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SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 230

[Release Nos. 33-9973; 34-76319; File No. S7-22-15]

RIN 3235-AL80

Exemptions to Facilitate Intrastate and Regional Securities Offerings

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rules.

SUMMARY: We are proposing amendments to Rule 147 under the Securities Act of 1933, which currently provides a safe harbor for compliance with the Section 3(a)(11) exemption from registration for intrastate securities offerings. Our proposal would modernize the rule and establish a new exemption to facilitate capital formation, including through offerings relying upon recently adopted intrastate crowdfunding provisions under state securities laws. The proposed amendments to the rule would eliminate the restriction on offers and ease the issuer eligibility requirements, while limiting the availability of the exemption at the federal level to issuers that comply with certain requirements of state securities laws.

We further propose rule amendments to Rule 504 of Regulation D under the Securities Act to facilitate issuers' capital raising efforts and provide additional investor protections. The proposed amendments to Rule 504 would increase the aggregate amount of securities that may be offered and sold in any twelve-month period from $1 million to $5 million and disqualify certain bad actors from participation in Rule 504 offerings.

DATES: Comments should be received by [insert date 60 days after publication in the Federal Register].

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment forms (http://www.sec.gov/rules/proposed.shtml);
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-22-15 on the subject line; or
- Use the Federal Rulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-22-15. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's website (http://www.sec.gov/rules/proposed.shtml). Comments also are available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

Studies, memoranda or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the SEC's website. To ensure direct electronic

receipt of such notifications, sign up through the "Stay Connected" option at www.sec.gov to receive notifications by e-mail.

FOR FURTHER INFORMATION CONTACT: Anthony G. Barone, Special Counsel, or Zachary O. Fallon, Special Counsel, Office of Small Business Policy, Division of Corporation Finance, at (202) 551-3460, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

SUPPLEMENTARY INFORMATION: We propose to amend Rule 147[1] and Rule 504[2] of Regulation D[3] under the Securities Act of 1933 (the "Securities Act")[4] and to make technical amendments to Rules 504 and 505[5] of Regulation D.

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1 17 CFR 230.147.

2 17 CFR 230.504.

3 17 CFR 230.500 through 230.508.

4 15 U.S.C. 77a *et seq*.

5 17 CFR 230.505.

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INTRODUCTION AND BACKGROUND

Today's proposals are part of the Commission's efforts to assist smaller companies with capital formation consistent with other public policy goals, including investor protection. These proposals also complement recent efforts by the U.S. Congress,[6] state legislatures,[7] and state securities regulators[8] to modernize existing federal and state securities laws and regulations to assist smaller companies with capital formation. We believe that the proposed amendments to Rule 147 and the amendment to increase the offering amount limitation in Rule 504 will help to facilitate capital formation by smaller companies by increasing the utility of these rules while maintaining appropriate protections for investors who purchase securities in these offerings. We believe that the proposed disqualification of certain bad actors from participation in Rule 504 offerings will provide for greater consistency across Regulation D and increase investor protection in such offerings.

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[6] Congress enacted the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act"), which was signed into law by President Obama on April 5, 2012. Pub. L. No. 112-106, 126 Stat. 306. Pursuant to Title II of the JOBS Act, the Commission adopted new paragraph (c) of Rule 506 of Regulation D, removing the prohibition on general solicitation or general advertising for securities offerings relying on Rule 506. *See* SEC Rel. No. 33-9415 (July 10, 2013). Pursuant to Title IV of the JOBS Act, the Commission amended Regulation A in order to permit issuers to raise up to $50 million annually. SEC Rel. No. 33-9741 (March 25, 2015) ("2015 Regulation A Release"). Pursuant to Title III of the JOBS Act, the Commission adopted rules permitting companies to use the Internet to offer and sell securities through crowdfunding ("Regulation Crowdfunding"). *See* SEC Rel. No. 33-9974 (Oct. 30, 2015) ("Regulation Crowdfunding Adopting Release").

[7] *See, e.g.*, ALA. CODE § 8-6-11 (2014); ARIZ. REV. STAT. ANN. § 44-1844 (2015); COLO. REV. STAT. § 11-51-304(6) (2014); FLA. STAT. § 571.021, 517.061, 517.0611, 517.12, 517.121, 517.161, 626.9911; IND. CODE § 6-3.1-24-14 (2014); KY. REV. STAT. ANN. § 292.410-292.415 (2015); ME. REV. STAT. ANN. tit. 32, § 16304, sub-§6-a (2014).

[8] *See, e.g.*, D.C. MUN. REGS. tit. 26-B, § 250 (2014); GA. COMP. R. & REGS. 590-4-2-.08 (2011); IDAHO CODE ANN. § 30-14-203 (providing an exemption by order on a case-by-case basis); KAN. ADMIN. REGS. § 81-5-21 (2011).

We propose to modernize and expand Rule 147 under the Securities Act, a safe harbor for intrastate offerings exempt from registration pursuant to Securities Act Section 3(a)(11).[9] Consistent with the suggestions of market participants and state securities regulators,[10] the proposal would expand upon the statutory exemption in order to modify certain regulatory requirements of the rule that no longer comport with modern business practices or communications technology, thereby limiting the utility of the safe harbor for intrastate offerings, particularly in offerings by issuers seeking to raise capital pursuant to recently adopted crowdfunding provisions under state securities laws. The proposed amendments would eliminate the current restriction on offers, while continuing to require that sales be made only to residents of the issuer's state or territory. The proposed amendments also would redefine what it means to be an "intrastate offering" and ease some of the issuer eligibility requirements in the current rule, making the rule available to a greater number of businesses seeking intrastate financing. We also propose to limit the availability of the exemption to offerings that are either registered in the state in which all of the purchasers are resident or conducted pursuant to an exemption from state law registration in such state that limits the amount of securities an issuer may sell pursuant to such exemption to no more than $5 million in a twelve-month period and imposes an investment limitation on investors.

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[9] 15 U.S.C. 77c(a)(11) (exempting "any security which is a part of an issue offered and sold only to persons resident within a single state or territory, where the issuer of such security is a person residing and doing business within, or, if a corporation, incorporated by and doing business within such state or territory.").

[10] *See, e.g.*, Transcript of Record at 78, SEC Advisory Committee on Small and Emerging Companies (June 3, 2015), *available at* http://www.sec.gov/info/smallbus/acsec/acsec-minutes-060315.pdf; State Based Crowdfunding, presentation by Michael S. Pieciak, NASAA Corporate Finance Chair, SEC Advisory Committee on Small and Emerging Companies (June 3, 2015), *available at* http://www.sec.gov/info/smallbus/acsec/state-based-crowdfunding.pdf; Letter from Stanley Keller, Fed. Regulation of Sec. Comm. of the Bus. Law Section of the American Bar Assoc., to Linda C. Quinn and Mary E.T. Beach of the SEC Div. of Corp. Fin. ("ABA Letter"), submitted as appendix to letter from Stanley Keller to the SEC Advisory Committee on Small and Emerging Companies (June 1, 2015), *available at* http://www.sec.gov/comments/265-27/26527-50.pdf.

We also propose to amend Rule 504 of Regulation D under the Securities Act to increase the aggregate amount of securities that may be offered and sold pursuant to Rule 504 in any twelve-month period from $1 million to $5 million and to disqualify certain bad actors from participation in Rule 504 offerings. The proposed increase would facilitate capital formation by increasing the flexibility that state securities regulators have to implement coordinated review programs to facilitate regional offerings.[11] The proposed bad actor disqualification provisions would provide for greater consistency across Regulation D. If adopted, the amendments to Rule 504 could result in the diminished utility of Rule 505, which historically has been little utilized in comparison to Rule 506[12] of Regulation D. We therefore seek comment on whether Rule 505 should be retained in its current or a modified form as an exemption from registration, or repealed.

II. PROPOSED AMENDMENTS TO RULE 147

A. Rationale for Proposed Amendments to Rule 147

The proposed amendments to Rule 147 would establish a new Securities Act exemption for intrastate offerings of securities by companies doing business in-state, including offerings relying upon newly adopted and proposed crowdfunding provisions under state securities laws.

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[11] The state registration of securities offerings under coordinated review programs are examples of efforts undertaken by states to streamline the state registration process for issuers seeking to undertake multi-state registrations. These programs establish uniform review standards and are designed to expedite the registration process, thereby potentially saving issuers time and money. Participation in such programs is voluntary and imposes no additional costs on issuers. The states have created coordinated review protocols for equity, small company and franchise offerings; direct participation program securities; and for certain offerings of securities pursuant to Regulation A. For more information on coordinated review programs, *see http://www.nasaa.org/industry-resources/corporation-finance/coordinated-review/*.

[12] For the period 2009 through 2014, 109,237 Forms D were filed, of which 1,409 reported an offering made in reliance upon Rule 505 of Regulation D, representing 1% of all offerings made in reliance upon Regulation D during this time period and 2% of all Regulation D offerings raising less than $5 million. During this same time period, 3,789 filings reported an offering made in reliance upon Rule 504, representing 3% of all offerings made in reliance upon Regulation D during this time period and 10% of all Regulation D offerings raising less than $1 million. The vast majority of Form D filings during this period reported an offering made in reliance on Rule 506.

The proposed amendments seek to modernize Rule 147, while retaining the underlying intrastate character of Rule 147 that permits companies to raise money from investors within their state pursuant to state securities laws without concurrently registering the offers and sales at the federal level.

Securities Act Section 3(a)(11) provides an exemption from registration under the Securities Act for, "[a]ny security which is part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory."[13] In 1974, the Commission adopted Rule 147 under the Securities Act to provide objective standards for local businesses seeking to rely on Section 3(a)(11).[14] The Rule 147 safe harbor was intended to provide assurances that the intrastate offering exemption would be used for the purpose Congress intended in enacting Section 3(a)(11), namely the local financing of companies by investors within the company's state or territory.[15] Nothing in Rule 147 obviates the need for compliance with any state law relating to the offer and sale of the securities[16] and nothing in our proposed amendments would affect continued compliance with such laws.

Section 3(a)(11) and the Commission's Rule 147 safe harbor limit both *offers* and *sales* to residents of the same state or territory in which the issuer is resident and doing business.

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[13] 15 U.S.C. 77c(a)(11).

[14] SEC Rel. No. 33-5450 (Jan. 7, 1974) [39 FR 2353 (Jan. 21, 1974)] ("Rule 147 Adopting Release"); SEC Rel. No. 33-5349 (Jan. 8, 1973) [38 FR 2468 (Jan. 26, 1973)] ("Rule 147 Proposing Release").

[15] *See* Rule 147 Adopting Release. *See also* H.R. REP. NO. 73-85, at 6-7 (1933), H.R. REP. NO. 73-1838, at 40-41 (1934) (Conf. Rep.) and SEC Rel. No. 33-4434, at 4 (Dec. 6, 1961) [26 FR 11896 (Dec. 13, 1961)] ("1961 Release").

[16] *See* 17 CFR 230.147 (Preliminary Note 2).

Rule 147 also includes prescriptive threshold requirements that an issuer must satisfy in order to be considered "doing business" in-state. To satisfy these requirements, an issuer must, among other things:

- derive at least 80% of its consolidated gross revenues in-state;
- have at least 80% of its consolidated assets in-state; and
- intend to use and use at least 80% of the net proceeds from an offering conducted pursuant to Rule 147 in connection with the operation on an in-state business or real property.[17]

Market participants and commenters have indicated that the combined effect of Section 3(a)(11)'s statutory limitation on offers and the prescriptive threshold requirements of Rule 147 unduly limit the availability of the exemption for local companies that would otherwise conduct intrastate offerings.[18] For example, market participants and commenters have noted that the use of the Internet for offerings makes it difficult for issuers to limit offers to in-state residents.[19] These concerns, in addition to developments in communication technologies and the increasing interstate nature of small business activities that have occurred since Section 3(a)(11) was enacted and Rule 147 was originally adopted, suggest that the current limitations are in need of modernization.[20]

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[17] 17 CFR 230.147(c)(2)(i)-(iii).

[18] *See* note 10 above.

[19] *See, e.g.*, Transcript of Record at 84, SEC Advisory Committee on Small and Emerging Companies (June 3, 2015).

[20] Rule 147 has not been substantively changed since it was adopted in 1974.

A number of states have adopted and/or enacted crowdfunding[21] provisions in their rules or statutes, which may serve as another valuable tool small companies can use to raise capital.[22] Other states have similar forms of state-based crowdfunding bills pending.[23] State-based crowdfunding provisions generally require that an issuer, in addition to complying with various state-specific requirements to qualify for the exemption,[24] also comply with Section 3(a)(11) and Rule 147.[25] The Commission has received feedback from state securities regulators and market participants, however, who have indicated that the current statutory requirements in Section 3(a)(11) and regulatory requirements in Rule 147 make it difficult for issuers to take advantage of these new state crowdfunding provisions.[26]

The most common concerns expressed about Rule 147 are:

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21 As the Commission noted in its proposing release for the rules implementing Title III of the JOBS Act, crowdfunding is a relatively new and evolving method to raise money using the Internet. Crowdfunding serves as an alternative source of capital to support a wide range of ideas and ventures. An entity or individual raising funds through crowdfunding typically seeks small individual contributions from a large number of people. *See* SEC Rel. No. 33-9470 (Oct. 23, 2013) [79 FR 66428 (Nov. 5, 2013)].

22 As of the date of this proposal, data from the North American Securities Administrators Association ("NASAA") indicates that 29 states and the District of Columbia have enacted some form of a state-based crowdfunding exemption to state registration either through legislation, regulation or administrative orders. *See* notes 7-8 above; *see also* Intrastate Crowdfunding Directory, NASAA, http://www.nasaa.org/industry-resources/corporation-finance/instrastate-crowdfunding-resource-center/intrastate-crowdfunding-directory/.

23 *See, e.g.*, Intrastate Crowdfunding Legislation, prepared by NASAA, *available at* http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2014/12/NASAA-Crowdfunding-Index_8-1-2015a1.pdf (summarizing the latest developments in intrastate crowdfunding, including the status of proposed state intrastate crowdfunding legislation and regulations).

24 *See, e.g.*, ALA. CODE § 8-6-11 (2014) (aggregate offering limits); ARIZ. REV. STAT. ANN. § 44-1844 (2015) (investor limits); FLA. STAT. §§ 571.021, 517.061, 517.0611, 517.12, 517.121, 517.161, 626.9911 (2015) (audited financial statement requirements); IND. CODE § 6-3.1-24-14 (2014) (state filing requirements); KY. REV. STAT. ANN. §§ 292.410-292.415 (2015) (delivery of a disclosure document).

25 Of the 29 states and the District of Columbia that have adopted intrastate crowdfunding provisions, only Maine allows an issuer to rely upon a federal exemption other than a combination of Securities Act Section 3(a)(11) and Rule 147, namely the exemption provided by Rule 504 of Regulation D. *See* ME. REV. STAT. tit. 32, § 16304(6-A)(D) (2013).

26 *See* note 18 above. *See also* Recommendation to the Commission by the Advisory Committee on Small and Emerging Companies (Sept. 23, 2015), *available at http://www.sec.gov/info/smallbus/acsec/acsec-recommendation-modernize-rule-147.pdf.*

- the limitation of offers to in-state residents only, which raises questions about the proper use of the Internet for these offerings;
- the limitation of eligible issuers only to those that are incorporated or organized in-state, which excludes local issuers with local operations that incorporate or organize in a different state for business reasons; and
- the limitation of eligible issuers only to those that can satisfy each of the three 80% thresholds concerning their revenues, assets and use of net proceeds in order for the issuers to be deemed "doing business" within a state or territory, which unduly restricts the local businesses that may rely upon the exemption for local financings in their home state or territory.[27]

The proposed amendments to Rule 147 would amend these requirements and revise the rule to allow an issuer to engage in any form of general solicitation or general advertising, including the use of publicly accessible Internet websites, to offer and sell its securities, so long as all sales occur within the same state or territory in which the issuer's principal place of business is located, and the offering is registered in the state in which all of the purchasers are resident or is conducted pursuant to an exemption from state law registration in such state that limits the amount of securities an issuer may sell pursuant to such exemption to no more than $5 million in a twelve-month period and imposes an investment limitation on investors. The proposed amendments would define an issuer's principal place of business as the location in which the officers, partners, or managers of the issuer primarily direct, control and coordinate the activities of the issuer and further require the issuer to satisfy at least one of four threshold

[27] *Id.*

requirements that would help ensure the in-state nature of the issuer's business.[28] As proposed, certain provisions of existing Rule 147 regarding legends and mandatory disclosures to purchasers and prospective purchasers would continue to apply to offerings conducted pursuant to the exemption.[29] In addition, any offer or sale under the proposed amendments to Rule 147 would need to comply with state securities laws.

