NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.
750 First Street N.E., Suite 1140
Washington, D.C. 20002
202/737-0900
Fax: 202/783-3571
www.nasaa.org

NASAA

March 24, 2014

Submitted electronically to rule-comments@sec.gov

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Comments in Response to Release Nos. 33-9497; 34-71120; 39-2493; File No. S7-11-13: Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act

Dear Ms. Murphy,

The North American Securities Administrators Association, Inc. ("NASAA")[1] submits the following comments in response to the Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act ("Regulation A Proposal" or "the Proposal").

For the reasons explained below, the Securities and Exchange Commission ("Commission") must make substantial revisions to the Proposal to, among other things, craft rules for the implementation of Title IV of the Jumpstart Our Business Startups Act ("JOBS Act")[2] that will promote responsible capital formation, protect investors, and preserve the authority of the states to review and register these offerings. As more fully outlined below, it is our strong belief that the Commission's attempt to preempt state registration in the Proposal exceeds the Commission's statutory authority and fails to adequately consider all relevant costs and potential harm to both issuers and investors.

[1] The oldest international organization devoted to investor protection, the North American Securities Administrators Association, Inc. was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.
[2] Pub. L. No. 112-106, 126 Stat. 306.

Executive Summary

In Title IV of the JOBS Act, Congress amended Section 3(b) of the Securities Act of 1933 by adding new Section 3(b)(2) to increase the annual offering limits for securities issued pursuant to this exemption from $5 million to $50 million.[3] Title IV also provided that Regulation A securities would be covered securities and exempt from state registration to the extent that the securities were sold on a national securities exchange or sold to "qualified purchasers."[4] The Commission now proposes to implement Title IV by way of amendments to Regulation A that expand the preemptive reach of the exemption beyond the clear language and intent of Title IV of the JOBS Act and the National Securities Markets Improvement Act of 1996 ("NSMIA").[5]

Of greatest concern to NASAA is the Commission's attempt to circumvent a Congressional directive to maintain state registration for offerings that are sold to unsophisticated investors and those with modest means. NASAA is opposed to the Commission's approach to define "qualified purchaser" for purposes of securities issued under Regulation A as all offerees in Tier 1 and Tier 2 offerings and all purchasers in Tier 2 offerings. The practical effect on most Regulation A offerings would be exemption from state regulatory review, a direct contravention of Congress's intent when it passed the JOBS Act.

As a regulatory agency, the Commission lacks the authority to define "qualified purchaser" and preempt state registration in the manner contemplated in the Regulation A Proposal. The legislative history of the JOBS Act indicates Congress considered broad preemption of state authority over Section 3(b)(2) securities and soundly rejected it. Furthermore, the Commission's proposed definition of "qualified purchaser" is contrary to the plain meaning of Sections 18(b)(3) and 18(b)(4)(D) of the Securities Act, the legislative history of the provisions, and prior Commission pronouncements. The Commission's proposed approach is contrary to enacted law such that, should it be finalized, there is a significant likelihood that issuers and their counsel, concerned about the legality of the Commission's actions, would be reluctant to engage in Regulation A offerings.[6] NASAA is concerned that the Commission would consider an approach inconsistent with Congressional intent and prior agency interpretations that is ultimately harmful to both issuers and investors.

The Commission points to a 2012 report issued by the Government Accountability Office ("GAO Report")[7] that explored potential causes for the limited use of the Regulation A exemption in the Proposal's cost benefit analysis and as a reason for preemption. The purpose of the GAO Report was to provide information about Regulation A offerings directly to Congress and should not be used as a foundation for preemption. Moreover, the GAO Report identified a number of other factors that limited or discouraged issuer use of the exemption, including a comparatively low $5 million offering limitation, a slow and costly filing process associated with

---

[3] *Id*.
[4] *Id*.
[5] Pub. L. No. 104-290, 110 Stat. 3416.
[6] Letter from Mike Liles, Jr., Karr, Tuttle, Campbell, to S.E.C. (January 17, 2014), *available at* http://www.sec.gov/comments/s7-11-13/s71113-5.pdf.
[7] U.S. GOV'T ACCOUNTABILITY OFFICE, SECURITIES REGULATION: FACTORS THAT MAY AFFECT TRENDS IN REGULATION A OFFERINGS, GAO-12-839 (2012).

both state and Commission review, and the availability of other exemptions under the federal securities laws.[8]

The Commission's Proposal to preempt state regulatory review is further flawed given the agency's failure to conduct a fair and adequate cost benefit analysis of the effect preemption would have on issuers and investors. While the Commission spent considerable time detailing the benefits it perceives in preempting state review, there is little, if any, consideration in the Proposal of the adverse costs that come with preemption, particularly the potential harm to investors.[9] Whenever the Commission engages in rulemaking, it is required to give due consideration to the potential effects on investor protection, separate and aside from the debate regarding effects on issuers.[10]

The Proposal fails to examine any of the harm investors might incur in the absence of state review in the area of small and thinly traded company offerings. Data should be readily available to the Commission in light of investors' experience with preemption and microcap issuers in the Regulation D, Rule 506 context. While it is fairly well established that the Commission has not made Regulation D, Rule 506 review or enforcement one of its regulatory priorities,[11] for the past three consecutive years, Regulation D, Rule 506 offerings have been the single most common investment product or scheme involved in state enforcement actions.[12] That was the case even before the Commission permitted general solicitation and general advertising in new Rule 506(c). While Regulation D does not entail the same qualification and review process as Regulation A, Regulation A offerings will likely target more vulnerable unsophisticated investors in both the primary and secondary markets.

As reflected in NASAA's December 12, 2013, and February 19, 2014, correspondence to the Commission, the states conducted a thorough, year-long self-assessment of their registration processes based in part on the GAO Report findings. The result was a new coordinated filing and review program created with active industry input. The states have embraced this opportunity for change and modernization, voting overwhelmingly in support of the NASAA

---

[8] *Id*. at 15-16.

