the Commission address the differing treatment of registered funds and private funds in this regard.

The Commission should consider granting relief from the provisions of Sections 17(a) and 57(a) of the Investment Company Act that prevent a sponsor from managing a registered fund that invests in private funds managed by the same sponsor

In addition, Question 114 of the Concept Release asks if there are regulatory provisions or practices that discourage registered funds from participating in exempt offerings.

The Committee notes that a significant issue that has prevented development of registered funds that are able to provide retail investors with access to private companies is that the Investment Company Act currently does not permit a registered fund to invest in affiliated private funds. Sections 17(a) and 57(a) of the Investment Company Act prohibit a private equity fund from selling its securities to a registered fund managed by the same sponsor. Currently, no exemptive rule, no-action letter or exemptive relief permits such a structure.

Question 115 of the Concept Release asks what restrictions should be placed on the ability of registered funds to invest in private funds. In light of the barriers to offering a registered fund of affiliated private funds, the Committee requests that the Commission consider ways to lift the restrictions preventing this fund structure in a manner that retains appropriate investor protections. We believe this would help to facilitate the development of registered funds that are able to offer retail investors access to private fund strategies.

The Committee believes that a fund of affiliated private funds may offer investors benefits unavailable to a fund of unaffiliated private funds. Certain registered funds currently offer accredited investors access to private funds of a single sponsor, but those registered funds are managed by an investment adviser unaffiliated with the sponsor of the private funds. A private fund sponsor has the most insight into the fund's portfolio, which naturally places an unaffiliated investment adviser at a disadvantage when compared to the private fund's sponsor. In addition, such a structure would alleviate concerns about the ability of a registered fund to value underlying private fund holdings accurately or to test for compliance with restrictions applicable to registered funds, because of the availability of proprietary, real-time information to the sponsor.

The Committee recognizes that a fund of affiliated private funds structure raises potential conflicts of interest concerns that underpin Sections 17(a) and 57(a) of the Investment Company Act. The Commission has permitted fund of affiliated fund arrangements involving mutual funds under Section 12(d)(1)(G) of the Investment Company Act and Rule 12d1-2 thereunder, and recently proposed Rule 12d1-4 to further level the playing field for such products. The conflicts of interest considerations for a fund of affiliated private funds are somewhat different than for a fund of affiliated mutual funds, but we believe the Commission could adopt certain guidelines that would help address these concerns and strike a workable balance between the interests of retail investors and the Commission's interest in preserving investor protections. Potential guidelines could include the following:

- Advisers would have to demonstrate to the registered fund's board of directors that fund-level fees, if any, are for services that are in addition to and not duplicative of services at the underlying private fund level (to avoid impermissible layering of fees);
- The registered fund would not be permitted to own more than a certain percentage of any underlying closed-end private funds (to avoid the concern that retail money was being used to "seed" an untested or otherwise unattractive strategy);
- The registered fund would not be permitted to own more than a certain percentage of any underlying private open-end funds and be restricted from seeding private open-end funds (to address the same seeding concerns as in the prior bullet);
- The registered fund would not invest in other funds of funds (to avoid three-tier structures) and would not invest more than a certain percentage of its assets in a single private fund (to avoid being deemed to be formed for the purpose of investing in such fund);

- The registered fund would vote its interests in any underlying private fund in the same proportion as the vote of all other shareholders in the particular underlying private fund (to avoid complex control structures); and

- The registered fund would receive most favored nation treatment with respect to all investments in underlying private funds (to ensure that any joint transaction would not be disadvantageous to the registered fund participant).

The Committee recommends that the Commission encourage innovation in registered funds by permitting a registered fund of affiliated private funds structure, which would also expand retail investor access to private fund investment strategies.

Staff positions that discourage participation by registered investment companies and BDCs in exempt offerings

Informal Staff position that registered funds that invest more than 15% of their assets in private funds, including registered funds whose shares are registered under the Securities Act, must be offered only to accredited investors

Another regulatory practice that discourages registered funds from participating in exempt offerings is the Commission Staff's informal position that a registered fund that invests more than 15% of its assets in private funds may only be offered to accredited investors.[22] The Commission acknowledges in the Concept Release that "the possibility of offering closed-end funds that make significant investments in private funds to retail investors has historically raised staff concerns under the Investment Company Act, insofar as these investors could not invest directly in private funds."[23] The Committee echoes the calls by the Committee on Capital Markets Regulation[24] and others for the Commission to change the informal position taken by the Staff that currently prevents investors that do not qualify as accredited investors from investing in registered closed-end funds that invest more than 15% of their assets in private funds. The Staff has not, to our knowledge, explained the legal or policy basis for this informal position and it has effectively curtailed retail access to private fund strategies through registered funds.