B. Explanation of Proposed Amendments to Rule 147

As noted above, Rule 147 was adopted as a safe harbor for compliance with Section 3(a)(11). Our proposed amendments to the rule, however, would allow an issuer to make offers accessible to out-of-state residents and to be incorporated out-of-state, so long as sales are made only to in-state residents and the issuer's principal place of business is in-state and it satisfies at least one additional requirement that would further demonstrate the in-state nature of the issuer's business. As proposed, an issuer would only be able to avail itself of the proposed exemption if the offering is registered in the state in which all of the purchasers are resident or is conducted pursuant to an exemption from state law registration in such state that limits the amount of securities an issuer may sell pursuant to such exemption to no more than $5 million in a twelve-month period and imposes an investment limitation on investors. Rule 147, as proposed to be amended, would no longer fall within the statutory parameters of Section 3(a)(11).[30] Accordingly, we propose to amend Rule 147 to create an exemption pursuant to our general exemptive authority under Section 28 of the Securities Act.[31] As amended, Rule 147 would

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[28] *See* proposed Rule 147(c).

[29] *See* proposed Rule 147(f).

[30] Issuers that seek guidance on how to comply with Section 3(a)(11) after the adoption of any final rules amending Rule 147, as proposed, would continue to be able to rely on judicial and administrative interpretive positions on Rule 147 issued prior to the effectiveness of any such final rules.

[31] 15 USC 77z-3.

function as a separate exemption from Securities Act registration rather than as a safe harbor under Section 3(a)(11).[32] The proposed amendments, if adopted, would not alter the fact that the Section 3(a)(11) statutory exemption continues to be a capital raising alternative for issuers with local operations seeking local financing.

1. Elimination of Limitation on Manner of Offering

To satisfy Section 3(a)(11) and the current Rule 147 safe harbor, all of the securities in an offering must be both offered *and* sold exclusively to residents of the state or territory in which the issuer is resident and doing business. While the language limiting offers and sales to in-state residents in the statute and rule is clear, the legislative history of Section 3(a)(11), its subsequent amendments, and prior Commission guidance have created some uncertainty as to the scope of permissible offers that may be made pursuant to the exemption.

When Congress enacted Section 3(a)(11) in 1934, the legislative history stated, among other things, that "a person who comes within the purpose of the exemption, but happens to use a newspaper for the circulation of his advertising literature, which newspaper is transmitted in interstate commerce, does not thereby lose the benefits of the exemption."[33] Consistent with this statement, the Commission in 1937 released staff guidance on the nature of the Section 3(a)(11) exemption in the form of a letter from the Commission's General Counsel.[34] In this letter, the General Counsel stated that, "the so-called 'intrastate exemption' is not in any way dependent

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[32] As noted above, our proposed amendments to Rule 147 are intended, in part, to facilitate the use of state-based crowdfunding statutes. Because many state statutes and rules require issuers to comply with the requirements of both Section 3(a)(11) and Rule 147, states should consider whether our proposed amendments to Rule 147 would require additional amendments to their respective statutes or rules to allow issuers to comply with requirements at both the state and federal level.

[33] *See* H.R. Rep. No. 73-1838, at 40-41 (1934) (Conf. Rep.). Section 3(a)(11) initially was enacted as Securities Act Section 5(c). When Congress enacted the Securities Exchange Act of 1934, it also amended the Securities Act, including revising and re-designating Section 5(c) as Section 3(a)(11).

upon absence of use of the mails or instruments of transportation or communication in interstate commerce in the distribution."[35] Rather, the letter explained that, so long as all the statutory requirements of the exemption are satisfied, such securities may be offered and sold through the mails and may even be delivered in interstate commerce to purchasers, if such purchasers, though resident, are temporarily out of the state. In this context, the letter further noted that securities exempt from registration pursuant to Section 3(a)(11) "may be made the subject of general newspaper advertisement (provided the advertisement is appropriately limited to indicate that offers to purchase are solicited only from, and sales will be made only to, residents of the particular state involved)."[36]

The Commission released further guidance on Section 3(a)(11) in 1961 that restated the staff guidance in the 1937 Letter of General Counsel.[37] In its 1961 Release, the Commission explained that in order "[t]o give effect to the fundamental purpose of the exemption, it is necessary that the entire issue of securities shall be offered and sold to, and come to rest only in the hands of residents within the state. If any part of the issue is offered or sold to a non-resident, the exemption is unavailable not only for the securities so sold, but for all securities forming a part of the issue, including those sold to residents."[38]

As noted above, however, market participants and commenters have indicated that Section 3(a)(11)'s statutory limitation on offers unduly limits the availability of the exemption,

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34 *See* SEC Rel. No. 33-1459 (May 29, 1937) [11 FR 10958 (Sept. 27, 1946)] ("1937 Letter of General Counsel").

35 *Id.*

36 *Id.*

37 *See* 1961 Release at 4.

38 *Id.*; *see also* 1937 Letter of General Counsel (stating that Section 3(a)(11) is "limited to case in which the entire issue of securities is offered and sold exclusively to residents of the state in question.").

for example, by limiting the manner in which issuers may communicate with or locate potential in-state investors over the Internet.[39] Rule 147, as proposed to be amended, would require issuers to limit sales to in-state residents, but would no longer limit offers by the issuer to in-state residents.[40] Accordingly, amended Rule 147 would permit issuers to engage in general solicitation and general advertising that could reach out-of-state residents in order to locate potential in-state investors using any form of mass media, including unrestricted, publicly available websites, to advertise their offerings, so long as all sales of securities so offered are made to residents of the state or territory in which the issuer has its principal place of business.

Given that amended Rule 147 would allow offers to be accessible by out-of-state residents, the proposed amendments would require an issuer to include a prominent disclosure on all offering materials used in connection with a Rule 147 offering, stating that sales will be made only to residents of the same state or territory as the issuer.[41] This proposed disclosure requirement is intended to advise investors who are not residents of the state in which sales are being made that the intrastate offering would be unavailable to them.

Request for Comment

1. Should we amend Rule 147 to eliminate the limitation on offers to in-state residents, as proposed? Why or why not? Please explain.
2. Should we retain the existing safe harbor and create a new rule pursuant to our authority under Section 28 to reflect our proposed revisions? Why or why not? How would our proposed revisions interact with other recent rules adopted pursuant to the JOBS Act, if at all?

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[39] *See, e.g.*, notes 10 and 19 above.

[40] *See* proposed Rule 147(d).

3. Should we adopt the proposed disclosure requirement for all offering materials used in reliance on this rule? Why or why not? Should we require additional or different disclosure? If so, what language would be appropriate?

2. Elimination of Residence Requirement for Issuers

Rule 147 currently requires issuers to be incorporated or organized under the laws of the state or territory in which the intrastate offering is conducted.[42] This requirement, while based on the language of Section 3(a)(11), is at odds with modern business practice in which issuers incorporate or organize in states other than the state or territory of their principal place of business, for example, to take advantage of well-established bodies of corporate or partnership law.[43] We do not believe that locus of entity formation should affect the ability of an issuer to be considered "resident" for purposes of an intrastate offering exemption at the federal level. Given modern business practices, the current requirement may be unnecessarily restrictive and may limit the usefulness of the exemption.

Therefore, for corporations, limited partnerships, trusts, or other forms of business organizations, we propose to eliminate the current requirement of Rule 147 that limits the availability of the rule to issuers organized in the state in which an offering takes place.[44] Our proposed amendments would expand the universe of eligible issuers by eliminating the current "residence" requirement, while continuing to require that an issuer have a sufficient in-state

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41 *See* proposed Rule 147(f)(3).

42 *See* Rule 147(c)(1)(i) [17 CFR 230.147(c)(1)(i)]. For issuers such as general partnerships or other forms of business organizations that are not organized under any state or territorial law, Rule 147(c)(1)(ii) considers such issuers residents of the state or territory where the issuers' principal offices are located.

43 For example, data provided by issuers in Form D filings with the Commission indicates that approximately 30% of issuers conducting Rule 504 offerings and 62% of issuers conducting either Rule 505 or Rule 506 offerings have a principal place of business in a state other than the issuer's state of incorporation or organization. *See* discussion in Section 0 below.

44 Rule 147(c)(1)(i).

presence determined by the location of the issuer's principal place of business.[45] In conjunction with the proposed requirement that all purchasers be in-state residents,[46] we believe that requiring an issuer to have an in-state principal place of business and to satisfy at least one additional requirement that demonstrates the in-state nature of the issuer's business should adequately ensure the intrastate nature of the offering, such that state authorities can effectively regulate an issuer's activities and enforce states' securities laws for the protection of resident investors.

The proposed amendments also would replace the current rule's "principal office" requirement for an issuer, such as a general partnership or other form of business organization that is not organized under any state or territorial law,[47] with the proposed "principal place of business" requirement.[48]

Request for Comment

4. Should we amend Rule 147 to eliminate the requirement that entities be incorporated or organized under the laws of the state in which the offering takes place, as proposed? Additionally, should we limit availability of the exemption to issuers organized or incorporated in the United States or one of its territories? Why or why not? Please explain.

5. Should we amend Rule 147, as proposed, to eliminate the current issuer residence requirement, while continuing to require an issuer to have a principal place of business

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45 *See* proposed Rule 147(c)(1). *See also* discussion on principal place of business in Section II.B.0. below, and the related discussion of the proposed requirement that an issuer satisfy at least one of four threshold requirements in order to help ensure the in-state nature of its business.

46 *See* discussion in Section II.B.0.

47 Rule 147(c)(1)(ii).

48 *See* proposed Rule 147(c)(1).

in the state in which an intrastate offer and sale takes place? Would this requirement, in conjunction with the additional proposed requirements for an issuer to demonstrate the in-state nature of its business[49] and the requirement that all purchasers be in-state residents,[50] adequately ensure the intrastate nature of the offering such that a state can effectively regulate an issuer's activities?

6. In addition to requiring that an issuer have its principal place of business in the state where the offer and sale occurs, should we also require that the issuer be registered in-state as an out-of-state entity and/or that the issuer have obtained all licenses and registrations necessary to lawfully conduct business in-state? Why or why not?

3. Requirements for Issuers "Doing Business" In-State

The Section 3(a)(11) intrastate offering exemption allows businesses to raise money within the state from investors who are more likely than those outside the state to be familiar with the issuer and its management. Accordingly, the doing business requirement of Section 3(a)(11) has traditionally been viewed strictly.[51] In adopting Rule 147, the Commission adhered to the concepts in existing court and Commission interpretations of Section 3(a)(11) that not only should the issuer's business be physically located within the state, but the principal or

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49 *See* discussion in Section II.B.0 (Requirements for Issuers "Doing Business" In-State) below.

50 *See* note 46 above.

51 Rule 147 Adopting Release at 3.

predominant business must be carried on there[52] and substantially all of the proceeds of the offering must be put to use within the state.[53]

Rule 147 followed these concepts by setting forth three 80% threshold tests for the issuer to be deemed "doing business" in-state. Specifically, Rule 147(c)(2) deems an issuer to be doing business in-state if its principal office is located within the state and at least:

- 80% of its consolidated gross revenues are derived from the operation of a business or of real property located in or from the rendering of services within such state or territory;
- 80% of its consolidated assets are located within such state or territory; and
- 80% of the net proceeds from the offering are intended to be used by the issuer, and are in fact used, in connection with the operation of a business or of real property, the purchase of real property located in, or the rendering of services within such state or territory.[54]

We propose to simplify the doing business in-state determination by amending the current rule requirements so that an issuer's ability to rely on the rule would be based on the location of the issuer's principal place of business, as opposed to its "principal office."[55] For purposes of the rule, we propose to define the term "principal place of business" to mean the

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52 *Id.* at 3, n. 4, *citing,* Chapman v. Dunn, 414 F.2d 153 (6th Cir. 1969). *See also* 1961 Release at 2 ("In view of the local character of the Section 3(a)(11) exemption, the requirement that the issuer be doing business in the state can only be satisfied by the performance of substantial operational activities in the state of incorporation. The doing business requirement is not met by functions in the particular state such as bookkeeping, stock record and similar activities or by offering securities in the state.").

53 *Id.* at 3, n.5, *citing,* SEC v. Truckee Showboat, Inc., 157 F.Supp. 824 (S.D. Cal. 1957). *See also* 1961 Release at 2 ("If the proceeds of the offering are to be used primarily for the purpose of a new business conducted outside of the state of incorporation and unrelated to some incidental business locally conducted, the exemption should not be relied upon.").

54 17 CFR 230.147(c)(2).

55 *See* 17 CFR 230.147(c)(2)(iv). We note that the issuer's "principal place of business" is conceptually consistent with the current rule's requirement that the "principal office" of the issuer be located within the

location from which the officers, partners, or managers of the issuer primarily direct, control and coordinate the activities of the issuer.[56] As defined, an issuer would only be able to have a "principal place of business" within a single state or territory and would therefore only be able to conduct an offering pursuant to amended Rule 147 within that state or territory. Issuers also would be required to register the offering in the state in which all of the purchasers are resident, or rely on an exemption from registration that limits the amount of securities an issuer may sell pursuant to such exemption to no more than $5 million in a twelve-month period and imposes an investment limitation on investors.[57]

As discussed more fully in Section II.B.4.c below, we believe that our rules should continue to require that the securities sold in an intrastate offering in one state should have to come to rest within such state before sales are permitted to out-of-state residents.[58] Consistent with this view, we propose to limit the ability of an issuer that has changed its principal place of business to conduct an intrastate offering in a different state until such time as the securities sold in reliance on the proposed exemption in the prior state have come to rest in that state.[59] For these purposes, we propose that issuers that have changed their principal place of business after making sales in an intrastate offering pursuant to proposed Rule 147 would not be able to conduct an intrastate offering pursuant to proposed Rule 147 in another state for a period of nine

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state or territory of the offering. *See* proposed Rule 147(c)(1). *See also* related discussion on issuer residency requirements in Section II.B.0 and note 47 above.

56 Proposed Rule 147(c)(1). The proposed principal place of business definition is consistent with the use of that term in Exchange Act Rule 3a71-3, 17 CFR 240.3a71-3, for cross-border security based swap dealing activity and the use of the term "principal office and place of business" in Investment Advisers Act Rule 203A-3(c), 17 CFR 275.203A-3(c).

57 *See* discussion in Section II.B.0 (State Law Requirements) below.

58 *See* 1961 Release at 4.

59 *See* proposed Rule 147(e) (proposing to limit resales of a given security purchased in an offering pursuant to Rule 147 to out-of-state residents for a nine-month period from the date such security is sold by the issuer).

months from the date of the last sale in the prior state, which is consistent with the duration of the resale limitation period specified in proposed Rule 147(e).[60]

Additionally, we propose to require issuers to satisfy an additional criterion that we believe would provide further assurance of the in-state nature of the issuer's business within the state in which the offering takes place. For these purposes, we propose to retain the 80% threshold tests of the current rule in modified form with the addition of an alternative test based on the location of a majority of the issuer's employees.[61] While the substance of the 80% threshold requirements of current Rule 147(c)(2) would be retained in the proposed rules, we propose to make compliance with any one of the 80% threshold requirements sufficient to demonstrate the in-state nature of the issuer's business. This would be a change to the current test, which requires issuers to meet all three conditions. We further propose to make certain technical revisions to the existing 80% thresholds that would simplify the structure, and clarify the application, of the rules.[62] In light of our proposal to require issuers to satisfy only one of the threshold tests, we propose to eliminate the current provision in Rule 147(c)(2)(i)(B), which does not apply the revenue test to issuers with less than $5,000 in revenue during the prior fiscal year.[63] While this accommodation may be reasonable in the context of the current conjunctive 80% threshold requirements of Rule 147(c)(2), we do not believe it would be necessary under the

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60 *See* Note 1 to proposed Rule 147(c)(1), specifying that an issuer that has previously conducted an intrastate offering pursuant to proposed Rule 147 may not conduct another intrastate offering pursuant to the exemption, based upon satisfaction of the principal place of business definition in a different state or territory, until the expiration of the time period specified in proposed Rule 147(e), calculated on the basis of the date of the last sale in such offering.

61 *See* proposed Rule 147(c)(2).

62 For example, in order to streamline the presentation of proposed Rule 147(c)(2), we propose to redesignate current Rule 147(c)(2)(i)(A)-(B), 17 CFR 230.147(c)(2)(i)(A)-(B), which includes instructions on how to calculate revenue under Rule 147(c)(2)(i), as a note to the rule.