[9] Even the Commission's perceptions of the perceived benefits are skewed as many commenters still find the Proposal too costly to make Regulation A an attractive method of raising capital. *See* Letter from E. Cartier Esham, Executive Vice President, Emerging Companies, Biotechnology Industry Organization ("BIO"), to Elizabeth Murphy, Secretary, S.E.C. (March 11, 2014), at 5-6, *available at* http://www.sec.gov/comments/s7-11-13/s71113-39.pdf; *see also* Letter from Gregory S. Fryer, Esq., Partner, Verrill Dana LLP, to Elizabeth Murphy, Secretary, S.E.C. (February 28, 2014), *available at* http://www.sec.gov/comments/s7-11-13/s71113-30.pdf; Letter from Rutheford B. Campbell, Jr., Professor, University of Kentucky College of Law, to Elizabeth Murphy, Secretary, S.E.C. (March 5, 2014), *available at* http://www.sec.gov/comments/s7-11-13/s71113-36.pdf.

[10] *See* Securities Act of 1933 § 2(b), 15 U.S.C § 77b(b); *see also* Securities Exchange Act of 1934 § 3(f), 15 U.S.C. § 77c(f).

[11] *See* SEC. EXCH. COMM'N, OFFICE OF THE INSPECTOR GEN., OFFICE OF AUDITS, REGULATION D EXEMPTION PROCESS, Report No. 459 (March 31, 2009), *available at* http://www.sec.gov/about/offices/oig/reports/audits/2009/459.pdf. ("Overall, we found that [Division of Corporate Finance] does not generally take action when [division's] staff learn that issuers have not complied with the requirements of the Regulation D exemptions." *Id*. at v.).

[12] NASAA, 2013 ENFORCEMENT REPORT 3 (2013), *available at* http://www.nasaa.org/wp-content/uploads/2013/10/2013-Enforcement-Report-on-2012-data.pdf; NASAA, 2012 ENFORCEMENT REPORT 3 (2012), *available at* http://www.nasaa.org/wp-content/uploads/2012/10/2012-Enforcement-Report-on-2011-Data.pdf; NASAA 2011 ENFORCEMENT REPORT 2 (2011), *available at* http://www.nasaa.org/wp-content/uploads/2011/08/2010-Enforcement-Report.pdf.

Coordinated Review Program for Regulation A Offerings. NASAA will work with states over the next several weeks to implement the Program. The Coordinated Review Program for Regulation A Offerings will provide greater efficiencies in the state review process, maintain important investor protections, and facilitate responsible capital formation.

In contrast, the Commission's Regulation A Proposal has not adequately considered the costs, benefits, and harms associated with its proposal.[13] Significantly, the Commission has not addressed the cost or harm to investors arising from preemption or the Commission's ability to carry out the agency's regulatory responsibility given its budgetary challenges. Furthermore, Form 1-A and corresponding Models A and B disclosure documents should all be updated and streamlined to further reduce small business issuer costs.

The Commission should remove the preemptive provisions from the Proposal and partner with state regulators and industry to update Form 1-A and related disclosure templates. A streamlined process with scaled disclosure and reporting, relying on NASAA's Coordinated Review Program, is the optimal path to making Regulation A a workable exemption. We stand firm in our belief that, working together, the Commission and the states have a tremendous opportunity to create a filing and review process that works well for issuers and investors. To this end, we include in the latter portion of this letter our comments responsive to certain discrete provisions in the Proposal that would hopefully move the Commission closer to a final rule built on a collaborative state-federal process.

I. The Commission Lacks the Authority to Define "Qualified Purchaser" and Preempt the States in the Manner Contemplated in the Regulation A Proposal.

A. The legislative history of the JOBS Act is clear—Congress considered broad preemption of state authority over Section 3(b)(2) securities and soundly rejected it.

The JOBS Act was signed into law by President Obama on April 5, 2012.[14] The text of Title IV of the JOBS Act is drawn directly from H.R. 1070, the Small Company Capital Formation Act of 2011. H.R. 1070 was added to the JOBS Act (H.R. 3606, which became Public Law No. 112-106) without any further substantive change by the House of Representatives or by the Senate, thus making the legislative history of H.R. 1070 particularly relevant to the preemption issue presented by the Commission's Proposal.

As originally introduced, H.R. 1070 increased the offering limits of securities sold pursuant to an exemption from registration under Section 3(b) and contained no preemption provisions.[15] During a markup by the House Financial Services Subcommittee on Capital

[13] The Commission has yet to strike the proper balance between capital formation and investor protection in the Proposal. As Commissioner Kara Stein has noted, "I am concerned that the Proposed Rule . . . does not yet achieve the appropriate balance between promoting capital formation for issuers and protecting investors." Kara M. Stein, S.E.C. Comm'r, Remarks at S.E.C. Open Meeting (Dec. 18, 2013), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370540516481#.UyyjoqhdU2Y.

[14] Andrew Ackerman and Jared A. Favole, *Obama Signs Bill Easing IPO Rules*, WALL STREET JOURNAL, Apr. 5, 2012, *available at* http://online.wsj.com/news/articles/SB10001424052702303302504577325913968307518.

[15] *See* H.R. 1070, "Small Company Capital Formation Act of 2011", 112th Cong. 1st Sess., Mar. 14, 2011, *available at* http://www.gpo.gov/fdsys/pkg/BILLS-112hr1070ih/pdf/BILLS-112hr1070ih.pdf.