The Committee suggests that instead of prohibiting registered closed-end funds from investing a significant portion of their assets in private funds, the Commission consider instead permitting such investments, subject to certain guardrails to maintain appropriate investor protections. For example, the Commission could limit the percentage of assets that a registered closed-end fund could invest in a single private fund. Additionally, the Commission could prevent registered closed-end funds from investing in private funds designed to indirectly target retail investors, as such funds could pose a greater risk of taking advantage of retail investors. A

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[22] *See* Concept Release at 188, Question 114.

[23] Concept Release at 186-187.

[24] Committee on Capital Markets Regulation, Expanding Opportunities for Investors and Retirees: Private Equity (Nov. 2018), at 38-41, *available at*: https://www.capmktsreg.org/wp-content/uploads/2018/10/Private-Equity-Report-FINAL-1.pdf.

typical private fund currently has sophisticated institutional investors that diligence a sponsor and negotiate the terms of their investment in the fund. If the Staff's position is removed as an impediment to registered closed-end funds investing in private funds, there is a risk that private funds could be formed that eschew institutional capital in favor of indirect retail capital, thereby removing the protective benefits provided by a sophisticated investor base. A possible solution to this risk is to permit a registered closed-end fund to invest in a private fund only so long as a significant percentage of the private fund's capital is owned by investors other than registered funds. While the Staff has not explained the nature of its concerns in letting retail investors invest indirectly in private funds, these types of restrictions may serve to address the Staff's concerns and support investor protection.

Staff position that prevents registered funds of private funds from being listed on an exchange

The Concept Release requests comment on whether the availability of secondary market liquidity affects investor decision making with respect to closed-end funds and BDCs, and whether the Commission should consider any changes to its rules to encourage the establishment or improvement of secondary trading opportunities for these funds.[25] Currently, the Staff has taken a position, which is discussed above, that in effect prevents a registered fund of private funds from listing its shares on an exchange. This Staff position results in diminished liquidity for investors, who otherwise would be able to exit and/or enter the fund on a daily basis at the then-prevailing market price.

As discussed above, we urge the Commission to change the current Staff position that limits a registered fund of private funds to accredited investors. If that restriction is lifted, we see no reason why such funds should be prohibited from publicly listing their shares and do not believe any other changes to Commission rules would be required in order for a secondary market to develop for registered funds of private funds. Current listing standards for registered closed-end funds are agnostic in terms of investment strategy/portfolio.[26] Listing shares of a fund of private funds would enhance investor protection by significantly increasing the liquidity of their investment in the fund.[27]

"Qualified purchaser" and "accredited investor" standards

The Concept Release solicits comment on whether the Commission should consider defining an "accredited investor" under Regulation D to specifically include a "qualified purchaser." The Managed Funds Association[28] and others have recommended that the Commission harmonize the existing sophisticated investor tests under the federal securities laws

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[25] Concept Release at 193, Question 129.

[26] *See, e.g.*, NYSE 102.04.

[27] While it is possible for the market price of a fund's shares to reflect a discount to the fund's net asset value such that an investor could suffer a loss on their investment by selling in the open market, we believe that the benefits of having the option to sell fund shares on an exchange clearly outweigh the risks to investors of being deprived of that liquidity option altogether.

[28] Letter from the Managed Funds Association dated Jun. 16, 2016, at 3, available at: https://www.sec.gov/comments/4-692/4692-37.pdf.

by including "qualified purchasers," as defined in Section 2(a)(51) of the Investment Company Act, as "accredited investors." Although not a practical concern in most cases for registered investment companies and BDCs, this change would simplify the analysis for certain types of investors (i.e., irrevocable trusts) that sometimes, as a result of the existing mismatch in standards for private fund investors, can be deemed "qualified purchasers" but not "accredited investors." In addition, this change would maintain existing financial thresholds and continue to ensure that only sophisticated investors are able to invest in private funds, as qualified purchasers include individuals with at least $5 million in investments, and institutions with at least $25 million in investments, and qualified clients are persons who have at least $1,000,000 under the management of the investment adviser or have a net worth of more than $2 million.

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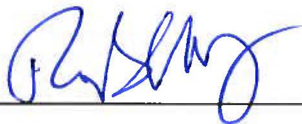
The Committee appreciates the opportunity to comment on the Concept Release and respectfully requests that the Commission consider the recommendations set forth above. We are available to meet and discuss these matters and to respond to any questions.

Very truly yours,



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