63 17 CFR 230.147(c)(2)(i)(B).

proposed rule. We further propose to add an alternative requirement to the three modified 80% threshold requirements that relates to the location of a majority of the issuer's employees. This proposed requirement would provide an additional method by which an issuer could demonstrate that it conducts in-state business sufficient to justify reliance on Rule 147, as proposed to be amended. For these purposes, we propose to permit an issuer to satisfy the requirement of proposed Rule 147(c)(2) by having a majority of its employees based in such state or territory.[64] We believe that these proposed requirements would not only provide important indicia of the in-state nature of the issuer's business, but also would provide issuers with additional flexibility to satisfy the proposed requirements, especially in light of the different roles employees play within smaller companies and the different locations at which such roles are carried out.

As proposed, and in addition to the requirement that an issuer have its principal place of business in-state, an issuer would be required to meet at least one of the following requirements:

- The issuer derived at least 80% of its consolidated gross revenues from the operation of a business or of real property located in or from the rendering of services within such state or territory;[65]
- The issuer had at the end of its most recent semi-annual fiscal period prior to the first offer of securities pursuant to the exemption, at least 80% of its consolidated assets located within such state or territory;[66]
- The issuer intends to use and uses at least 80% of the net proceeds to the issuer from sales made pursuant to the exemption in connection with the operation of a business or of real

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64 *See* proposed Rule 147(c)(2)(iv).

65 *See* proposed Rule 147(c)(2)(i) and related notes to the rule indicating how and when an issuer would calculate its revenue for purposes of compliance with the proposed rule, based on when the first offer of securities is made pursuant to the exemption.

property, the purchase of real property located in, or the rendering of services within such state or territory;[67] or

- A majority of the issuer's employees are based in such state or territory.[68]

We believe the proposed amendments would expand capital raising opportunities for companies while continuing to require them to have an in-state presence sufficient to justify reliance on the exemption. Given the increasing "interstate" nature of small business activities, it has become increasingly difficult for companies, even smaller companies that are physically located within a single state or territory, to satisfy all of the residence requirements of current Rule 147(c)(2).[69] The proposed modification of these requirements would facilitate the use of the exemption for capital raising by providing issuers with greater flexibility to comply with the requirements and would help to eliminate potential uncertainty about the availability of the exemption.[70] If we were to adopt a final rule, we expect the staff would undertake to study and submit a report to the Commission no later than three years following the effective date of the amendments on whether this framework appropriately provides assurances that an issuer is doing business in the state in which the offering takes place. The Commission could also independently decide to engage in a retrospective review of the rule at any time.

In addition, states could decide whether to adopt specific additional requirements not specifically contemplated in this proposal that are consistent with their respective interests in

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66 *See* proposed Rule 147(c)(2)(ii).

67 *See* proposed Rule 147(c)(2)(iii).

68 *See* proposed Rule 147(c)(2)(iv).

69 *See* discussion in Section 0 below.

70 *See, e.g.*, Transcript of Record 82-91, SEC Advisory Committee on Small and Emerging Companies (June 3, 2015); *see also Exempted Transactions Under the Securities Act of 1933*, J. William Hicks, Thomas Reuters/West (2009), Ch. 4 (Intrastate Offerings Under Section 3(a)(11)) at §4:66 (noting confusion and uncertainty in the application of Rule 147's objective standards to specific factual situations).

facilitating capital formation and protecting their resident investors in intrastate securities offerings within their jurisdiction.[71] If we were to adopt a rule in substantially the form proposed today, we believe that states that currently have statutes and/or rules that require compliance with Securities Act Section 3(a)(11) and Rule 147 would need to amend their provisions in order for issuers to fully avail themselves of the new rule.[72] We further believe that, in connection with any such amendment to their statutes and/or rules, states could consider whether any additional requirements should be adopted at the state level to regulate local offerings within their jurisdiction and provide additional investor protections.

Request for Comment

7. Should we amend Rule 147 as proposed to require an issuer to have an in-state principal place of business and satisfy at least one of four alternative requirements that demonstrate the in-state nature of the issuer's business? Why or why not?

8. As proposed, should we limit the ability of issuers that have previously conducted an intrastate offering in reliance on proposed Rule 147, but that have since changed their principal place of business, to conduct an offering in reliance on the proposed rule in a different state until all of the securities sold in a prior intrastate offering have come to rest in the state in which the previous offering took place? Why or why not? Or, would the integration provisions of proposed Rule 147(g) sufficiently prevent an issuer from conducting two intrastate offerings pursuant to proposed Rule 147 within a short period

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[71] States currently employ this approach to varying degrees in their respective state crowdfunding statutes. *See, e.g.*, D.C. MUN. REGS. tit. 26-B, § 250 (2014) (escrow required until minimum offering amount satisfied), IND. CODE § 6-3.1-24-14 (2014) (funding portal required). *See* discussion in Section II.B.0 below for specific state law requirements for reliance on the proposed exemption.

[72] *See* note 25 and related discussions in Section 0 above and Section II.B.0 below.

of time, such that the proposed limitation would not be necessary? Should the proposed limitation be longer (*e.g.*, 12 months)? Why or why not?

9. Should we modify, as proposed, the current 80% threshold requirements of Rule 147(c)(2)(i)-(iii) to no longer require an issuer to satisfy all of the thresholds and include an alternative requirement based on the location of a majority of the issuer's employees? Why or why not? If not, should we retain the current threshold requirements for an issuer to be deemed "doing business" within a state or territory, but at lower percentage thresholds? If so, please specify the appropriate percentage thresholds. Or should we use different alternative threshold tests than under the current or proposed rules? Please explain.

10. As proposed, if we retain the threshold requirements in modified form, should issuers only be required to meet one or more of the requirements? Should they be required to meet two or more of the requirements? Please explain.

11. Do the proposed 80% threshold requirements provide sufficient guidance to issuers as to how to comply with such requirements? If not, what additional guidance, rules or revisions to the proposed rules should the Commission provide to clarify compliance with the proposed requirements?

12. Is the proposed alternative requirement that an issuer have derived at least 80% of its consolidated gross revenues in-state an appropriate indicator of in-state business activities for purposes of an issuer's eligibility for the proposed exemption? Does this alternative requirement provide sufficient clarity for issuers that would seek to comply with it? As proposed, should this requirement continue to require an issuer to calculate gross revenue on a consolidated basis? Please explain.

13. Is the proposed alternative requirement that the issuer had, at the end of its most recent semi-annual fiscal period prior to an initial offer of securities in any offering or subsequent offering pursuant to the exemption, at least 80% of its consolidated assets located in-state an appropriate indicator of in-state business activities for purposes of an issuer's eligibility for the proposed exemption? Does this alternative requirement provide sufficient clarity for issuers that would seek to comply with it? As proposed, should this requirement continue to require an issuer to calculate assets by including the assets of its subsidiaries on a consolidated basis? Please explain.

14. Is the proposed alternative requirement that the issuer intend to use and use at least 80% of the net proceeds from sales made pursuant to the exemption in connection with the operation of a business or of real property, the purchase of real property located in, or the rendering of services within such state or territory an appropriate indicator of in-state business activities for purposes of an issuer's eligibility for the proposed exemption? Does this alternative requirement provide sufficient clarity for issuers that would seek to comply with it? Please explain.

15. As proposed, and in addition to the proposed alternative 80% threshold requirements, should we add an alternative threshold requirement based on the location of a majority of an issuer's employees? Why or why not?

16. In addition to the requirement in proposed Rule 147(c)(1) that an issuer have a principal place of business in-state, does the proposed requirement that an issuer be able to satisfy the requirements of proposed Rule 147(c)(2) by having a majority of its employees based in such state or territory provide a sufficient basis to determine the in-state nature of the issuer's business? Why or why not? If not, what additional or

alternative criteria could we add to the proposed requirement to provide a sufficient basis?

17. As proposed, should we limit availability of the exemption to those issuers that can satisfy the proposed "principal place of business" definition and at least one of the additional requirements of proposed Rule 147(c)(2) that would demonstrate the in-state nature of the issuer's business? Why or why not? Please explain.

18. Is our proposed definition of "principal place of business" appropriate? Why or why not? Would the proposed definition of "principal place of business" alone adequately establish in-state status for purposes of determining eligibility to conduct an offering pursuant to the exemption at the federal level? Are there any additional or alternative requirements that should be included in the rule to establish in-state status?

4. Additional Amendments to Rule 147

a. Reasonable Belief as to Purchaser Residency Status

Current Rule 147(d) requires that offers and sales of securities pursuant to the rule be made only to persons resident within the state or territory of which the issuer is a resident.[73] Regardless of the efforts an issuer takes to determine that potential investors are residents of the state in which the issuer is a resident, the exemption would be lost for the entire offering if securities are offered or sold to one investor that was not in fact a resident of the state. We believe that this requirement in the current rule is unnecessarily restrictive and gives rise to uncertainty for issuers. We therefore believe it should be changed in the amended rule.

[73] 17 CFR 230.147(d).

Consistent with the requirements in Regulation D,[74] we propose to add a reasonable belief standard to the issuer's determination as to the residence of the purchaser at the time of the sale of the securities.[75] As proposed, an issuer would satisfy the requirement that the purchaser in the offering be a resident of the same state or territory as the issuer's principal place of business by either the existence of the fact that the purchaser is a resident of the applicable state or territory, or by establishing that the issuer had a reasonable belief that the purchaser of the securities in the offering was a resident of such state or territory.[76] We believe that permitting issuers to sell on the basis of a reasonable belief of a purchaser's in-state residency status will increase the utility of the exemption by providing issuers with additional certainty about the availability of the exemption.

Consistent with our proposal to permit issuers to satisfy the purchaser residency requirement by establishing a reasonable belief that such purchasers are in-state residents, we propose to eliminate the current requirement in Rule 147 that issuers obtain a written representation from each purchaser as to his or her residence.[77] We believe that this requirement is unnecessary in light of the proposed reasonable belief standard. In the context of the current intrastate exemption, the Commission has previously indicated that "[t]he mere obtaining of formal representations of residence … should not be relied upon without more as establishing the availability of the exemption."[78] Whether an issuer has formed a reasonable belief that the

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74 Rule 501(a) of Regulation D includes in the definition of "accredited investor," persons who come within the enumerated categories of the rule, or who the issuer reasonably believes come within any of such categories, at the time of sale to such person. [17 CFR 230.501(a)].

75 *See* proposed Rule 147(d).

76 *Id*.

77 17 CFR 230.147(f)(1)(iii).

78 *See* 1961 Release at 3.

prospective purchaser is an in-state resident would need to be determined on the basis of all facts and circumstances. Such facts and circumstances could include, but would not be limited to, for example, a pre-existing relationship between the issuer and the prospective purchaser that provides the issuer with sufficient insight and knowledge as to the prospective purchaser's primary residence so as to enable the issuer to establish a reasonable basis to believe that the prospective purchaser is an in-state resident. An issuer may also consider other facts and circumstances establishing the residency of a prospective purchaser, such as evidence of the home address of the prospective purchaser as documented by a recently dated utility bill, pay-stub, information contained in state or federal tax returns, or any state-issued documentation, such as a driver's license or identification card.

Additionally, we are concerned that maintaining the current requirement for an issuer to obtain a written representation from purchasers of in-state residency status may cause confusion with the proposed reasonable belief standard. Issuers, particularly smaller issuers likely to conduct intrastate offerings, may mistakenly believe that obtaining a written representation from purchasers of in-state residency status would, without more, be sufficient to establish a reasonable belief that such purchasers are in-state residents, which, as noted above, would not be the case. For these reasons, we propose to eliminate the requirement that issuers obtain a written representation from purchasers as to their in-state residency. We are, however, seeking comment on whether this requirement should be retained.

Request for Comment

19. Should we add a reasonable belief standard to the issuer's determination as to the residence of the purchaser at the time of the sale of the securities, as proposed? Why or why not?

20. Should we eliminate the requirement to obtain a written representation from the purchaser, as proposed? Why or why not? Alternatively, should we retain the requirement to obtain a written representation but supplement it with a reasonable belief standard? Why or why not? What additional benefit, if any, would be provided by supplementing the current written representation requirement with a reasonable belief standard?

21. Should the rules provide a safe harbor for determining an individual purchaser's residence, based upon certain objective criteria, such as: (1) the jurisdiction in which a person owns or leases its primary home, (2) the jurisdiction in which a person maintains certain other indicia of residence (such as a driver's license, voting registration, tax situs), or (3) the jurisdiction in which a person's principal occupation is based? Why or why not? Are there other criteria that should be used to establish such a safe harbor?

b. Residence of Entity Purchasers

The proposed amendments also would define the residence of a purchaser that is a legal entity, such as a corporation, partnership, trust or other form of business organization, as the location where, at the time of the sale, the entity has its principal place of business.[79] The proposed amendments define a purchaser's "principal place of business," consistent with the proposed definition for issuer eligibility purposes, as the location in which the officers, partners, or managers of the entity primarily direct, control and coordinate the activities of the issuer.[80]

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[79] *See* proposed Rule 147(d). Under the current rule, an entity is a resident of the state or territory where the entity has its "principal office." We have not defined "principal office." Rule 147(c)(2)(iv) [17 CFR 230.147(c)(2)(iv)].

[80] *See* proposed Rule 147(c)(1).

Request for Comment

22. Should we define the residence of a purchaser that is a legal entity, such as a corporation, partnership, trust or other form of business organization, as the location where, at the time of the sale, the entity has its principal place of business? Why or why not? Should we define principal place of business differently for this purpose? If so, how should we define it?

23. Current Rule 147(d)(3) provides that an entity organized for the specific purpose of acquiring the securities offered pursuant to the rule is not treated as a resident of the state or territory unless all of the beneficial owners of such organization are also residents of such state or territory.[81] Should we revise the rule to base the test upon the location of the principal place of business of the specific purpose entity, as opposed to the residency of all of its beneficial owners? Why or why not?

c. Limitation on Resales

Under current Rule 147(e), "during the period in which securities that are part of an issue are being offered and sold by the issuer, and for a period of nine months from the date of the last sale by the issuer of such securities, all resales of any part of the issue, by any person, shall be made only to persons resident within such state or territory."[82] The limitation on resales in Rule 147(e), which is also a condition that must be satisfied in order for the issuer to be able to rely on the safe harbor,[83] is designed to help ensure that the securities issued in an intrastate offering have come to rest in the state of the offering before any potential redistribution out-of-

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[81] 17 CFR 230.147(d)(3).

[82] 17 CFR 230.147(e).

[83] *See* Rule 147(a), 17 CFR 230.147(a).

state.[84] While this requirement may be appropriate for purposes of compliance with a safe harbor under Section 3(a)(11), we believe it is unduly restrictive[85] and that its application in Rule 147 can give rise to uncertainty for issuers in the offering process by conditioning the availability of the safe harbor on circumstances beyond the issuer's control. We therefore propose to amend both the substance and application of Rule 147(e).

As the Commission previously noted when discussing resales pursuant to Section 3(a)(11), the requirement that the entire distribution of securities pursuant to the intrastate exemption be offered and sold to in-state residents should not be read to suggest "that securities which have actually come to rest in the hands of resident investors, such as persons purchasing without a view to further distribution or resale to non-residents, may not in due course be resold by such persons, whether directly or through dealers or brokers, to non-residents without in any way affecting the exemption."[86]

The Commission's approach in the 1961 Release reflects the view that the determination as to when a given purchase of securities in an intrastate offering has come to rest in-state depends less on a defined period of time after the final sale by the issuer in such offering than it does on whether a resident purchaser—that seeks to resell any securities purchased in such an offering—has taken the securities "without a view to further distribution or resale to non-residents."[87] In this regard, we believe that a time-based limitation on potential resales to non-residents of securities purchased in an intrastate offering that relates back to the date of the

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84 *See* 1961 Release at 3.

85 For example, in an offering of securities that takes an issuer one year to complete, a purchaser of securities on day one of the offering must wait twenty-one months before it is able to resell to an investor out-of-state, while the last purchaser in such offering would only be required to wait for a period of nine months before similarly being able to sell to out-of-state purchasers.

86 1961 Release, at 4.

initial purchase by a resident investor from the issuer would more precisely address the concern regarding out-of-state resales.[88]

For these reasons, we propose to amend the limitation on resales in Rule 147(e) to provide that "for a period of nine months from the date of the sale by the issuer of a security sold pursuant to this rule, any resale of such security by a purchaser shall be made only to persons resident within such state or territory, as determined pursuant to paragraph (d) of this rule."[89] We believe that a nine-month limitation on resales by resident purchasers to non-residents would adequately ensure that the securities purchased by such residents were purchased without a view to further distribution to non-residents.[90]

Additionally, as mentioned above, the application of Rule 147(e) in the context of the Section 3(a)(11) safe harbor may give rise to uncertainty in the offering process that we propose to address in the amended rules. Currently, Rule 147(a) requires issuers to comply with all of the terms and conditions of the rule in order for an offering to come within the safe harbor.[91] This provision makes the safe harbor unavailable to an issuer for the entire offering if, regardless of the efforts the issuer takes to ensure that secondary sales comply with the resale limitations,[92] securities are sold in the secondary market before the expiration of the resale period to a person

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87 *Id.*

88 *Id.* ("[i]f the securities are resold but a short time after their acquisition to a non-resident this fact, although not conclusive, might support an inference that the original offering had not come to rest in the state . . ."). The Commission previously has taken a time-based holding period approach, for example, in Securities Act Rule 144, regarding resales of restricted securities issued in private offerings in order to help ensure that resellers of the securities are not engaged in a distribution of securities and, therefore, not considered underwriters of the securities issued under the definition of such term in Securities Act Section 2(a)(11).