Markets and Government Sponsored Enterprises on May 4, 2011, Representative David Schweikert, the original sponsor of the bill, offered an amendment that preempted states from regulating Section 3(b)(2) securities sold by broker-dealers. The Schweikert Amendment, however, expressly defined all other Section 3(b)(2) securities as non-covered securities that would not be "exempt from State regulation under section 18(a)."[16] The Schweikert Amendment was adopted by the Subcommittee, over the objection of the Subcommittee's Ranking Member, Representative Maxine Waters.[17]

H.R. 1070, as amended, was considered by the House Committee on Financial Services on June 22, 2011, where Representative Schweikert offered another amendment, in the nature of a substitute, that further preempted the states from regulating the newly proposed Section 3(b)(2) securities. Representative Schweikert's substitute amendment preempted the states by defining as covered securities any Section 3(b)(2) securities offered or sold by a broker-dealer, offered or sold on a national securities exchange, or sold to a "qualified purchaser" as defined by the Commission pursuant to its authority to define the term under NSMIA.[18]

Representative Schweikert's substitute amendment was adopted over Ranking Member Representative Barney Frank's strong opposition. During the markup, Representative Frank offered his own amendment that would have limited state preemption to those Section (3)(b)(2) securities sold on a national exchange or sold to "qualified purchasers."[19] While Representative Frank's amendment was not adopted by the Committee,[20] the minority's view was expressed in the House Report on H.R. 1070:

> There was one contentious issue that arose during the markup that had nothing to do with the principle of an exemption limit increase, but instead with new language preempting state law. This language preempts state securities law for Regulation A securities offered or sold by a broker or dealer, creating a class of security not subject to state level review, but which will not receive adequate attention at the federal level. Regulation A securities are sometimes high-risk offerings that may be susceptible to fraud, making the protections provided by state review essential. To address these concerns, the Democrats offered an amendment to clarify that state securities [laws] would only be preempted if the Regulation A security is sold on an exchange or sold only to a qualified

[16] Amendment to H.R. 1070 offered by Representative David Schweikert, at 2 (May 2, 2011), *available at* http://financialservices.house.gov/media/pdf/hr1070schweikertam.pdf.

[17] *See Markup of H.R. 1070 – The Small Company Capital Formation Act of 2011; H.R. 1062 – The Burdensome Data Collection Relief Act; H.R. 33 – To amend the Securities Act of 1933 to allow church plans to invest in collective trusts; H.R. 940 – The United States Covered Bonds Act of 2011; H.R. 1082 – The Small Business Capital Access and Job Preservation Act; H.R. 1539 – The Asset-Backed Market Stabilization Act of 2011; and H.R. 1610 – The Business Risk Mitigation and Price Stabilization Act of 2011*, Before the H. Comm. on Financial Services, Sub Comm. on Capital Markets and Government Sponsored Enterprises, 112th Cong. (May 3, 2011), *available at* http://financialserv.edgeboss.net/wmedia/financialserv/markup050311.wvx.

[18] Amendment in the Nature of a Substitute to H.R. 1070 offered by Representative David Schweikert, at 5 (June 22, 2011), *available at* http://financialservices.house.gov/uploadedfiles/062211hr1070schweikertam.pdf.

[19] Amendment to the Amendment in the Nature of a Substitute to H.R. 1070 offered by Representative Barney Frank, (June 22, 2011), *available at* http://financialservices.house.gov/uploadedfiles/062211hr1070frank03am.pdf.

[20] Record Vote No. 43, House Financial Services Committee, 111th Congress, *available at* http://financialservices.house.gov/uploadedfiles/fc-43.pdf.

> purchaser. While that amendment was defeated, we will continue to work to ensure that the final bill provides adequate oversight.[21]

Following the Committee on Financial Services' favorable report on H.R. 1070, the bill was placed on the Union Calendar on September 14, 2011. Then, on November 2, 2011, House Financial Services Committee Chairman Spencer Bachus moved to suspend the Rules of the House and pass H.R. 1070, as amended. The move by Chairman Bachus to call up H.R. 1070 under suspension of the Rules permitted him to offer a motion to amend the bill a final time and strike the preemptive language added by Reprehensive Schweikert's May 4, 2011, substitute amendment. The nature of Chairman Bachus's amendment and the fact that the bill needed a supermajority to pass suggests clearly that a compromise had been reached between Representative Schweikert and Representative Frank on the question of preempting state Blue Sky law.

The Congressional Record of the day reflects that, prior to calling up the bill, such a compromise was in fact reached on the question of preemption, and that its terms effectively mirrored those proposed by Ranking Member Frank during the bill's consideration during the June 22nd markup:

> Finally, the gentleman from Arizona has also worked with Democrats on the remaining issue of contention, and that was the preemption of State law. The gentleman from Arizona's substitute amendment to H.R. 1070 removes the exemption from State level review that was previously provided to an issuer using a broker-dealer to distribute an[] issue. ***Regulation A securities can be high-risk offerings that may also be susceptible to fraud, making protections provided by the State regulators an essential [feature]***.[22]

The legislative history of H.R. 1070 makes clear that preemption was the subject of significant debate in Congress as the bill progressed through the legislative process and was ultimately rejected:

> Equally important, Congress did not explicitly preempt these smaller offerings from all state securities regulation. To the contrary, Congress deliberately revised the bill to ensure that state securities laws were not explicitly preempted before the bill's final passage.[23]

Although clearly rejected, the Commission, contrary to Congressional intent, is now proposing the same type of broad preemption, albeit through a different regulatory mechanism. By proposing to define "qualified purchaser" as every offeree in a Tier 1 or Tier 2 offering, and every purchaser in a Tier 2 offering, the Commission is attempting now to revive preemption in a form explicitly rejected by Congress and in a manner that defies Congressional intent. The debate over preemption was a policy question settled within the province of Congress. The Commission cannot now second guess Congress's decision no more than it can ignore its obligation to draft rules that faithfully reflect the intent of Congress.

---

[21] H.R. Rep. No. 206, 112th Cong. 1st Sess. at 13 (2011).
[22] Congressional Record Volume 157, Number 166 (Wednesday, Nov. 2, 2011), p. H7231 (emphasis added).
[23] Kara M. Stein Remarks, *supra* note 13.

B. The Commission's proposed definition of qualified purchaser is contrary to the plain meaning of Sections 18(b)(3) and 18(b)(4)(D) of the Securities Act, the legislative history of the provisions, and prior Commission pronouncements.