89 Proposed Rule 147(e).

90 In such circumstances, resales of securities that were initially purchased in an intrastate offering must themselves be registered or exempt from registration in any state in which such resale takes place.

91 Rule 147(a), 17 CFR 230.147(a).

92 *See, e.g.*, Rule 147(f) (requiring legends and stop transfer instructions to the issuer's transfer agent).

that is not in fact an in-state resident. The application of Rule 147(e) in the overall scheme of the safe harbor can therefore cause uncertainty for issuers during, and for a period of nine months after the completion of, the offering about whether the safe harbor is or continues to be available based on circumstances outside of the issuer's control.[93]

While we propose to maintain the resale limitations in Rule 147(e), in the modified form discussed above, we also propose to amend Rule 147(b) so that an issuer's ability to rely on Rule 147 would no longer be conditioned on a purchaser's compliance with Rule 147(e).[94] We believe that this proposed amendment to the application of Rule 147(e), as it relates to Rule 147(b), would increase the utility of the exemption by eliminating the uncertainty created in the offering process for issuers under the current rules. Additionally, we do not believe that eliminating this uncertainty would result in an increased risk of issuer non-compliance with the rules because, as proposed, issuers would remain subject to requirements relating to, for example, in-state sales limitations, and legend, stop transfer instructions for transfer agents, and offeree and purchaser disclosures, in order to satisfy the exemption at the federal level. In addition, issuers would continue to be subject to the antifraud and civil liability provisions of the federal securities laws, as well as state securities law requirements.

Request for Comment

24. Should we amend the rule, as proposed, to impose a limitation on resales by resident purchasers to non-residents based on the date of sale by the issuer to the relevant purchaser rather than based on the date when the offering terminates? Why or why

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93 *See, e.g.*, *Exempted Transactions Under the Securities Act of 1933*, at §4:52. *See also* Section II.B.0 above, discussing related concerns regarding the uncertainty interjected into the offering process by the current 80% requirement as to the issuer's in-state use of proceeds in Rule 147(c)(2)(iii).

94 *See* proposed Rule 147(b). As proposed, current Rule 147(a) would be re-designated as Rule 147(b).

not?

25. Is the proposed nine-month period appropriate? Should it be longer or shorter? If so, what would be the appropriate amount of time (*e.g.*, six months, one year, etc.)?

26. Instead of adopting the limitation on resales proposed in Rule 147(e), should securities issued under amended Rule 147 be considered "restricted securities" under Rule 144(a)(3)?[95] Or is the purpose underlying the limitation on resales in Rule 147 (*i.e.*, that the securities must come to rest in-state before sales to out-of-state residents are permitted) sufficiently distinct from the purpose underlying the limitation on resales of restricted securities such that securities issued in a Rule 147 transaction should not be considered restricted securities? Why or why not?

27. As proposed, should we no longer condition an issuer's ability to satisfy Rule 147 on investor compliance with Rule 147(e)? Why or why not? Are there any risks to investors posed by the proposed revisions to Rule 147(b) that would no longer condition the availability of the rule on an issuer's compliance with Rule 147(e)?

d. Integration

The integration safe harbor of current Rule 147(b)(2) provides that offers or sales of securities that take place either prior to the six-month period immediately preceding, or after the six-month period immediately following, any Rule 147 offering will not be integrated with any offers or sales of securities by the issuer made in reliance on the safe harbor.[96] For offers or sales of securities occurring within the six-month period immediately before or after any offers or sales pursuant to a Rule 147 offering, Preliminary Note 3 to the rule states that the determination

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[95] 17 CFR 230.144(a)(3).

[96] 17 CFR 230.147(b)(2); *see also* Rule 147 Adopting Release at 3.

of whether offers and sales of securities are deemed part of the same issue, or should be deemed "integrated," is a question of fact that will depend on the particular circumstances.[97]

Integration safe harbors provide issuers, particularly smaller issuers whose capital needs often change, with valuable certainty about their eligibility to comply with an exemption from Securities Act registration.[98] We believe that, while the existing Rule 147 safe harbor provides issuers with some certainty with respect to the integration of offers or sales of securities within the six-month period immediately preceding and following a Rule 147 offering, amended Rule 147 should reflect the Commission's most recent statements on the subject.[99]

The concept of integration has evolved since the adoption of Rule 147 in 1974,[100] particularly as it relates to the integration of potential offers and sales that occur concurrently with, or close in time with the particular exempt offering being considered.[101] We therefore propose to update the rule's integration provisions by expanding the scope of the current

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97 *See* 17 CFR 230.147 (Preliminary Note 3). Preliminary Note 3 cites to the guidance provided in Release. No. 33-4552, at 3 (Nov. 6, 1962) [27 FR 11316 (Nov. 16, 1962)], in which the Commission describes the traditional five-factor test for integration, and explains that "any one or more of the following factors may be determinative of the question of integration:

1. are the offerings part of a single plan of financing;
2. do the offerings involve issuance of the same class of security;
3. are the offerings made at or about the same time;
4. is the same type of consideration to be received; and
5. are the offerings made for the same general purpose."

98 *See* 2015 Regulation A Release at Section II.B.5. (Integration).

99 *Id*.

100 At the time the Commission adopted Rule 147, the Commission generally deemed intrastate offerings to be "integrated" with those registered or private offerings of the same class of securities made by the issuer at or about the same time. Paragraph (b) of Rule 147 was intended to create greater certainty and to eliminate in certain situations the need for a case-by-case determination of when certain intrastate offerings should be integrated with other offerings, such as those registered under the Act or made pursuant to the exemption provided by Section 3 or 4(a)(2) of the Act. *See* Rule 147 Adopting Release at 3.

101 *See e.g.*, Rule 251(c) of Regulation A [17 CFR 230.251(c)]; 2015 Regulation A Release, at Section II.B.5.; SEC Rel. No. 33-8828, Section II.C.1 (Aug. 3, 2007) [72 FR 45116 (Aug. 10, 2007)]; Rule 701 [17 CFR 230.701].

provision in a manner that is consistent with the Commission's most recently adopted integration safe harbor, Rule 251(c) of Regulation A.[102] We believe that this approach to integration would not only benefit issuers, particularly smaller issuers, by providing valuable certainty as to the availability of an exemption for a given offering, but that such issuers would also benefit from increased consistency in the application of the integration doctrine among the exemptive rules available to smaller issuers.[103]

The proposed Rule 147 safe harbor would include any prior offers or sales of securities by the issuer, as well as certain subsequent offers or sales of securities by the issuer occurring within six months after the completion of an offering exempted by Rule 147. As proposed, offers and sales made pursuant to Rule 147 would not be integrated with:

- Prior offers or sales of securities; or
- Subsequent offers or sales of securities that are:
    - Registered under the Act, except as provided in Rule 147(h);
    - Exempt from registration under Regulation A (17 CFR § 230.251 *et seq.*);
    - Exempt from registration under Rule 701 (17 CFR § 230.701);
    - Made pursuant to an employee benefit plan;
    - Exempt from registration under Regulation S (17 CFR §§ 230.901 through 230.905);

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[102] *See* 17 CFR 230.251(c). Rule 251(c) was originally adopted as an integration safe harbor in 1992. *See* SEC Rel. No. 33-6949 (July 30, 1992) [57 FR 36442 (Aug. 13, 1992)]. The 2015 Regulation A Release did not substantively change Rule 251(c), except for the addition to the safe harbor list of subsequent offers or sales of securities issued pursuant to Securities Act Section 4(a)(6). *See* Rule 251(c)(2)(vi).

[103] *See* Rule 251(c) of Regulation A [17 CFR 230.251(c)]; Rule 701 [17 CFR 230.701].

- Exempt from registration under section 4(a)(6) of the Act (15 U.S.C. 77d(a)(6)); or
- Made more than six months after the completion of an offering conducted pursuant to this rule.[104]

As with Rule 251(c) of Regulation A, the proposed safe harbor from integration provided by proposed Rule 147(g) would expressly provide that any offer or sale made in reliance on the rule would not be integrated with any other offer or sale made either before the commencement of, or more than six months after, the completion of the Rule 147 offering. In other words, for transactions that fall within the scope of the safe harbor, issuers would not have to conduct an independent integration analysis of the terms of any offering being conducted under the provisions of another rule-based exemption in order to determine whether the two offerings would be treated as one for purposes of qualifying for either exemption. This bright-line rule would assist issuers, particularly smaller issuers, in analyzing certain transactions, but would not address the issue of potential offers or sales that occur concurrently with, or close in time after, a Rule 147 offering.

Consistent with the current integration guidance in Preliminary Note 3 to Rule 147, our proposed amendments would clarify that, if the safe harbor does not apply, whether subsequent offers and sales of securities would be integrated with any securities offered or sold pursuant to this rule would depend on the particular facts and circumstances. There would be no presumption that offerings outside the integration safe harbors should be integrated.

An offering made in reliance on Rule 147 would not be integrated with another exempt offering made concurrently by the issuer, provided that each offering complies with the

requirements of the exemption that is being relied upon for the particular offering.[105] For example, an issuer conducting a concurrent exempt offering for which general solicitation is not permitted would need to be satisfied that purchasers in that offering were not solicited by means of the offering made in reliance on amended Rule 147.[106] Alternatively, an issuer conducting a concurrent exempt offering for which general solicitation is permitted would need to comply with the legend and disclosure requirements of proposed Rule 147(f).[107] If the concurrent exempt offering for which general solicitation is permitted imposes additional restrictions on the general solicitation, such as, for example, the limitations imposed on advertising pursuant to Rule 204 of Regulation Crowdfunding, the issuer's general solicitation would not be able to go beyond the more restrictive requirements. Also, an issuer conducting a concurrent Rule 506(c) offering could not include in its Rule 506(c) general solicitation materials an advertisement of a concurrent Rule 147 offering, unless that advertisement also included the necessary disclosure for, and otherwise complied with, Rule 147(f).[108]

Consistent with our approach to integration in Rule 251(c), we are proposing that offers or sales made in reliance on Rule 147 should not be integrated with subsequent offers or sales that are registered under the Securities Act, except as provided under our proposed paragraph (h) to Rule 147, or qualified by the Commission pursuant to Regulation A. While prior offers or

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104 *See* proposed Rule 147(g).

105 We adopted a similar approach to integration in the context of offerings under Regulation A. *See* 2015 Regulation A Release at Section II.B.5.

106 For a concurrent offering under Rule 506(b), an issuer would need to conclude that purchasers in the Rule 506(b) offering were not solicited by means of a general solicitation under amended Rule 147. For example, the issuer may have had a preexisting substantive relationship with such purchasers. Otherwise, the solicitation conducted in connection with the Rule 147 offering may preclude reliance on Rule 506(b). *See also* SEC Rel. No. 33-8828 (Aug. 3, 2007) [72 FR 45116 (Aug. 10, 2007)].

107 *See* proposed Rule 147(f).

108 *See id.*; *see also* discussion in Section II.B.0 above.

sales of securities made in reliance on Rule 147 are currently not integrated with subsequent Regulation A offerings,[109] we believe that expressly adding subsequent offers or sales of securities made in reliance on Regulation A to the Rule 147 integration safe harbor would provide issuers with clarity and additional certainty about their eligibility to conduct a Rule 147 offering before commencing an offering pursuant to Regulation A. Additionally, we believe that issuers that seek to register offerings under the Securities Act should be encouraged to do so without the risk that prior offers or sales pursuant to Rule 147 could be integrated with such offerings. We are mindful, however, of the risk that offers made pursuant to Rule 147 shortly before a registration statement is filed could be viewed as conditioning the market for that registered offering. Accordingly, proposed Rule 147 would address this risk by excluding from the safe harbor any such offer made to persons other than qualified institutional buyers and institutional accredited investors within the 30-day period before a registration statement is filed with the Commission.[110]

Additionally, subsequent offers or sales pursuant to Securities Act Rule 701 or an employee benefit plan would be included in the proposed Rule 147(g) integration safe harbor. While these types of offerings to employees and to persons that provide similar functions for the issuer may provide the issuer with capital, they are primarily compensatory in nature and benefit the issuer and its employees in a manner that is distinct from other types of securities offerings, such as by aligning employee and company interests. For these reasons, we believe that these

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109 *See* Rule 251(c)(1) of Regulation A, 17 CFR 230.251(c)(1).

110 In such circumstances, whether an offer made within the thirty-day period before the filing of a registration statement would constitute an impermissible offer for purpose of Securities Act Section 5(c) would be based on the facts and circumstances of such offer.

types of compensatory employee benefit offerings should be included in the safe harbor, if they occur subsequent to a Rule 147 offering.

We also propose to include subsequent offers or sales made pursuant to Regulation S[111] in proposed Rule 147(g), as this exemption is only available for offers and sales of securities that are made outside the United States.[112] Given their offshore character, we do not believe that offerings conducted pursuant to Regulation S should be integrated with previous Rule 147 intrastate offerings.

Additionally, we propose to include in the list of transactions covered by the Rule 147 safe harbor subsequent offers or sales of securities made pursuant to rules we are concurrently adopting today in a companion release for securities-based crowdfunding transactions under Title III of the JOBS Act.[113] Given the unique capital formation method available to issuers and investors in the crowdfunding rules we are adopting and the small dollar amounts involved, we do not propose to integrate offers or sales of such securities issued in federal crowdfunding transactions that occur subsequent to the completion of any offering conducted pursuant to Rule 147.[114]

Request for Comment

28. As proposed, should we include any prior offers or sales of securities made by the issuer before the start of a Rule 147 offering in the Rule 147(g) integration safe harbor? Why or why not?

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111 17 CFR 230.900 through 905.

112 *See* Preliminary Note 6 of Regulation S.

113 *See* Regulation Crowdfunding Adopting Release.

114 *See id*. An issuer contemplating a securities-based crowdfunding transaction pursuant to Section 4(a)(6) subsequent to any offers or sales conducted in reliance on Rule 147, as proposed to be amended, should

29. Should the Rule 147(g) integration safe harbor include, as proposed, the list of subsequent offers or sales of securities by the issuer that may be made within six months after the termination of the Rule 147 offering without being subject to integration? Why or why not?

30. Should we expand the list of subsequent offers or sales of securities by the issuer that may be made within six months after the termination of the Rule 147 offering without being subject to integration to include other types of offers and sales of securities by the issuer? Alternatively, should we narrow the list of subsequent offers or sales of securities included in the integration safe harbor? Why or why not? Please explain.

31. Should we include language in the rule text expressly stating that an offering made in reliance on Rule 147 would not be integrated with another exempt offering made concurrently by the issuer, provided that each offering complies with the requirements of the exemption that is being relied upon for the particular offering? Why or why not?

32. Should we include a new paragraph (h) to Rule 147, as proposed, concerning offers to investors other than qualified institutional investors and institutional accredited investors within 30 calendar days prior to a registered offering? Why or why not?

e. Other Considerations

Currently, Rule 147(f)(3) requires issuers, in connection with any offers or sales pursuant to the rule, to disclose, in writing, the limitations on resale contained in Rule 147(e)[115] and the requirements for stop transfer instructions for the issuer's transfer agent set forth in

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look to the rules for securities-based crowdfunding transactions to ensure compliance with the advertising provisions of the exemption.

[115] 17 CFR 230.147(e). *See also* discussion in Section II.B.4.0 above.

Rule 147(f)(1)(i)-(ii).[116] The same requirements apply in connection with the issuance of new certificates for any of the securities that are part of the same issue that are presented for transfer during the period specified in Rule 147(e). We believe that these disclosure requirements provide important protections to investors and issuers alike by helping to ensure that investors understand the limitations and restrictions associated with a purchase of securities pursuant to the rule. Currently, however, the rule does not specifically identify to whom or when such disclosure should be provided.[117] We propose to retain the substance of these requirements, in modified form, in the amended rules, while clarifying the application of the disclosure requirements.[118]

Specifically, we propose to clarify in the text of the amended rule the specific language of the required disclosure and that such disclosure should be prominently provided to each offeree and purchaser at the time any offer or sale is made by the issuer to such person pursuant to the exemption.[119] The rule, however, would no longer require that such disclosure be made in writing in all instances. We propose to amend the current requirement to provide issuers with flexibility by permitting them to provide the required disclosure to offerees in the same manner in which an offer is communicated,[120] while continuing to require written disclosure to all

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116 17 CFR 230.147(f)(1)(i)-(ii).