Securities Act Section 18(b)(4)(D) provides that Regulation A securities are covered securities and thereby exempt from state registration to the extent that they are offered or sold on a national securities exchange or offered or sold to qualified purchasers, as defined pursuant to Securities Act Section 18(b)(3).[24] When attempting to understand the meaning of a statute, the starting point is the plain language of the statute.[25]

The logical place to start in the analysis is the meaning of the word "qualified." "Qualified" is defined as "having the necessary skill, experience, or knowledge to do a particular job or activity."[26] Congress's placement of "qualified" before the word purchaser in the statute demonstrates its clear, unambiguous intent that the focus is on the qualification of the purchasing investor and not, as the Commission has proposed, the issuer.

Section 18(b)(3) gives the Commission the authority to define "qualified purchaser;" however, the agency can only do so to the extent that the proposed definition comports with the express intent of Congress.[27] Furthermore, while an agency's interpretation of a statute is sometimes entitled to deference, this deference is warranted only where "Congress has not directly spoken to the precise question at issue."[28] Because Congress has clearly established a standard that looks to the qualification of the person buying the security and not the entity selling the security as the Commission has proposed, it is clear that the Commission has exceeded its authority and is, therefore, not entitled to any deference.[29]

Further, the legislative history of NSMIA, which added Section 18(b)(3) to the Securities Act, explains that while the Commission was granted the authority to establish various definitions for the term "qualified purchaser," that authority is limited to the extent that "in **all** cases…the definition be rooted in the belief that 'qualified purchasers' are sophisticated investors, capable of protecting themselves in a manner that renders regulation by State authorities unnecessary." [30] Similarly, the Senate Committee on Banking, Housing, and Urban

---

[24] *See* Securities Act of 1933, § 18(b)(4)(D), 15 U.S.C. § 77r(b)(4)(D)(ii).

[25] *American Bar Assoc. v. Fed. Trade Comm'n*, 430 F.3d 457, 467 (D.C. Cir. 2005) (citing *Group Life and Health Ins. Co. v. Royal Drug Co.*, 440 U.S. (1979)); *see also SEC v. Ambassador Church*, 679 F.2d 608, 611 (6th Cir. 1982) ("It is a universally recognized rule of statutory construction that a court should look first to the language of the statute to determine the legislative purpose."); *Fashion Boutique of Short Hills, Inc. v. Fendi, USA, Inc.*, 314 F.3d 48, 56 (2nd Cir. 2002) ("It is a basic rule of statutory construction that a court begins with the plain and ordinary meaning of statutory terms.").

[26] The Merriam-Webster Dictionary, available at http://www.merriam-webster.com/dictionary/qualified.

[27] *See Dixon v. U.S.*, 381 U.S. 68, 74, (1965) ("[T]he power to adopt regulations to carry into effect the will of Congress as expressed by the statute." (quoting *Manhattan General Equipment Co. v. Commissioner*, 297 U.S. 129, 134 (1936)); *see also Manhattan General Equipment Co.*, 297 U.S. at 134 (A regulation that does not carry out the will of Congress but instead conflicts with the statute as written is invalid).

[28] *Chevron USA, Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984).

[29] *Id*.

[30] H.R. Rep. 104-622, at 31 (1996) (Conf. Rep.), *reprinted in* 1996 U.S.C.C.A.N. 3877, 3893-94 (emphasis added).

Affairs explained that "qualified purchasers" were the types of purchasers that, based on their wealth and sophistication, did not need the protection of state registration laws.[31]

From the plain language of Securities Act Sections 18(b)(3) and 18(b)(4)(D) to the provisions' legislative history, the intent of Congress as to the definition of "qualified purchaser" is without question. Congress deliberately used the term "qualified purchaser" to mean persons who could, based on qualifying factors such as wealth, income, or sophistication, fend for themselves. It is antithetical to reverse such analysis to convey "qualified purchaser" status to anyone to whom the security is offered or to certain purchasers of a specified type of security.

In 2001 the Commission undertook a rulemaking to define "qualified purchaser" under Section 18 of the Securities Act ("Qualified Purchaser Release").[32] In its Qualified Purchaser Release the Commission relied on the Congressional reports cited above and asserted that the term "qualified purchaser" should be defined using the same income and net worth standards as those applicable to accredited investors. In the words of the Commission, "Congress authorized us to define 'qualified purchaser' under the Securities Act to include 'sophisticated investors, capable of protecting themselves in a manner that renders regulation by State authorities unnecessary.'"[33] Further, the Commission explained that the regulatory and legislative history of both the "accredited investor" and "qualified purchaser" standards are "based upon similar notions of the financial sophistication of investors."[34] The Commission's approach in 2001 was consistent with the intent of Congress that the term "qualified purchaser" be based on the **investor's** sophistication.

If the Commission elects to adopt a definition of "qualified purchaser" as part of the promulgation of Title IV of the JOBS Act, the current Proposal must be revised to identify objective characteristics of the investor, not the product or the issuer, that are strong indicators of investor sophistication. It may be the same notions of financial means and experience used in the accredited investor standard, but presumably would be defined to correspond to a heightened standard in light of the freely tradable nature of these securities in the secondary market. Such an approach is consistent with the clear language and intent of Congress.

As explained above, the Commission's Proposal to define "qualified purchaser" in the manner suggested in the Proposal is not supported by the plain meaning or the intent of either NSMIA or the JOBS Act. Should the "qualified purchaser" definition be adopted as proposed, the Commission should expect that the significant questions raised over the legality of this approach will have a chilling effect on the actual use of Regulation A moving forward. One commenter has already noted the possible deterrent effects of the Commission's proposal stating, "if adopted, [the Proposal] might not withstand legal challenge, and that possibly might discourage efforts by regional investment bankers from committing the significant resources required to properly service small business public offerings until [the Proposal's] ability to withstand a challenge has been definitively decided by the court . . .."[35] Neither issuers nor

[31] *See* S. Rep. 104-293, at 15 (1996).
[32] Defining the Term "Qualified Purchaser" under the Securities Act of 1933, 66 Fed. Reg. 66839 (Proposed Dec. 27, 2001).
[33] *Id*. at 66840.
[34] *Id*.
[35] Letter from Mike Liles, *supra* note 6.

investors benefit from a final rule subject to significant uncertainty. It is, therefore, critical to the success of Regulation A that the Commission remove the highly questionable preemptive provisions.

II. NASAA's Coordinated Review Program for Regulation A Offerings Will Provide Greater Efficiencies in the State Review Process, Maintain Important Investor Protections, and Facilitate Responsible Capital Formation.

A. The NASAA Coordinated Review Program will facilitate the use of Regulation A for the benefit of issuers and investors.

State regulators, through NASAA, have developed a Coordinated Review Program for Regulation A Offerings ("Coordinated Review Program" or "Program") that will help streamline state registration of offerings under both Section 3(b)(1) and 3(b)(2) and that addresses the findings contained in the GAO Report. The Program contemplates the electronic filing of offering materials with one state (the program administrator) for distribution to the states in which the issuer wishes to register. In designing this Coordinated Review Program and its protocols, members of NASAA's Small Business/Limited Offerings Project Group met with and collected feedback from the ABA Business Law Section's working group on Section 3(b)(2) offerings. The need for such a Program and the guidelines that should apply to such offerings were thoroughly discussed. Furthermore, NASAA has received support for the Program through NASAA's public comment process.

The protocol for the Program establishes that after an issuer files its registration materials with the program administrator, the program administrator will select a lead merit examiner and a lead disclosure examiner from among the states in which registration is sought. If the issuer is not applying for registration in a state that applies merit standards, then only a lead disclosure examiner will be identified. The lead examiners will be responsible for drafting and circulating a comment letter to the participating jurisdictions. The lead examiners will also be responsible for seeking resolution of those comments with the issuer or its counsel. The Program includes strict review and comment timeframes to be adhered to by the participating states, generally no more than 21 business days from start to finish for an offering with no application deficiencies.

The Coordinated Review Program is not restricted to common stock offerings. As such, its protocol specifies that comments will be based on applicable NASAA statements of policy. In response to comments received from the ABA Business Law Section's working group and others, the Program provides relief from some provisions of the NASAA statements of policy, including changes to certain merit review standards to accommodate the needs and special circumstances of startup companies. For example, the Statement of Policy Regarding Promoters' Equity Investment is not applicable and discounted shares issued to promoters will be subject to a maximum escrow or lock-in period of two years from completion of the offering, with provision for release of 50% of such shares after one year from completion of the offering.

NASAA's Coordinated Review Program for Regulation A Offerings effectively addresses the concerns regarding state law raised in the GAO report about the limited use of Regulation A. The program was officially approved by over 90% of the U.S. NASAA membership on March 7, 2014. Within three weeks of approving the program, over two-thirds

of U.S. NASAA members have officially signed on to a Memorandum of Understanding demonstrating their agreement to participate in the Program and signaling broad support for the Program. NASAA will continue to work with all of its U.S. members over the coming weeks to secure additional approvals and to deploy the Program so that issuers may begin realizing its benefits.

B. Maintaining state registration of Regulation A offerings will promote investor protection and benefit issuers that rely on the exemption.

Congress has long acknowledged the important role that states play in the regulation of securities and the protection of investors. In 2004, in a Senate Hearing entitled, "The Role of State Securities Regulators in Protecting Investors" Senator Shelby, then Chairman of the Senate Banking, Housing, and Urban Affairs Committee, observed that "State regulators are the local cops on the beat, and their proximity to investors enables them to serve as an early detection system for growing frauds and scams."[36] Senator Paul Sarbanes, then Ranking Member of the Committee, echoed Senator Shelby's comments by noting that "[T]he State regulators have particular strengths that enable them to be effective and, as has often been said, to be the first line of defense against investor fraud."[37]

Almost ten years later, the investor protection benefits of state regulation continued to be acknowledged. As cited above, in the passage of the JOBS Act, Congress noted that Regulation A offerings may entail a high degree of risk and that the protections provided by state regulators are "essential."[38] In late 2013, as the Commission initiated rulemaking to implement Title IV of the JOBS Act, Commissioner Stein also noted the states "play an important role in protecting investors."[39] States cannot perform the essential investor protection function expected of them by investors or policy makers if they are preempted from registering Regulation A offerings. Congress has recognized the value of the state regulatory regime and the Commission is obligated to promulgate rules to preserve that role.

Undermining state authority over Regulation A offerings will frustrate Congress's goal of ensuring that states play an active role in offerings that could entail a "high degree of risk" while also ensuring that the JOBS Act's fundamental capital formation and employment growth goals are achieved. State legislatures are on the forefront in the adoption of laws designed to encourage entrepreneurship in certain businesses. For instance, the State of Washington recently adopted legislation to encourage the creation of community solar projects. State securities regulators in Washington have been following and participating in discussions concerning these laws and have consulted with business startups that are raising investor funds to complete community solar projects.

---

[36] *The Role of State Securities Regulators in Protecting Investors: Hearing on Efforts to Enforce Securities Laws, Investment Adviser Registration and Licensing, State Investigations into Mutual Fund Industry Abuses, and Investor Education Programs* Before the S. Comm. on Banking, Housing, and Urban Affairs, 108th Cong. (2004) (statement of Chairman Richard Shelby), *available at* http://www.gpo.gov/fdsys/pkg/CHRG-108shrg25485/html/CHRG-108shrg25485.htm.

[37] *Id*. (Statement of Ranking Member Paul Sarbanes).

[38] Congressional Record Volume 157, *supra* note 22, at p. H7231.

[39] Kara M. Stein remarks, *supra* note 13.

As Commissioner Luis Aguilar stated at the Open Meeting discussing and releasing the Regulation A Proposal, "the states have a history of working closely with issuers and investors in their jurisdictions, and have extensive experience reviewing small offerings."[40] At the same meeting, Commissioner Stein noted, "The states are often uniquely well-suited to oversee these kinds of offerings, with strong motivations to . . . support the success of their local businesses seeking to raise money."[41] It is noteworthy that Commissioners Aguilar's and Stein's statements in late 2013 echoed Senators Shelby's and Sarbanes's statements in 2004 regarding the proximity of state regulators to issuers and investors. State regulators are more knowledgeable of local laws, the local economy, and local businesses and better understand the economic conditions that will impact local issuers.