117 *See* 17 CFR 230.147(f)(3).

118 Proposed Rule 147(f)(1)(i) would retain the existing legend requirement for stock certificates but specify the exact language to be provided.

119 Currently, Rule 147(f)(3) requires issuers to disclose the required information "in connection with" any offers or sales of securities but does not specify the time at which such disclosure must be provided to offerees or purchasers. Proposed Rule 147(f)(3) would require issuers to provide the required disclosure to offerees and purchasers at the time of any offers or sales of securities, thereby eliminating the risk that an issuer could, for example, make an offer of securities at one point in time and provide the required disclosures at a later date. *See* proposed Rule 147(f)(3).

120 This proposed approach would be consistent with the treatment of the "testing the waters" legend requirements in Rule 255(b) of Regulation A. *See* 17 CFR 230.255(b).

purchasers. We believe that this approach would reduce the compliance obligations of issuers, particularly smaller companies likely to conduct offerings pursuant to the exemption, by no longer requiring disclosure to offerees in writing when offers are communicated orally. As the proposed requirement would apply to every offer of securities by the issuer pursuant to the exemption, including subsequent offers to the same offeree, and in light of the continuing requirement to provide written disclosure to all purchasers of the securities, we do not believe that the easing of the current requirement as it relates to oral offers would result in an increase in risks to investors.

As noted above, we propose to retain the substance of the disclosure requirements of current Rule 147(f)(3), in modified form, in the amended rules. As proposed, Rule 147(f)(3) would require issuers to make specified disclosures to offerees and purchasers about the limitations on resale contained in proposed Rule 147(e) and the legend requirement of proposed Rule 147(f)(1)(i), but would no longer require issuers to disclose to offerees and purchasers the stop transfer instructions provided by an issuer to its transfer agent[121] and the provisions of Rule 147(f)(2) regarding the issuance of new certificates during the Rule 147(e) resale period.[122] Although issuers would have to continue to comply with these requirements,[123] we believe that requiring issuers to disclose that information to offerees and purchasers does not add anything to

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121 Rule 147(f)(1)(ii), 17 CFR 230.147(f)(1)(ii).

122 Rule 147(f)(2), 17 CFR 230.147(f)(2). Additionally, as discussed in Section II.B.0 above, we propose to require issuers in offerings conducted pursuant to Rule 147 to disclose to each offeree in the manner in which any offer is communicated and to each purchaser of a security in writing that sales will be made only to residents of the same state or territory as the issuer. *See* proposed Rule 147(f)(3).

123 *See* proposed Rule 147(f)(1)(ii) and proposed Rule 147(f)(2).

the existing disclosures under Rules 147(e) and (f)(1), and we therefore propose to eliminate this disclosure requirement from the rule.[124]

Request for Comment

33. As proposed, should we modify the requirements of current Rule 147(f)(3) to require issuers to disclose to offerees and purchasers the resale limitations of Rule 147(e) and the legend requirement of Rule 147(f)(1)(i) at the time any such offer or sale is made, but no longer require an issuer to disclose to such persons the stop transfer instructions to its transfer agent, if any, and the provisions of Rule 147(f)(2) regarding the issuance of new certificates during the Rule 147(e) resale period?[125] Or should we preserve the existing rule requirements? Why or why not?

34. As proposed, should we permit the disclosures required by Rule 147(f)(3) to be provided orally? Should we instead require these disclosures to be made in writing, as under the current rule? Alternatively, should we no longer require these disclosures to be provided to offerees, while continuing to require that they be provided to purchasers? Or, prior to making any sales, should we require issuers that only make oral offers to provide, in addition to the required oral disclosure, written disclosure to offerees a reasonable time before any sales are made to such persons? Why or why not?

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124 *See* proposed Rule 147(f)(3).

125 *See also* Request for Comment 0 above regarding proposed Rule 147(f)(3) and the requirement that issuers disclose to offerees and purchasers that sales will be made only to residents of the same state or territory as the issuer.

35. Should the amendments to Rule 147 include a substantial compliance provision, similar to the provision in Rule 508 of Regulation D,[126] or otherwise account for insignificant deviations in a manner that is similar to Rule 260 of Regulation A?[127] In light of the proposal to permit issuers to sell securities pursuant to Rule 147 on the basis of a reasonable belief as to a purchaser's residency status, what additional situations, if any, could a substantial compliance or insignificant deviation rule address? Please explain.

36. Should we amend Rule 147 to make the exemption available for secondary distributions? Why or why not?

f. State Law Requirements

We believe the proposed amendments to Rule 147 would facilitate capital formation by smaller companies seeking to raise capital in-state by increasing the utility of the rule while maintaining appropriate protections for resident investors. Consistent with the policy underlying the adoption of objective standards for determining compliance with Section 3(a)(11) in current Rule 147, we believe that the protections afforded to resident investors in an intrastate offering primarily flow from the requirements of state securities law.[128] For example, as with the federal securities laws, states generally require an issuer to register an offering with appropriate state authorities when offers or sales of securities are made to their residents, unless the state has adopted, by rule or statute, an exemption from registration.

As discussed above,[129] in recent years a number of states have adopted and/or enacted provisions in their rules or statutes that generally require an issuer, in addition to complying with

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126 17 CFR 230.508.

127 17 CFR 230.260.

128 *See* note 14 above.

129 *See* Section 0 above.

various state-specific requirements to qualify for an exemption from registration,[130] to comply with Section 3(a)(11) and Rule 147.[131] Of the states that have adopted and/or enacted provisions that require an issuer to comply with Rule 147, either alone or in conjunction with Section 3(a)(11), no state has adopted and/or enacted a provision with an aggregate offering amount that exceeds $4 million.[132] Additionally, almost all of these states have adopted provisions that impose investment limitations on investors.

Rule 147 does not currently have an offering amount limitation and does not currently limit the amount of securities an investor can purchase in an offering pursuant to the rule. Preliminarily, however, we believe that, in light of the proposed changes to Rule 147, which, as noted above, would no longer be a safe harbor for compliance with Section 3(a)(11), a maximum offering amount limitation and investor investment limitations in the rule would provide investors with additional protection and would be consistent with existing state law crowdfunding provisions.[133] As such, we are proposing to limit the availability of Rule 147, as proposed to be amended,[134] to issuers that have registered an offering in the state in which all of the purchasers are resident or that conduct the offering pursuant to an exemption from state law

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130 *See* note 24 above.

131 *See* note 25 above.

132 *See* http://www.nasaa.org/industry-resources/corporation-finance/instrastate-crowdfunding-resource-center/intrastate-crowdfunding-directory/. Illinois is the only state with a crowdfunding provision allowing for a maximum aggregate offering amount up to $4 million in a twelve-month period. All other states that have adopted some form of a state-based crowdfunding provision limit the aggregate offering amount to between $1 million and $2.5 million. *See* ILLINOIS HOUSE BILL 3429, § 4.T. (2015), *available at*: https://legiscan.com/IL/text/HB3429/id/1257029.

133 States may have non-crowdfunding exemptions for larger offerings and issuers seeking to rely on any such state exemption could continue to conduct the offering pursuant to Section 3(a)(11) or find an alternate federal exemption. *See, e.g.*, Section 202(14) of the Uniform Securities Act of 2002 (exempting transactions to not more than 25 purchasers, other than institutional investors and federal covered investment advisers, that do not utilize a general solicitation or general advertising).

134 *See* discussions in Section II.B.0 through II.B.2.0 above for additional limitations and requirements that would apply to offerings conducted pursuant to proposed Rule 147.

registration in such state that limits the amount of securities an issuer may sell pursuant to such exemption to no more than $5 million in a twelve-month period and that limits the amount of securities an investor can purchase in any such offering.[135] We are particularly interested in getting feedback from the states and market participants, however, and are seeking comment on this issue, including whether additional or alternative requirements should be imposed on offerings conducted pursuant to the proposed rule at the federal level.

State crowdfunding laws allow, and in some states mandate, the use of an intermediary. The intermediary may be a federally registered broker-dealer, or an intrastate broker-dealer that is exempt from federal registration requirements. Section 15(a)(1) of the Exchange Act provides an exemption for a broker-dealer whose business is "exclusively intrastate and who does not make use of any facility of a national securities exchange." In the state crowdfunding context, some intermediaries may be small broker-dealers seeking to only operate intrastate. To the extent that information posted on the Internet in connection with a state crowdfunding offering by an intermediary would be considered an interstate offer of securities, such business would be ineligible for the intrastate broker-dealer exemption. We are seeking comment on these issues, including whether the proposed rule should require issuers to use the services of any such intermediary at the federal level.

Request for Comment

37. Should we limit the availability of Rule 147, as proposed to be amended, to issuers that have registered an offering in the state in which all of the purchasers are resident or that conduct the offering pursuant to an exemption from state law registration in such state that limits the amount of securities an issuer may sell pursuant to such exemption to no

[135] *See* proposed Rule 147(a).

more than $5 million in a twelve-month period and the amount of securities an investor can purchase in any such offering? Why or why not?

38. Would the proposed requirements that an issuer conduct the offering pursuant to an exemption from state law registration in such state that limits the amount of securities an issuer may sell pursuant to such exemption to no more than $5 million in a twelve-month period and that limits the amount of securities an investor can purchase in any such offering provide adequate investor protections at the federal level? Why or why not? Or, are the proposed maximum offering amount and/or investor investment limitations unnecessary at the federal level, in light of the local character of the intrastate offerings that would be conducted pursuant to the proposed rule and the presence of state oversight in such offerings? Please explain.

39. Should Rule 147, as proposed to be amended, specify the maximum offering amount limitation that must be included in a state exemption from registration? Why or why not? Should the proposed $5 million maximum offering amount limitation be adopted at a lower or higher dollar amount? If so, what amount and why? If not, why not?

40. Should Rule 147, as proposed to be amended, itself specify a maximum offering amount limitation for purposes of compliance with the proposed rule at the federal level and, in a change from the proposed rule, no longer require that a maximum offering amount limitation be included in any exemptive provision adopted at the state level? What benefit, if any, is derived from the proposed inclusion of a specified maximum offering amount limitation of not more than $5 million of securities in a twelve-month period at both the state and federal level? Please explain.

41. Should the proposed requirement that a state law exemption from registration impose investment limitations on investors, when the offering is conducted pursuant to proposed Rule 147 at the federal level, include specific maximum dollar amounts that an investor must be subject to or other specific criteria, such as criteria based on an investor's net worth and/or annual income? Why or why not? Please explain.

42. Should Rule 147, as proposed to be amended, include the proposed requirement that a state law exemption include investment limitations in order for the issuer to be able to conduct an intrastate offering pursuant to Rule 147, as proposed to be amended? Why or why not? Please explain.

43. Should we limit the application of the proposed requirement that a state law exemption include investment limitations, in order for the issuer to be able to conduct an intrastate offering pursuant to Rule 147, as proposed to be amended, to non-accredited investors only, while not requiring an accredited investor, as that term is defined in Rule 501(a) of Regulation D,[136] to be subject to an investment limitation? Why or why not?

44. Should the provisions at the federal level allow states to have greater flexibility in drafting exemptive provisions that in their judgment provide sufficient investor protections at the state level, whether or not such state law provisions include a maximum offering amount limitation or investor investment limitations? Why or why not?

45. As an additional or alternative requirement to the current requirements in proposed Rule 147, should we limit the availability of the exemption to issuers that have registered an offering in the state in which all of the purchasers are resident or that

[136] *See* 17 CFR 230.501(a).

conduct the offering pursuant to an exemption from state law registration in such state that requires the use of an intermediary? Why or why not?

46. Should we provide guidance about the operation of the intrastate broker-dealer exemption under the Exchange Act, including with respect to the use of the Internet in connection with offers and sales of securities? Why or why not? Should we permit intrastate broker-dealers to use the Internet to make interstate offers so long as all sales are limited to intrastate purchasers? Why or why not?

47. Should we adopt any minimum disclosure or delivery requirements for offerings that are conducted pursuant to the proposed rule that are offered pursuant to an exemption from state registration, such as narrative and/or financial statement disclosure and delivery requirements similar to the requirements of Rule 502(b) of Regulation D?[137] Should any potential disclosure or delivery requirements be limited to sales only to non-accredited investors? Why or why not?

48. Whether we adopt the proposed revisions to Rule 147 as amended Rule 147 or as a new rule, should we require a notice filing with the exemption? For example, if we repeal Rule 505 and adopt the exemption as new Rule 505, should we require issuers that conduct offerings pursuant to the new exemption to file offering related information with the Commission on a Form D? Why or why not? Should we instead adopt a new form to file offering related information that is similar to the information disclosed on Form D? If so, what information should that new form elicit?

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[137] 17 CFR 230.502(b).

C. Preservation of Section 3(a)(11) Statutory Intrastate Offering Exemption

The proposed amendments, if adopted, would not alter the fact that the Section 3(a)(11) statutory exemption continues to be a capital raising alternative for issuers with local operations seeking local financing. We believe, however, that it is possible that issuers will find it easier to satisfy the requirements of proposed Rule 147 than Section 3(a)(11).

The proposed amendments to Rule 147 would operate prospectively only. If adopted as proposed, Rule 147 would no longer be a safe harbor for conducting a valid intrastate exempt offering under Section 3(a)(11). An issuer that attempts to comply with amended Rule 147, but fails to do so, may claim any other exemption that is available. Failure to satisfy the requirements of amended Rule 147, however, would also likely result in a failure to satisfy the statutory requirements for the intrastate offering exemption under Section 3(a)(11) since the requirements of Section 3(a)(11) are more restrictive.

We recognize that none of the existing state crowdfunding provisions contemplate reliance upon the proposed amendments to Rule 147 and that states that have crowdfunding provisions based on compliance with Section 3(a)(11), or compliance with both Section 3(a)(11) and Rule 147, would need to amend these provisions in order for issuers to take full advantage of these amendments.[138] States that have adopted crowdfunding provisions based on current Rule 147 may need to consider the import of any final rule amendments at the federal level. We are seeking comment on how the amendments to Rule 147 would impact these provisions and whether it would be better if the proposed amendments to Rule 147 were adopted as a new exemption from registration, rather than as amendments to current Rule 147.

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[138] *See* note 25 and related discussion in Section 0 above.

Request for Comment

49. Should we leave existing Rule 147 in place and unchanged as a safe harbor for compliance with Section 3(a)(11) while adopting the proposed revisions to Rule 147 as a new rule instead? For example, if we were to repeal Rule 505 of Regulation D,[139] should the Commission adopt the proposed revisions to Rule 147 as new Rule 505 of Regulation D? If so, are there any additional changes to the proposed rule that should be made if it were to be adopted instead as a new rule? If so, please explain what changes are needed and why.

50. States that have adopted crowdfunding provisions based on current Rule 147 may need to consider the import of any final rule amendments at the federal level. How would the proposed amendments to Rule 147 impact these provisions? Would the Commission's rulemaking process, which in this case provides for a 60-day comment period, and the additional time before any final rules potentially would be adopted and thereafter become effective, provide sufficient time for states to consider and address the impact of the proposed amendments on their state law provisions? Why or why not? Please explain.

III. PROPOSED AMENDMENTS TO RULES 504 AND 505 OF REGULATION D

A. Overview of Rules 504 and 505

Rule 504[140] of Regulation D provides issuers with an exemption from registration for offers and sales of up to $1 million of securities in a twelve-month period, provided that the issuer is not:

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139 17 CFR 230.505. *See* discussion in Section 0 below.

140 17 CFR 230.504.

- subject to reporting pursuant to Section 13 or 15(d) of the Exchange Act;[141]
- an investment company;[142] or
- a development stage company that either has no specific business plan or purpose or that has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies ("blank check company").[143]

Additionally, Rule 504 imposes certain conditions, including limitations on the use of general solicitation or general advertising in the offering and the restricted status of securities issued pursuant to the exemption, with limited exceptions in this regard for offers and sales made:

- exclusively in one or more states that provide for the registration of the securities, and require the public filing and delivery to investors of a substantive disclosure document before sale that are made in accordance with state law requirements;
- in one or more states that have no provision for the registration of the securities or the public filing or delivery of a disclosure document before sale, if the securities have been registered in at least one state that provides for such registration, public filing and delivery before sale, offers and sales are made in that state in accordance with such provisions, and the disclosure document is delivered before sale to all purchasers (including those in the states that have no such procedure); or
- exclusively according to state law exemptions from registration that permit general solicitation and general advertising so long as sales are made only to "accredited investors" as defined in Rule 501(a) of Regulation D.[144]

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141 17 CFR 230.504(a)(1).