III. The Commission Has Not Adequately Considered the Costs, Benefits, and Harms Associated With The Proposal.

A. The Commission has not addressed the cost or harm to investors arising from preemption or the Commission's ability to carry out the agency's regulatory responsibility given its budgetary challenges.

The Commission's Proposal would preempt state registration of Regulation A offerings, but does not evaluate the potential harm or increased costs to investors. Whenever the Commission engages in rulemaking it is required to consider, in addition to the promotion of efficiency, competition, and capital formation, the effect of the proposal on **investor protection**.[42] The Commission's proposal discusses, in vague terms, the costs associated with state law compliance, but ignores the associated benefits and additional investor protections offered by state registration and review.[43] In fact, other than touting the newly proposed investor protections contained in the proposal, many of which were mandated by Congress, the Commission almost wholly ignores investor protection in its preemption discussion. For the reasons advanced herein we believe that the benefits of state registration outweigh the costs.[44]

---

[40] Luis Aguilar, S.E.C. Comm'r, Remarks at S.E.C. Open Meeting (Dec. 18, 2013), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370540514920#.UzBDqqhdUlQ.

[41] Kara M. Stein, *supra* note 13.

[42] *See* Securities Act of 1933 § 2(b), 15 U.S.C. § 77b(b); *see also* Securities Exchange Act of 1934 § 3(f), 15 U.S.C. § 77c(f) (emphasis added).

[43] While the Commission does not indicate the precise costs related to Regulation A offerings, the Commission references the costs associated with registered offerings made on Form S-1, indicating that state law filing fees average $35,000 in initial public offerings under $50,000,000. Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act, 79 Fed. Reg. 3925, 3975 (proposed Jan. 23, 2014). These state law filing fees are commensurate with the state law filings fees incurred by issuers in Regulation A offerings. The Commission also indicates the IPO-related legal and compliance fees incurred by issuers in S-1 offerings, however, fails to quantify how much of those costs are associated with state law compliance. *Id*. at 3978. While not entirely analogous to the costs in Regulation A Offerings, the registered offering costs cited by the Commission provide a reasonable comparison. Using the same data relied upon by the Commission concerning IPO-related fees, even if it is assumed that all legal fees incurred by an issuer in an offering of $5-$50 million are attributable to blue sky compliance (which is rather implausible) and those fees are combined with Blue Sky filing fees in those offerings, the total fees that could possibly be attributed to blue sky filing and compliance fees amounts to just 1.15% of the total offering amount. *Id*. Nowhere in the rulemaking release does the Commission explain how these costs would exceed the benefits provided by state regulation of Section 3(b)(2) offerings.

[44] The benefits of state regulation include the added protection of having a regulator with local knowledge evaluate the offering materials, having a regulator who is in closer proximity to investors and subject to a higher level of accountability to those investors evaluate the offering materials, and the assurance that merit standards have been

The Commission's Proposal also fails to address the agency's existing resource constraints and how those constraints might affect the Commission's ability to police the newly expanded Regulation A marketplace. If state regulatory review is foreclosed, the Commission alone would be responsible for reviewing these offerings. While the Proposal states that the agency expects ". . . that Regulation A offering statements would continue to receive the same level of Commission staff review as registration statements," the Proposal does not identify any new resources that will be added to the Commission to manage this review.[45] By its own admission, the Commission is having a difficult time obtaining the resources it needs to execute existing regulatory functions.[46] The Commission will not be able to carry out its mandate by assuming additional responsibilities that exceed its regulatory and budgetary capacities. Either the Commission's review will be shortcut at the expense of investors or too protracted to timely serve the needs of the issuer. The Commission should work together with the states in light of the new Coordinated Review Program to ensure these offerings are reviewed in a timely and meaningful fashion.

As Congress noted in striking the preemption amendment from the JOBS Act, preserving state registration and review for the proposed Tier 2 offerings is especially important given the risky nature of investments in the small, startup companies that will likely be the majority of Regulation A issuers. As former Commission Chairman Mary Schapiro has explained regarding this type of issuer:

> Startups are different from the typical company in which financial institutions and institutional investors invest because startups are characterized by uncertainty and information asymmetry (i.e., one party to a transaction has more or better information than another) and often have high levels of intangible assets, making it difficult for institutional investors (like QIBs) to value them accurately. They also are inherently risky and require a long-term investment philosophy.[47]

The Commission should also carefully consider the potential adverse impact on investor confidence that will come with significant investor losses when assessing the costs and benefits associated with the preemption provision set forth in its Proposal.

---

satisfied for the benefit of the investing public in those states that apply merit standards. The Commission acknowledges that there are benefits of state oversight in preserving state regulation of Tier 1 offerings but fails to explain how these benefits are outweighed by the costs of state regulation in Tier 2 offerings. Simply put, we believe that these benefits outweigh the costs. More directly, we believe the value of these benefits to investors exceeds 1.15% of the offering amount in a public offering.

[45] Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act, 79 Fed. Reg. at 3969.

[46] Chair Mary Jo White, Testimony on S.E.C. Budget, Before the Subcommittee on Financial Services and General Government, Committee on Appropriations, United States House of Representatives, May 7, 2013, *available at* http://www.sec.gov/News/Testimony/Detail/Testimony/1365171516034#.UzCgb6hdU2Y; *see also White Makes Case for Bigger S.E.C. Budget*, *available at* http://dealbook.nytimes.com/2013/05/07/white-makes-case-for-bigger-s-e-c-budget/.

[47] Letter from Mary Schapiro, Chair, S.E.C., to Darrell Issa, Chairman, Committee on Oversight and Government Reform, U.S. House of Representatives (April 6, 2011), at 24, *available at* http://www.sec.gov/news/press/schapiro-issa-letter-040611.pdf.

B. The Form 1-A and the corresponding Models A and B disclosure documents should all be updated and streamlined to further reduce small business issuer costs.

The Commission's Proposal fails to accommodate the needs of the smallest filers and fails to streamline and reinvigorate the filing process for all filers wishing to use the Regulation A exemption. As proposed, filing and reporting requirements are reportedly still too costly.[48] Through NASAA, the states have undertaken a year-long review of their filing processes to modernize and streamline the process for all filers, including startups. Ideally, those processes will be coordinated with the Commission's process to maximize filer efficiencies across the board.

While working with NASAA on the filing process should alleviate many filer concerns, there is still work that can and should be done on Form 1-A to make it more conducive to small business filers. As several commenters have observed, the Proposal restricts issuers to a single disclosure format that conforms too closely to Part 1 of the Form S-1. Updating the Form will require additional work. For example, NASAA is interested in suggestions by Commissioner Stein and some commenters that the disclosure and reporting requirements be further stepped or scaled to the size of the filer and the size of the offering amount.[49] NASAA recommends the Commission convene a working group with both Commission and state staff to work directly with all industry sectors to explore that approach and perform a complete review of eligible forms.[50] In the interest of time, NASAA would not be opposed to the Commission adopting a final rule that utilizes the existing Form 1-A with minor changes until a new and improved electronic form is made available. [51]

NASAA also recommends the Commission retain the Model A disclosure format for offering circulars under Part II of Form 1-A. Model A was designed by the states and the Commission as a question-and-answer guide to disclosure for small, unsophisticated issuers specifically to reduce legal fees in the preparation of offering materials. The Commission wishes

---

[48] *See* Letter from E. Cartier Esham, *supra* note 9, at 5-6; *see also* Letter from Gregory S. Fryer, *supra* note 9; Letter from Rutheford B. Campbell, Jr., *supra* note 9.

[49] *See* Kara M. Stein Remarks, *supra* note 13; *see also* Letter from Rutheford B. Campbell, Jr., *supra* note 9.

[50] NASAA appreciates the fact that the Commission made some effort to limit some disclosure requirements, but unfortunately, the efforts appear to deny investors important information without significant relief for the filer. For example, the Commission proposes to delete important material from Items 1 and 4 from the Form 1-A without any discussion of necessary data regarding the relevant costs and benefits to both filers and investors. Item 1 (Significant Parties) of current Part I of Form 1-A requires disclosure of the identity and contact information for persons that may trigger disqualification under current Rule 262. The removal of this information thwarts background checks and discourages due diligence inquiries by investors, intermediaries, and regulators. Item 4 requires disclosure of critical information regarding the harmful effects of dilution. The proposed changes in Item 4, limiting the scope in terms of time and class of security holder, would redefine and distort the traditional meaning of dilution for purposes of Regulation A offering. Dilution refers to all outstanding securities without time limit and should be disclosed as such. The Commission would be well served to sit down with the states, industry, and investors to more holistically review and update the content and format for Form 1-A.

[51] NASAA recommends that Part I be revised to also include the issuer's website address and the jurisdiction where its principal place of business is located in the XBRL portion of the form. The inclusion of these additional items of information add no burden but will greatly facilitate review by regulators, prospective investors, economists, journalists, and others. NASAA also supports the Commission's proposal to include checkboxes in Item 5 specifying the jurisdictions in which the securities are intended to be offered as it is equally helpful information to regulators and other interested parties.

to discontinue Model A, indicating it has been used less frequently than the traditional narrative format of Model B and because offerings using Model A have generally taken longer to qualify. The decline in the use of Model A may be more attributable to the lack of flexibility of the Commission staff as opposed to the usefulness of the form.

At least two commenters have specifically advocated for continued use of the Model A format.[52] In the first commenter's experience with a small business client, the Commission's examiner staff imposed its preference for Model B by forcing the small business filer to essentially reformat a Model A submission into a Model B format. Such practices defeat the purpose of offering a Model A format, and sheds light on why the Model A format has been used infrequently and has taken significantly longer to qualify than offerings that utilize the Commission's preferred Model B.

The Commission should accept the Model A disclosure document for what it is—a useful tool that allows issuers to prepare an offering circular and complete a registration without substantial assistance from experienced securities counsel. Here, again, the Commission provides no analysis of the costs or benefits of deleting Model A as an issuer option. Both model disclosures for the Form 1-A should be updated for modern use. At a minimum, Model A should be updated to reflect the most recent format for this disclosure as updated by NASAA in 1999.

IV. Additional Comments Regarding Discrete Provisions of the Proposal.

A. NASAA urges the Commission to require the filing of testing the waters materials prior to use.

The Commission should consider revising the Proposal concerning testing the waters materials to require an issuer to file any such materials prior to use. In the proposing release, the Commission justifies its departure from existing Regulation A based on the fact that testing the waters materials would remain subject to antifraud provisions under federal law. Antifraud prohibitions are an inadequate substitute, however, for the protection afforded investors by requiring any testing the waters materials to be submitted in advance. This problem is further exacerbated by the fact that the Commission has proposed that EDGAR access equals delivery for final offering circulars. Investors may never actually see any corrective disclosure included in the final offering circular. Filing, even on a confidential basis, give regulators the opportunity to prevent and deter the use of misleading advertising in a public offering.

B. NASAA strongly supports the proposed limitation on the amount of securities that may be sold under Regulation A by selling security holders.

In our advance comment letter, we urged the Commission to proscribe the use of Section 3(b)(2) for offerings of securities by selling security holders.[53] We noted that offerings by selling security holders are not the types of offerings contemplated with the passage of the JOBS

[52] *See* Letter from Gregory Fryer, *supra* note 9, at 3-4, *see also* Letter from E. Cartier Esham, *supra* note 9, at 5.
[53] Letter from A. Heath Abshure, NASAA President and Commissioner, Arkansas Securities Department, to Elizabeth M. Murphy, Secretary, S.E.C. (Apr. 10, 2013), *available at* http://www.sec.gov/comments/jobs-title-iv/jobstitleiv-25.pdf.