142 17 CFR 230.504(a)(2). Investment companies are companies that are registered or required to be registered under the Investment Company Act of 1940. 15 U.S.C. 80a-1 *et seq*.

Rule 504, together with Rules 505 and 506, comprise the Securities Act exemptions of Regulation D.[145] Adopted by the Commission in 1982,[146] Regulation D replaced three previously existing exemptions with a cohesive set of rules designed to:

- simplify existing rules and regulations;
- eliminate any unnecessary restrictions that those rules and regulations placed on issuers, particularly small businesses; and
- achieve uniformity between state and federal exemptions in order to facilitate capital formation consistent with the protection of investors.[147]

Regulation D offerings are exempt from the registration requirements of the Securities Act. Offerings conducted pursuant to Rule 504 or Rule 505, however, must be registered in each state in which they are offered or sold unless an exemption to state registration is available under state securities laws.[148] The vast majority of states require registration of Rule 504 offerings.[149] One state, however, recently adopted a form of state-based crowdfunding that permits the use of

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143 17 CFR 230.504(a)(3).

144 17 CFR 230.504(b)(1).

145 17 CFR §230.500 through 508. Rules 501 through 503 contain definitions, conditions, and other provisions that apply generally throughout Regulation D. Rules 504, 505 and 506(c) are exemptions from registration under the Securities Act, while Rule 506(b) is a "safe harbor" for compliance for the non-public offering exemption in Section 4(a)(2) of the Securities Act. Rule 507 disqualifies issuers from relying on Regulation D, under certain circumstances, for failure to file a Form D notice. Rule 508 provides a safe harbor for certain insignificant deviations from a term, condition, or requirement of Regulation D.

146 *See* SEC Rel. No. 33-6389 (Mar. 8, 1982) [47 FR 11251 (Mar. 16, 1982)].

147 *Id.* at 2.

148 Section 18(b)(4)(D) of the Securities Act provides "covered security" status to all securities sold in transactions exempt under Commission rules promulgated under Section 4(a)(2), which includes Rule 506 of Regulation D. Covered security status under Section 18 provides for the preemption of state securities laws registration and qualification requirements for offerings of such securities. In comparison, securities issued pursuant to either Rules 504 or 505 are not covered securities as these two exemptions are adopted pursuant to the Commission's authority under Section 3(b)(1) of the Securities Act.

149 New York and the District of Columbia do not require registration of Rule 504 offerings. *See* SEC Rel. No. 33-7644, 2 n.12 (Feb. 25, 1999) [64 FR 11090 (Mar. 8, 1999)] ("Seed Capital Release").

general solicitation, but still exempts the issuances of securities from state registration where, in addition to following various state-specific requirements to qualify for the exemption, an issuer also complies with Rule 504 of Regulation D.[150] Additionally, offerings conducted pursuant to Rules 505 and 506 are subject to bad actor disqualification provisions, while offerings conducted pursuant to Rule 504 are not subject to such provisions.[151]

B. Proposed Amendments to Rules 504 and 505

We propose to increase the aggregate amount of securities that may be offered and sold in any twelve-month period pursuant to Rule 504 from $1 million to $5 million and to disqualify certain bad actors from participation in Rule 504 offerings. We believe these amendments to Rule 504 will facilitate capital formation, result in increased efficiencies (and potentially lower costs) to issuers and increase investor protection. We also understand that state securities regulators have sought to expedite the state securities law registration process by developing coordinated review programs.[152] We believe these amendments could give state securities regulators greater flexibility to develop regional coordinated review programs that would rely on Rule 504 at the federal level by increasing the maximum amount of capital that can be raised by issuers under such programs and by providing states with assurance that certain bad actors would be excluded from the exemptive regime at the federal level. We further propose a technical

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150 Of the 29 states and the District of Columbia that have adopted intrastate crowdfunding provisions, only Maine allows an issuer to rely upon Rule 504 of Regulation D. *See* ME. REV. STAT. tit. 32, § 16304(6-A)(D) (2013).

151 *See* Rule 505(b)(2)(iii), 17 CFR 230.505(b)(2)(iii), and Rule 506(d), 17 CFR 230.506(d), of Regulation D.

152 For example, in order to address the potential inefficiencies associated with state law review and qualification of Regulation A offering statements, as highlighted by the GAO Report to Congress required under Title IV of the JOBS Act, state securities regulators and NASAA implemented a streamlined coordinated review program for Regulation A offerings that was designed to address many of the perceived concerns of market participants. *See* Factors that May Affect Trends in Regulation A Offerings, GAO-12-839 (July 2012) *available at*: http://www.gao.gov/assets/600/592113.pdf ("GAO Report"). *See also* note 11 above for a brief description of state coordinated review programs.

amendment to Rules 504 and 505 to account for the re-designation of Securities Act Section 3(b) as Section 3(b)(1) that occurred as a result of the enactment of the JOBS Act in 2012.[153] Additionally, in order to account for the proposed increase in the Rule 504 aggregate offering amount limitation, we propose technical amendments to the notes to Rule 504(b)(2) that would update the current illustrations in the rule regarding how the aggregate offering limitation is calculated in the event that an issuer sells securities pursuant to Rule 504 and Rule 505 within the same twelve-month period.[154] We also are seeking comment on whether any additional changes to Rule 504 should be made at this time that would further increase issuer capital formation options without any increase in risks to investors.

In light of the proposed changes to Rule 504, we also seek comment on the continued utility of Rule 505 as an exemption from registration. Rule 505 is used far less frequently than Rule 506, and an increase in the Rule 504 offering ceiling from $1 million to $5 million could diminish its utility.

The proposed amendments to Rule 504 would raise the aggregate amount of securities an issuer may offer and sell in any twelve-month period from $1 million to $5 million, which is the maximum statutorily allowed under Section 3(b)(1).[155] The Commission has not raised the 12-month aggregate offering limit in Rule 504 since 1988, when the Commission increased the original Rule 504 offering limit of $500,000 to $1 million.[156] We believe that raising the

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153 Pub. L. No. 112-106, 126 Stat. 306.

154 *See* Notes 1 and 2 to Rule 504(b)(2). [17 CFR 230.504(b)(2)].

155 Rules 504 and 505 were adopted pursuant to the Commission's small issues exemptive authority under Section 3(b)(1) of the Securities Act, which gives the Commission authority to adopt an exemption for offerings not exceeding $5 million where the Commission believes registration under the Securities Act is not necessary by reason of the small amount involved or the limited character of the public offering.

156 *See* SEC Rel. No. 33-6758 (Mar. 3, 1988) [53 FR 7870 (Mar. 10, 1988)]. *See also* discussion in Section 0 below.

aggregate offering limitation to the maximum statutorily allowed under Section 3(b)(1) would facilitate issuers' ability to raise capital. The proposed offering limitation would increase the flexibility of state securities regulators to set their own state offering limitations and to consider whether any additional requirements should be implemented at the state level. In addition, it would facilitate state efforts to increase the efficiencies associated with the registration of securities offerings in multiple jurisdictions through regional coordinated review programs.

Much like the deference that Congress provided to the states in the intrastate offering exemption under Section 3(a)(11), in adopting Rule 504, the Commission placed substantial reliance upon state securities laws and regulations.[157] As the Commission has stated previously, we believe that the size and local nature of the smaller offerings that are typically conducted by smaller issuers pursuant to Rule 504 does not warrant imposing extensive regulation at the federal level.[158]

The purpose of Rule 504 is to aid small businesses raising "seed capital."[159] Rule 504 permits eligible issuers[160] to offer and sell securities to an unlimited number of persons without regard to their sophistication, wealth or experience and, in certain circumstances, without delivery of any specified information.[161] These offerings are, however, subject to federal antifraud provisions and civil liability provisions[162] Securities issued under the exemption are

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157 Seed Capital Release at 1; *see also* SEC Rel. No. 33-6389 (Mar. 8, 1982) [47 FR 11251 (Mar. 16, 1982)].

158 Seed Capital Release, at 2.

159 *Id.* "Seed capital" refers to the initial investments that are typically made in newly formed startup companies in order to assist such companies with the beginning of their operations. These investments are usually relatively small in total dollar amounts.

160 *See* note 143 and related text in the discussion above.

161 Rule 504 permits sales to an unlimited number of accredited and non-accredited investors. *See* note 105 and related text in the discussion above.

162 Seed Capital Release, at 2. 15 U.S.C. 77*l*(a)(2).

restricted,[163] and the offering is subject to the prohibition against general solicitation and general advertising,[164] unless the rule's specified conditions permitting the issuance of freely tradable securities and a public offering are met.[165]

Similar to the rationale underlying our proposal to ease the eligibility requirements for issuers under Rule 147, increasing the Rule 504 offering limit to $5 million would create a larger federal exemptive framework for state regulators to tailor and coordinate among themselves state specific requirements for smaller offerings by smaller issuers that are consistent with their respective sovereign interests in facilitating capital formation and the protection of investors in intrastate and regional interstate securities offerings. Increasing the offering limit from $1 million to $5 million may also make the Rule 504 exemption more attractive to start-up companies seeking capital financing, as compared to alternative financing methods, as the legal and accounting expenses of the offering may be offset by the larger gross proceeds of the offering to the issuer.

In conjunction with our proposed increase to the Rule 504 aggregate offering amount limitation, we are proposing to adopt provisions that would disqualify certain bad actors from participation in offerings conducted pursuant to the exemption.[166] We believe that the proposed disqualification provisions, which are substantially similar to related provisions in Rule 506 of Regulation D,[167] would create a more consistent regulatory regime across Regulation D that would benefit investors in Rule 504 offerings with increased protections. We also believe that

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163 *See* Rule 504(b)(1) [17 CFR 230.504(b)(1)]; Rule 144(a)(3)(ii) [17 CFR 230.144(a)(3)(ii)].

164 *See* Rule 504(b)(1) [17 CFR 230.504(b)(1)]; Rule 502(c) [17 CFR 230.502(c)].

165 *See* note 144 and related text in the discussion above.

166 *See* proposed Rule 504(b)(3).

167 *See* 17 CFR 230.506(d). *See also* Rule 262 of Regulation A, 17 CFR 230.262, and Rule 505(b)(2)(iii) of Regulation D, 17 CFR 230,505(b)(2)(iii).

our proposed rule amendments may bolster efforts among the states to enter into, or revise existing, regional coordinated review programs that are designed to increase efficiencies associated with the registration of securities offerings in multiple jurisdictions without increasing risks to investors.

The proposed Rule 504 disqualification provisions would be implemented by reference to the disqualification provisions of Rule 506 of Regulation D.[168] We believe that creating a uniform set of bad actor triggering events across the various exemptions from Securities Act registration should simplify due diligence, particularly for issuers that may engage in different types of exempt offerings. As proposed, the bad actor triggering events for Rule 504 would be substantially similar to existing provisions in Regulation D,[169] Regulation A,[170] and those adopted today in Regulation Crowdfunding[171] and would apply to the issuer and other covered persons (such as underwriters, placement agents, and the directors, officers and significant shareholders of the issuer). Consistent with the Commission's treatment of disqualification in Rule 506(e), we propose that disqualification would only occur for triggering events that occur after effectiveness of any rule amendments,[172] but disclosure would be required for triggering events that pre-date effectiveness of any rule amendments.[173]

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168 *See* proposed Rule 504(b)(3), referencing the disqualification provisions of Rule 506(d), 17 CFR 230.506(d), and note to proposed Rule 504(b)(3), referencing the disclosure provisions of Rule 506(e), 17 CFR 230.506(e).

169 *See* Rules 505(b)(2)(iii) and 506(d) of Regulation D, 17 CFR 230,505(b)(2)(iii), 230.506(d).

170 *See* Rule 262 of Regulation A, 17 CFR 230.262.

171 *See* Rule 503 of Regulation Crowdfunding.

172 *See* proposed Rule 504(b)(3).

173 *See id.*

Issuers have overwhelmingly relied upon Rule 506 instead of Rule 504 for offerings of $1 million or less.[174] As discussed more fully in Section V below, data suggests that this may be due to the preemption of state registration requirements, which is available to Rule 506 offerings, but not Rule 504 or 505 offerings.[175] State regulators seeking to modernize and coordinate their regulatory regimes to facilitate early-stage capital financings may benefit from the proposed changes to Rule 504.

We also are seeking public comment on whether additional changes to Rule 504 should be adopted in the final amended rules. In particular, in conjunction with the proposed increase in the Rule 504 offering amount limitation, we are contemplating amending the calculation of the aggregate offering limitation in Rule 504(b)(2).[176] Currently, this rule requires issuers to aggregate all securities sold within the preceding 12 months in any transaction that is exempt under Section 3(b) or in violation of Section 5(a) of the Securities Act for purposes of computing the aggregate offering price under Rule 504.[177] This rule also includes illustrations of how the

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174 For the period 2009 through 2014, 34,705 Form D filings were made for offerings of less than $1 million, of which 3,719 reported an offering made in reliance upon Rule 504. This represented 11% of all Regulation D offerings raising less than $1 million. During this time period, 30,461 Form D filings reported an offering made in reliance upon Rule 506, representing 88% of all Regulation D offerings raising less than $1million. Only 525 Form D filings reported reliance upon Rule 505, representing only 2% of all Regulation D offerings during this time period raising less than $1 million. *See* Scott Bauguess, Rachita Gullapalli and Vladimir Ivanov, "Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009–2014" (October 2015) ("Unregistered Offerings White Paper"), *available at* http://www.sec.gov/dera/staff-papers/white-papers/unregistered-offering10-2015.pdf.

175 *Id*. The data on Regulation D offerings for the period from 2009 through 2014, suggests that the preemption of state securities laws registration and qualification requirements, which is unique to Rule 506 offerings in Regulation D, may be of greater value to issuers than the unique features of either Rules 504 or 505. Data suggests that Rule 506 is the dominant offering method even among those offerings eligible for Rules 504 or 505. Almost 50% of all Rule 506 offerings by non-funds issuers since 2009 were for $1 million or less and therefore may have qualified for the Rule 504 exemption based on offering size. An additional 20% of offerings were for between $1 million and $5 million and therefore could have claimed a Rule 505 exemption based on offering size.

176 We seek comment below on whether, if Rule 505 is retained in the final rules, a corresponding change should be made to Rule 505(b)(2), 17 CFR 230.505(b)(2). *See* Request for Comment 0 below.

177 17 CFR 230.504(b)(2); *see also* 17 CFR 230.505(b)(2).

aggregate offering limitation is calculated in the event that an issuer sells securities pursuant to Rule 504 and Rule 505 within the same twelve-month period.[178]

When the current aggregation provisions in Rules 504 and 505 were originally adopted in Rule 505's predecessor Rule 242, the Commission noted that aggregating offering amounts across offerings conducted pursuant to Section 3(b) was intended to "limit[] the potential for the issuer to raise large sums by circumventing the registration provisions of the Securities Act through multiple offerings pursuant to Section 3(b)."[179] In the intervening years, however, in implementing Congressional mandates,[180] the Commission has increased the potential for issuers, particularly smaller issuers, to raise large sums of capital in offerings that are exempt from registration in a more cost-effective manner, while continuing to provide appropriate safeguards for investors.[181] Therefore, we are seeking comment on whether the current requirements for Rule 504(b)(2), as they relate to the aggregation of offering proceeds across all offerings that are conducted pursuant to Securities Act Section 3(b), should be retained in the amended rules.

The Commission has brought a number of enforcement actions in recent years against persons that have sought to use the provision in Rule 504(b)(1)(iii) permitting conditional use of general solicitation and general advertising to engage in fraudulent offerings.[182] In light of the

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178 *See* Notes 1 and 2 to Rule 504(b)(2). [17 CFR 230.504(b)(2)].

179 SEC Rel. No. 33-6180 (Jan. 17, 1980). This provision was subsequently carried over into Rule 505 and adopted into Rule 504 when Regulation D was adopted by the Commission in 1982. *See* SEC Rel. No. 33-6389 (March 8, 1982); SEC Rel. No. 33-6339 (Aug. 7, 1981).

180 *See* JOBS Act, Pub. L. No. 112-106, 126 Stat. 306.

181 *See, e.g.*, Regulation A, 17 CFR 230.251 *et seq.*, providing non-Exchange Act reporting companies with the option to raise up to $20 million annually pursuant to the requirements of Tier 1 and up to $50 million annually pursuant to the requirements of Tier 2.