Act as they may have little to do with capital formation or job creation. In the alternative, we suggested that if the exemption is permitted to be used by selling security holders, it should require the approval by a majority of the issuer's independent directors upon a finding that the offering is in the best interests of both the selling security holders and the issuer. Although the Commission has not followed either of our suggestions, we support the proposed 30% limitation on the amount of an offering under Section 3(b)(2) that can be made by selling security holders. While we continue to believe that the facilitation of offerings by selling security holders was not the intent of Congress, as the Commission notes, the proposed limitation is consistent with current Regulation A. Ideally, the Commission would still implement a majority independent director approval requirement indicating that the offering is in the best interests of both the selling security holders and the issuer.

C. NASAA generally supports the periodic reporting regime proposed by the Commission but suggests a number of improvements.

NASAA generally supports the periodic reporting regime proposed by the Commission, provided the requirements are appropriately scaled to the size of the company in light of the total offering amount sought. Regular reporting is necessary to develop secondary trading in what may otherwise be illiquid securities and to allow investors to trade based on current information. Quarterly reporting is a standard reporting convention that helps issuers attract institutional and venture capital support and assists them in their effort to enter the public markets.

NASAA does not support, however, the proposal to require reports based on a "fundamental change" as opposed to a "material" event. The obligation to disclose material information is a cornerstone of state and federal securities laws for both investors and issuers. It is black letter law that an issuer is required to provide investors with all material information about its securities—failure to do so is textbook securities fraud. Focusing issuers on only "fundamental changes" may confuse them about their larger disclosure obligations for anti-fraud purposes. The change could also foster or conceal illicit conduct, particularly in the fraud and insider trading context.

D. The proposed limit on the amount of securities an investor can purchase from an issuer in a Regulation A offering as contained in the Proposal is illusory and unnecessary with appropriate state oversight.

The Commission touts the Proposal's investment concentration limits as a significant investor protection component of the Proposal, but the benefits to such measures are rendered meaningless by the Commission's failure to incorporate a real compliance or enforcement mechanism. As structured, the Proposal places the entire burden of compliance on the investor. Without adverse consequences to the issuer or other market player selling deals beyond the limit, there is no regulatory incentive to promote compliance. While concentration limits may sometimes be appropriate for retail investors investing in startups and other high-risk offerings, if done properly, Regulation A should attract a wide variety of investors and issuers that should not necessitate concentration limits across the board. Where necessary, concentration limits can be used on a case-by-case basis.

E. We support the Commission's proposal to make the exemption under Section 3(b)(2) unavailable to an issuer that has failed to make required reports in the prior two years.

NASAA supports the Commission's proposal to disqualify issuers that have not complied with the proposed ongoing reporting requirements during the two years preceding a new filing under Section 3(b)(2). An issuer that fails to comply with these requirements will have demonstrated either a lack of ability to comply with these requirements or a lack of concern with compliance. In either case, such an issuer will have negatively affected the ability of investors to trade its securities and may cause irreparable harm. A two-year disqualification from making a Tier 2 offering under Regulation A thus seems to be a reasonable consequence that may have the appropriate deterrent effect.

F. We support the continued limitation of the exemption under Regulation A to issuers organized and with their principal places of business in the United States or Canada.

NASAA strongly supports the Commission's proposed limitation on the use of the exemption to issuers organized and with their principal places of business in the United States or Canada. The stated purpose of the JOBS Act was to create jobs in the United States, so it is natural for the exemption to be restricted primarily to businesses principally located in and near the United States. Further, Title IV was largely understood to be an expansion of existing Regulation A, which is currently limited to issuers organized and with their principal places of business in the United States or Canada. As such, the limitation is consistent with the apparent intent of Congress for expanded Regulation A offerings. Further, given the regulatory relief granted to issuers under Regulation A as compared to issuers in fully registered offerings, it is appropriate to limit the availability of the exemption to issuers over which regulators may more easily assert jurisdiction in the event of fraud.

We also support the Commission's proposal to permit Canadian issuers to prepare financial statements in accordance with either U.S. GAAP or International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

G. We support the continued prohibition of the use of Regulation A by certain types of issuers.

As we have commented previously,[54] we strongly support the Commission's proposal to extend the existing prohibitions on the use of the exemption under Regulation A to Section 3(b)(2) offerings by investment companies, business development companies, blank check companies, special purpose acquisition vehicles, issuers of fractional undivided interests in oil and gas rights and similar interests in other mineral rights, and issuers of asset backed securities. We concur with the Commission that these are not the types of offerings that Congress had in mind in enacting the JOBS Act.

[54] *See id*.

H. NASAA objects to the proposed access equals delivery model for Regulation A offering circulars.

Current Regulation A requires the delivery of a preliminary or final offering circular to an investor a minimum of 48 hours prior to the mailing of the sale confirmation and in the case where only a preliminary offering circular has been provided, the final offering circular must be delivered to the investor with the confirmation of sale. The Commission has proposed to allow issuers and intermediaries to assume that investors have access to the internet and will deem their duty to deliver the final offering circular to investors satisfied where the final offering circular is filed with EDGAR.

We object to the proposed access equals delivery model for final offering circulars under Regulation A. Actual delivery of the final offering circular ought to be required to be made directly to investors to give them every opportunity to evaluate all material facts in these offerings. The opportunity to evaluate the final disclosure document is especially important in these offerings given the high degree of risk they present due to the fact that they are not required to be listed on an exchange, they may not involve an underwriter, and there may be limited involvement by third party selling agents, attorneys, and accountants. Furthermore, investors may experience difficulty searching for and identifying what filing constitutes an issuer's final offering circular given the difficult presentation of documents on EDGAR.

******

In conclusion, for all the reasons explained above, the Commission must withdraw the preemption provisions from its Regulation A Proposal and undertake a cooperative effort with state regulators to pursue follow-up rulemakings that will promote the use of Regulation A as intended by Congress. By adopting a rule compliant with the plain meaning and intent of the statute, while working closely with state securities regulators, the Commission will promote increased use of Regulation A for capital formation and preserve significant investor protections.

Sincerely,

Andrea Seidt
NASAA President
Ohio Securities Commissioner

cc: The Honorable Mary Jo White, Chair
The Honorable Luis A. Aguilar, Commissioner
The Honorable Daniel M. Gallagher, Commissioner
The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner
Keith F. Higgins, Director, Division of Corporation Finance