182 *See, e.g.*, SEC v. Stephen Czarnik, Case No. 10-cv-745 (S.D.N.Y.), Litigation Release No. 21401 (Feb. 2, 2010); SEC v. Yossef Kahlon, a/k/a Jossef Kahlon and TJ Management Group, LLC, Case No. 4:12-cv-517 (E. D. Tex.) (Aug. 14, 2012).

foregoing, we also are seeking comment on whether we should adopt additional changes to Rule 504 that could potentially increase investor protections in such offerings. In particular, we are considering, and seeking comment on, whether limitations on resale should be imposed on securities sold in reliance on Rule 504(b)(1)(iii) or whether Rule 504(b)(1)(iii) should be repealed.[183]

Lastly, we propose certain technical amendments to Rules 504 and 505. We propose a technical amendment to Rule 504(b)(2), and its related provision in Rule 505(b)(2), that would update the reference to Securities Act Section 3(b) to Section 3(b)(1). This technical revision is necessary in light of the re-designation of Section 3(b) as Section 3(b)(1) that occurred as a result of the Securities Act amendments in Title IV of the JOBS Act.[184] Additionally, we propose technical amendments to the notes to Rule 504(b)(2) that would update the current illustrations of how the aggregate offering amount limitation is calculated in the event that an issuer sells securities pursuant to Rule 504 and Rule 505 within the same twelve-month period.[185] This technical revision is necessary in order to account for the proposed increase to the Rule 504 aggregate offering amount limitation.

Request for Comment

As proposed, should we increase the Rule 504 offering limit from a maximum of $1 million of securities in a twelve-month period to a maximum of $5 million of

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183 Any such amendment would not affect the resale status of securities sold under the exemptions in Rules 504(b)(1)(i) and 504(b)(1)(ii), which exempt certain offerings of securities that are registered under a state securities law that requires the public filing and delivery of a disclosure document to investors before sale. As such, the resale limitations of Rule 502(d) would continue not to apply to securities sold in transactions that are exempted by those rules and those securities would not be "restricted securities" for purposes of Rule 144.

184 Pub. L. No. 112-106, 126 Stat. 306, at Sec. 401.

185 *See* Notes 1 and 2 to proposed Rule 504(b)(2).

securities in a twelve-month period? Why or why not? Should we adopt a higher or lower aggregate offering limit? If so, what should the aggregate offering limit be and why? For example, should we use our general exemptive authority to adopt a $20 million annual offering limit in Rule 504 that aligns with the maximum offering limit permitted under Tier 1 of Regulation A? **52.**

52. Would the proposed increase in the Rule 504 aggregate offering amount limitation give state securities regulators greater flexibility to develop regional coordinated review programs that would rely on Rule 504 at the federal level? Why or why not? What additional changes, if any, could we make to Rule 504 in order to facilitate efforts by state securities regulators to develop robust coordinated review programs that include appropriate investor protections and encourage capital formation?

53. Should we amend Rule 504, as proposed, to include bad actor disqualification provisions that align with those included in Rule 506(d) of Regulation D? Why or why not?

54. As proposed, should issuers only be disqualified from reliance on Rule 504 for bad actor disqualifying events that occur after the effectiveness of any final rule amendments? Why or why not?

55. If we adopt bad actor disqualification provisions for Rule 504 offerings, should we require issuers to provide disclosure to purchasers of any bad actor disqualifying events that occur before effectiveness of any final rule amendments as proposed? Why or why not?

56. Should we amend the method by which an issuer calculates compliance with the Rule 504 aggregate offering amount limitation to remove the reference to other

offerings conducted pursuant to Section 3(b)(1)? Or should we instead continue to require issuers to aggregate Rule 504 offerings with all offerings conducted within the prior twelve-month period pursuant to Section 3(b)(1) and/or in violation of Section 5(a) when calculating the offering amount limitation? Why or why not? Should offerings made in violation of Section 5(a) be aggregated in all instances?

57. Are there additional changes to Rule 504 that would increase the general utility of the exemption or provide additional investor protections? If so, please explain.

58. Should Rule 504 be available to Exchange Act reporting companies? Why or why not?

59. Should securities sold in reliance on Rule 504(b)(1)(iii) pursuant to a state law exemption that permits general solicitation and general advertising so long as sales are made only to accredited investors be subject to the limitations on resale in Rule 502(d) and, as such, be deemed "restricted securities" for purposes of Rule 144? Alternatively, should we adopt a requirement, similar to proposed Rule 147(e),[186] that would require the securities to come to rest within such state by only prohibiting resales to out of state residents for a period of nine months after such securities are purchased by an investor? Why or why not?

60. Are there other amendments we should make to Rule 504(b)(1)(iii) to address concerns about potential abuse of this provision? Please explain.

61. Should we repeal Rule 504(b)(1)(iii), in light of our proposed revisions to Rule 147? With the exception of the unrestricted status of securities sold pursuant to

[186] *See* proposed Rule 147(e) and related discussion in Section II.B.4.c above.

Rule 504(b)(1)(iii), what value would this rule continue to provide to issuers and investors?

C. Continued Utility of Rule 505 as an Exemption from Registration

As noted above, in light of the proposed changes to Rule 504, we also are seeking comment on the continued utility of Rule 505 as an exemption from registration. Rule 505 is used far less frequently than Rule 506, and an increase in the Rule 504 offering ceiling from $1 million to $5 million could diminish its utility. Rule 505 is available to both non-reporting and reporting issuers,[187] so long as the aggregate offering amount does not exceed $5 million in any twelve-month period.[188] An issuer relying upon Rule 505 may not engage in general solicitation or general advertising and securities issued under the exemption are restricted securities.[189]

Issuers relying upon Rule 505 are subject to additional conditions not required under Rule 504, such as the following:

- Sales to no more than 35 non-accredited investors and an unlimited number of accredited investors;[190]
- Delivery of a disclosure document to non-accredited investors[191] that generally contains the same information as included in a Securities Act registration statement.[192]

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187 Rule 505 is available to any issuer that is not an investment company.

188 As with Rule 504, the aggregate offering price includes proceeds from offers and sales under Section 3(b) or in violation of Section 5(a) of the Securities Act. *See* note 176 above.

189 *See* Rule 505(b), 17 CFR 230.505(b).

190 Rule 505(b)(2)(ii), 17 CFR 230.505(b)(2)(ii).

191 Rule 505(b)(1), 17 CFR 230.505(b)(1). An issuer may decide what information to give to accredited investors, subject to the antifraud provisions of the federal securities laws. If the issuer provides information to accredited investors, it must make this information available to the non-accredited investors as well. As noted in Section 0 above, however, certain offerings conducted pursuant to Rule 504 also require the delivery of a disclosure document to investors, as required under state law.

192 Financial statements required to be provided to non-accredited investors under Rule 502(b) must be audited by a certified public accountant. As indicated in the note to Rule 502(b)(1), "issuers providing required

- Disqualification of felons and other "bad actor" from participating in the offering.[193]

With the exception of the offering limitation contained in Rule 505, the Rule 505 requirements are substantially similar to the requirements of Rule 506.[194] Nevertheless, issuers have overwhelmingly elected to rely upon Rule 506 instead of 505, including in offerings of up to $5 million.[195] As discussed more fully in Section V below, data from Forms D filed with the Commission suggest that the preemption of state securities law registration and qualification requirements available only to issuers relying upon Rule 506 may offset the unique features of Rule 504 or 505 offerings.[196]

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information to non-accredited investors should also consider providing such information to accredited investors as well, in view of the antifraud provisions of the federal securities laws."

193 Rule 505(b)(2)(iii) refers to the disqualification provisions of Rule 262 of Regulation A. Issuers relying upon Rule 506 of Regulation D are also subject to similar disqualification provisions under Rule 506(d) of Regulation D. While not currently applicable to Rule 504 offerings, we propose to adopt bad actor disqualification provisions for Rule 504 that would be substantially similar to those applicable to Rule 506 offerings. *See* discussion Section 0 above.

194 Unlike Rule 504, Rule 505 is available to companies that are subject to the requirements of Section 13 or 15(d) of the Exchange Act, as well as to development stage companies that either have no specific business plan or purpose or have indicated that their business plan is to engage in a merger or acquisition with an unidentified company or companies. Data suggests, however, that less the 4% of all issuers during the 2009-2014 period that conducted Rule 505 offerings were Exchange Act reporting companies (50 companies out of a total of 1337 companies).

195 For the period 2009 through 2014, 65,514 offerings on Form D were filed for offerings raising less than $5 million, of which 1,368 filings reported an offering made in reliance upon Rule 505 of Regulation D, representing only 2% of all offerings made in reliance upon Regulation D during this time period, and 60,427 Form D filings reported an offering made in reliance upon Rule 506, representing approximately 92% of all offerings reporting reliance upon Regulation D during this time period. Variations in percentages are due to reporting errors and issuers ability to claim more than one exemption on the Form D. Issuers also overwhelmingly relied upon Rule 506 instead of Rule 504 when undertaking offerings for $1 million or less. *See* discussion on the use of Rule 504 in Section V.B.0 below.

196 *See* note 175 and related text in the discussion above. For the period 2009 through 2014, $5.773 trillion was raised under Regulation D of which 0.1% was raised in reliance on Rule 504, 0.1% was raised in reliance on Rule 505, and at least 99.2% was raised in reliance on Rule 506 (we do not have data with respect to the remaining 0.6% of aggregate capital raised under Regulation D). During the same time period, there were 118,846 new and continuing offerings under Regulation D of which 3.3% were made in reliance on Rule 504, 1.2% were made in reliance on Rule 505, and at least 94.8% were made in reliance on Rule 506 (we do not have data with respect to the remaining 0.7% of new and continuing offerings made under Regulation D during this time period). In 2014, Rule 505 offerings represented 1.48% of all new Regulation D offerings and 0.04% of all aggregate capital raised under Regulation D.

Amending Rule 504 to allow for a larger aggregate offering amount of up to $5 million may reduce the incentives to use Rule 505 by issuers contemplating an exempt offering. Absent additional amendments to Regulation D, if we were to eliminate Rule 505, Regulation D would be limited to two offering exemptions, Rule 504 and Rule 506. Rule 504 would be available only to non-reporting issuers[197] that are not investment companies[198] or development stage companies[199] for offerings of up to $5 million in a twelve-month period and would permit general solicitation and the issuance of unrestricted securities in certain limited situations. Rule 506 would be available to all issuers without any aggregate offering limitations and would permit the issuance of only restricted securities, while allowing general solicitation under certain limited circumstances.[200] We are seeking comment on the utility of Rule 505 in light of the proposed changes.

Request for Comment

62. Should we repeal Rule 505? Why or why not?

63. If Rule 505 is retained, should it be modified in some manner? For example, if we amend the manner in which the aggregate offering amount limitation is calculated in Rule 504 offerings, should we make a corresponding change to the manner in which the Rule 505 aggregate offering amount limitation is calculated?[201] What additional changes, if any, should be made to the rule?

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197 *See* 17 CFR 230.504(a)(1).

198 *See* 17 CFR 230.504(a)(2).

199 *See* 17 CFR 230.504(a)(3).

200 In such scenario, Rule 505 of Regulation D would be repealed and reserved.

201 *See* discussion in Section 0 and request for comment 0 above.

64. Should Rule 505 be replaced with a new Securities Act exemption having, any, or all, of the following features:

- early-stage capital formation as its primary purpose;
- eligibility only for non-Exchange Act reporting issuers;
- subject to the anti-fraud provisions of the federal securities laws and the civil liability provisions of Section 12(a)(2) of the Securities Act;
- exempting holders of the securities from the registration requirements of Section 12(g) of the Exchange Act;
- a relatively low maximum aggregate offering amount over a 12-month period, such as $100,000;
- a limit on the maximum investment amount per investor, such as $2,000;
- a higher maximum investment amount for more sophisticated investors, based on criteria, such as net worth, net income or some other proxy for investment sophistication;
- "covered security" status under Section 18 of the Securities Act by either enacting a new "safe harbor" pursuant to Securities Act Section 4(a)(2) or by defining purchasers of securities issued in an offering pursuant to the exemption as "qualified purchasers," pursuant to Securities Act Section 18(b)(3);
- additional or alternative criteria?

65. Alternatively, whether or not we repeal Rule 505 and if, as proposed, we increase the aggregate offering amount that may be raised pursuant to Rule 504 to $5 million of securities in a twelve-month period, should the amendments to Rule 504 include some of the provisions currently required by Rule 505? If so, which ones and why?

Should any such requirement of current Rule 505 only be required if the Rule 504 offering exceeds a certain aggregate offering amount of securities, such as the Rule 504 current annual offering limit of $1 million or some other amount?

IV. GENERAL REQUEST FOR COMMENT

We solicit comment, both specific and general, on each component of the proposals. We request and encourage any interested person to submit comments regarding:

- the proposals that are the subject of this release;
- additional or different revisions to the rules discussed above; and
- other matters that may have an effect on the proposals contained in this release.

Comment is solicited from the point of view of both issuers and investors, as well as of capital formation facilitators, such as broker-dealers, and other regulatory bodies, such as state securities regulators. Any interested person wishing to submit written comments on any aspect of the proposal is requested to do so. With regard to any comments, we note that such comments are of particular assistance to us if accompanied by supporting data and analysis of the issues addressed in those comments. We urge commenters to be as specific as possible.

V. ECONOMIC ANALYSIS

This section analyzes the expected economic effects of the proposed amendments relative to the current baseline, which is the regulatory framework and state of the market[202] in existence today, including current methods available to potential issuers to raise capital up to $5 million.

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[202] The term "market" as used throughout this economic analysis refers to capital markets in general, and where discussed in the context of a specific rule, relates to the provisions of the relevant exemption or safe harbor. We refer, for example, to the Rule 147 and Rule 504 exemptions as the Rule 147 and Rule 504 markets because each of those rules' provisions prescribe requirements that determine who can participate and how the participants (issuers/investors/intermediaries) can engage in transactions under each exemption. Participants face different trade-offs when choosing between the markets created by each of the exemptions and safe harbors.

We are mindful of the costs imposed by, and the benefits obtained from, our proposed amendments. Relative to this baseline, our analysis considers the anticipated benefits and costs for market participants affected by the proposed amendments as well as the impact of the proposed amendments on efficiency, competition, and capital formation.[203] We also analyze the potential benefits and costs stemming from alternatives to the proposed rule amendments that we considered. Many of the benefits and costs discussed below are difficult to quantify, especially when analyzing the likely effects of the proposed amendments on efficiency, competition, and capital formation. For example, it is difficult to precisely estimate the extent to which the proposed amendments to Rule 147 would promote future reliance by issuers on this exemption, or the extent to which future use of Rule 147 would affect the use of other offering methods. Similarly, it is difficult to quantify the effect of the proposed amendments on investor protection. Therefore, much of the discussion in this section is qualitative in nature. However, where possible, we have attempted to quantify the expected effects of the proposed amendments.

A. Baseline

The proposed amendments would primarily impact the financing market for startups and small businesses.[204] The baseline for our economic analysis of the proposed amendments to Rule 147 and Rule 504 — including the baseline for our consideration of the effects of the proposed amendments on efficiency, competition and capital formation — is the regulatory framework and market structure in existence today, in which startups and small businesses

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[203] Securities Act Section 2(b) requires us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. *See* 15 U.S.C. 77b(b).

[204] In 2013, there were more than 5 million small businesses defined by the U.S. Census Bureau as having fewer than 500 paid employees. *See* U.S. Department of Commerce, United States Census Bureau,

seeking to raise capital through securities offerings must register the offer and sale of securities under the Securities Act, unless they can rely on an existing exemption from registration under the federal securities laws. In addition to a description of the type and number of issuers that currently offer and sell securities in reliance on the Rule 147 and Rule 504 exemptions, our analysis includes a description of investors who purchase or may consider purchasing such securities and a discussion of the role of intermediaries in such offerings.

1. Current Market Participants

As discussed above, existing Rule 147 is a safe harbor for complying with the intrastate offering exemption provided by Section 3(a)(11) of the Securities Act. Consistent with the statutory exemption, Rule 147 imposes no offering amount limit but requires that issuers offer and sell securities to residents of the same state or territory in which the issuer is resident. In addition, issuers seeking to rely on the safe harbor must satisfy certain prescriptive threshold requirements to be considered "doing business" in-state. Existing Rule 504 limits the offering amount to $1 million in a 12-month period and permits general solicitation under certain conditions, such as that offers and sales are made exclusively in one or more states that provide for securities registration and the public filing and delivery to investors of a substantive disclosure document before sale.[205] Table 1 summarizes the main characteristics of Rule 147 and Rule 504.

Table 1: Main Characteristics of Existing Rule 147 and Rule 504

Business Dynamics Statistics, Data: Firm Characteristics (2013), *available at* http://www.census.gov/ces/dataproducts/bds/data_firm.html.

[205] *See* Section III.A above.

Type of Offering	Offering Limit[206]	Solicitation	Issuer and Investor Requirements	Filing Requirement	Restriction on Resale	Blue Sky Law Preemption
Rule 147	None	Only intrastate solicitation	All issuers must be incorporated and "doing business" in state. All investors must be residents in state.	None	Interstate resales are restricted for nine months from the later of the last sale in, or the completion of, the offering[207]	No
Rule 504 Regulation D	$1 million	General solicitation permitted in certain cases[208]	Excludes investment companies, blank-check companies, and Exchange Act reporting companies	File Form D[209]	Restricted in some cases[210]	No

The proposed amendments to Rule 147 and Rule 504 would primarily affect securities issuers, particularly startups and small businesses that rely on unregistered offerings under these and other exemptions to raise capital, and accredited and non-accredited investors in unregistered offerings.

a. Issuers

i. Rule 147 Issuers

206 Aggregate offering limit on securities sold within a 12-month period.

207 Rule 147(e), 17 CFR 230.147(e). Additional resale restrictions may apply under state securities laws, which typically restrict in-state resales for a period of one-year.

208 No general solicitation or advertising is permitted unless the offering is registered in a state requiring the use of a substantive disclosure document or sold under a state exemption for sales to accredited investors with general solicitation.

209 Filing is not a condition of the exemption, but it is required under Rule 503.

210 Restricted unless the offering is registered in a state requiring the use of a substantive disclosure document or sold under a state exemption limiting sales only to accredited investors.

Under current Rule 147, there are no restrictions on the type of issuers that can utilize the safe harbor, and there is no limit on the amount of capital that can be raised. However, there are in-state residency and eligibility requirements that an issuer must satisfy in order to rely on Rule 147. Eligible issuers are those that are incorporated or organized in-state, have their "principal office" in-state, and can satisfy three 80% thresholds concerning their revenues, assets and use of net proceeds.

While we do not have access to data on the number and size of offerings,[211] the amount of capital raised, and the type of issuers currently relying on the Rule 147 safe harbor, the nature of the eligibility requirements leads us to believe that the rule is currently being used by U.S. incorporated firms that are likely small businesses seeking to raise small amounts of capital without incurring the costs of registering with the Commission.

Currently, issuers that intend to conduct intrastate crowdfunding offerings are required to use Rule 147 by most of the states that have enacted crowdfunding provisions.[212] Based on information from NASAA,[213] as of September 2015, 29 states and the District of Columbia have enacted state crowdfunding provisions, and more states are expected to promulgate similar provisions in the near future. Since December 2011, when the first state (Kansas) enacted its crowdfunding provisions, 118 state crowdfunding offerings have been reported to be filed with

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211 Unlike Regulation D, which requires the filing of a Form D, Rule 147 does not require any filing with the Commission, and we thus have no source of reliable data about the prevalence and scope of Rule 147 offerings.

212 *See* http://www.nasaa.org/industry-resources/corporation-finance/instrastate-crowdfunding-resource-center/intrastate-crowdfunding-directory/.

213 *See* NASAA's Intrastate Crowdfunding Resource Center at http://www.nasaa.org/industry-resources/corporation-finance/instrastate-crowdfunding-resource-center/. *See also* http://www.nasaa.org/industry-resources/corporation-finance/instrastate-crowdfunding-resource-center/intrastate-crowdfunding-directory/. .

the respective state regulator.[214] Of these offerings, 102 were reported to be approved or cleared, as of August 1, 2015. Most of the cleared offerings were in Georgia, Michigan, Oregon, Kansas and Indiana.

Given that almost all the enacted state crowdfunding provisions currently exclude reporting companies and entities defined as an investment company under the Investment Company Act of 1940, we expect that issuers that rely on Rule 147 are likely operating companies ("non-fund issuers"). While information on the size of these issuers is not available, data from NASAA shows that most issuers are from varied industries such as agriculture, manufacturing, business services, retail, entertainment, and technology.

We anticipate that many potential issuers of securities under proposed Rule 147, particularly those utilizing Rule 147 for intrastate crowdfunding, will continue to be small businesses, early stage firms and start-ups that are close to the "idea" stage of the business venture. Some of these issuers may lack business plans that are sufficiently developed to attract venture capitalists (VCs) or angel investors that invest in high risk ventures, or may not offer the profit potential or business model to attract such investors.[215]

ii. Rule 504 and Rule 505 Issuers

Rule 504 of Regulation D provides an exemption from registration under Section 3(b)(1) of the Securities Act for offerings that do not exceed $1 million during a 12-month period. An analysis of Form D filings indicates that reliance on Rule 504 exemptions has been declining over time. As shown in Figure 1, while offerings under Rule 506 of Regulation D grew

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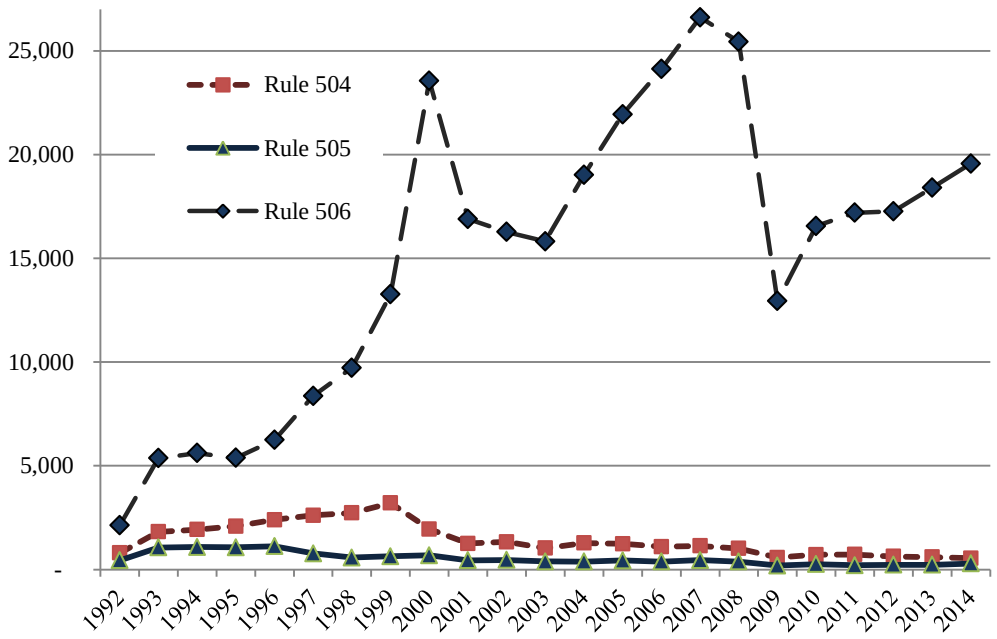
214 *Id*. The jurisdictions included in the estimate are Alabama, District of Columbia, Georgia, Idaho, Indiana, Kansas, Maine, Maryland, Massachusetts, Michigan, Oregon, Texas, Vermont, Washington and Wisconsin.

215 In this regard, a study of one large crowdfunding platform revealed that relatively few companies on that platform operate in technology sectors that typically attract VC investment activity. *See* Ethan R. Mollick, *The Dynamics of Crowdfunding: An Exploratory Study* (Working Paper) (June 26, 2013), *available at*

significantly from 1993 to 2014, offerings under Rule 504 and Rule 505 in 2014 were one quarter of 1993 levels. In addition, while offering activity under Rule 504 has been higher than under the Rule 505 exemption, the number of new Rule 504 offerings peaked in 1999, with 3,402 new offerings initiated, and steeply declined afterward. Compared to the early 1990s when Rule 504 offerings constituted approximately 28% of all new Regulation D offerings, the proportion of Rule 504 offerings between 2009 and 2014 ranged between 3% and 4% of all new Regulation D offerings.

Figure 1: Number of New Offerings under Regulation D Exemptions[216]



The current limited use of the Rule 504 exemption and the predominance of Rule 506 are also evident when we consider the total amount raised in offerings under each of these

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2088298.

216 Data is not readily available for the period 2002−2008 during which Form D was a paper-based filing. The form became available electronically in March 2009. Since the data for year 2009 is only for the period April to December, the number of new Regulation D offerings shown is underestimated for 2009.

exemptions. Overall, capital formation in the Rule 504 market constituted approximately 0.1% of the capital raised in all Regulation D offerings initiated during 2009−2014.[217] Considering only Regulation D offerings of up to $1 million (the maximum amount that a Rule 504 offering can raise in a year) initiated by non-fund issuers, the share of Rule 504 offerings was slightly higher at 7%.

During the period 2009−2014, issuers relying on the Rule 504 exemption were predominantly non-fund issuers. As shown in Table 2, less than 3% of new Rule 504 offerings during 2009-2014 were initiated by fund issuers.[218] Similarly, between 2009 and 2014, the amounts raised by fund issuers in both new and continuing[219] Rule 504 offerings constituted a small proportion (1% to 6%) of amounts reported to be raised in all Rule 504 offerings.

Table 2: Rule 504 Capital Raising Activity, 2009−2014

	Number of Offerings	Proportion by Non-Fund Issuers	Total Amount Raised ($ million)	Proportion by Non-Fund Issuers
2009	579	98%	91	94%
2010	714	99%	131	99%
2011	721	98%	113	99%
2012	632	98%	109	96%
2013	599	96%	97	94%
2014	544	97%	94	96%

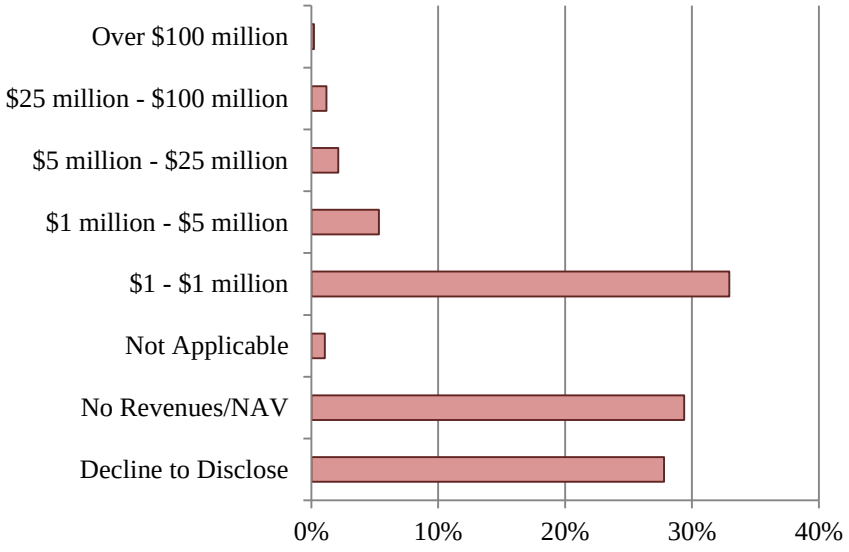
217 *See* Unregistered Offerings White Paper.

218 Based on an analysis of Form D filings. Our analysis uses the same assumptions and methodologies described in Unregistered Offerings White Paper, note 174 above.

219 These offerings were initiated in previous years and continued raising capital in subsequent years. In order to accurately capture the level of capital formation under the Rule 504 exemption, we consider capital raised during a year by new offerings as well as incremental capital raised during the year by continuing offerings.

Figure 2 shows the size of Rule 504 issuers during the period 2009−2014.[220] Of all the issuers that disclosed their size in their Form D filings (approximately 80% of all Rule 504 issuers), more than three quarters of offerings were initiated by issuers that had no revenues, or had revenues or net asset values of less than $1 million. From this reported size, we believe that a vast majority of Rule 504 issuers likely consist of startups and small businesses. The small size of issuers is also reflected in the average age of issuers, as measured by years since incorporation. Based on Form D filings, 51% of Rule 504 issuers initiated their offerings during the year of their incorporation or in the subsequent year. Another 14% of issuers initiated their offerings between two and three years since incorporation.[221]

Figure 2: Size of Rule 504 Issuers, 2009−2014



Most Rule 504 issuers in the past five years reported to operate in the technology, real estate or other industry (Figure 3).[222]

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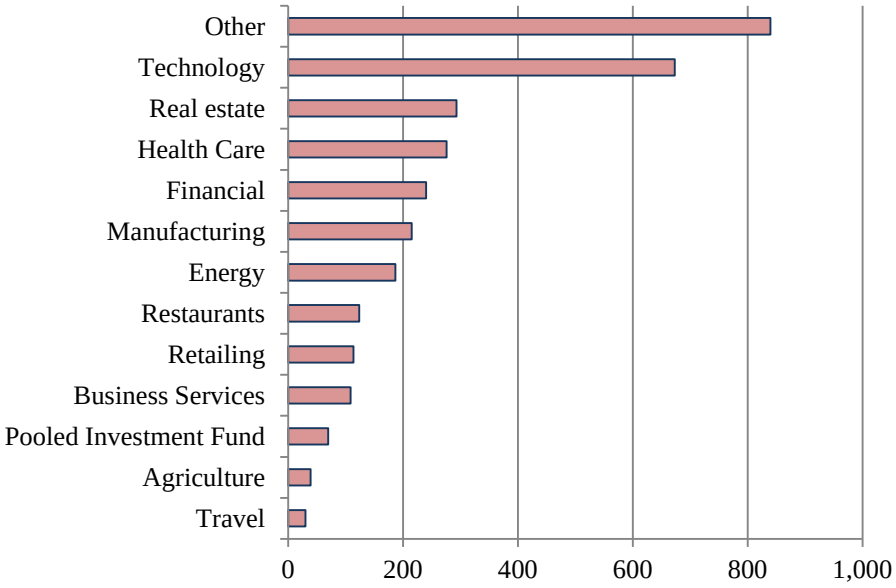
220 Based on an analysis of Form D filings.

221 *Id.*

222 *Id.*

Figure 3: Rule 504 Offerings by Industry, 2009-2014



As reported in Form D filings, during the period 2009-2014, Rule 504 issuers had their principal place of business in California (22%), followed by Texas, New York, Florida, Colorado and Illinois, though most were incorporated in Delaware (19%), California (14%) and Nevada (10%). In addition, approximately 32% of the Rule 504 offerings had separate states of incorporation and principal places of business. While only approximately 2% of Rule 504 offerings were initiated by foreign-incorporated issuers, a larger number (5%) reported their principal place of business to be outside the United States. In addition, approximately 90% of issuers in the Rule 504 market initiated only one offering, and approximately 83% of such offerings were of equity securities during the period 2009−2014.

b. Investors

Currently, Rule 147 limits offers and sales to residents of the same state as the issuer. There are no other limitations on who can invest in Rule 147 and Rule 504 offerings. Although the Commission does not track data concerning investors participating in Rule 147 offerings, data from Form D filings provide some insights into the number and type of investors in

Rule 504 offerings.

Table 3 below, shows that almost 31,000 investors participated in new Rule 504 offerings initiated during the period 2009−2014.[223] An analysis of Form D filings indicates that the average and median number of investors in Rule 504 was approximately 11 and 4, respectively.

Table 3: Number and Type of Investors in Rule 504 Offerings, 2009−2014

	Total Investors	Average number of investors	% Offerings with Non-Accredited Investors
2009	4,004	9	53%
2010	5,427	10	54%
2011	5,512	11	57%
2012	6,295	13	58%
2013	5,573	13	61%
2014	3,996	10	60%
2009-2014	30,807	11	57%

Offerings that involved non-accredited investors between 2009 and 2014 were typically smaller and, on average, had fewer investors than those offerings that involved only accredited investors. The presence of non-accredited investors was larger in Rule 504 offerings, where the number of non-accredited investors is not limited, than in Rule 505 or Rule 506 offerings, where the number of non-accredited investors is limited to 35. Table 3 above shows that approximately 57% of Rule 504 offerings during 2009−2014 reported having sold, or intending to sell, to non-accredited investors.[224] These offerings, on average, had 16 investors, compared to 8 investors in Rule 504 offerings that reported not having sold or intending to sell to non-accredited investors.[225]

223 Based on an analysis of Form D filings. *See also* Unregistered Offerings White Paper.

224 *Id*.

225 Based on an analysis of Form D filings.

We believe, given investment limitations under state crowdfunding provisions, that many investors affected by the proposed amendments to Rule 147 would likely be individual retail investors whose broad access to potentially riskier investment opportunities in early-stage ventures is currently limited, either because they do not have the necessary accreditation or sophistication to invest in most private offerings or because they do not have sufficient funds to participate as angel investors. Intrastate crowdfunding offerings may provide retail investors with additional investment opportunities, although the extent to which they invest in such offerings will likely depend on their view of the potential return on investment as well as the potential risks, including fraud.

In contrast, larger, more sophisticated or well-funded investors may be less likely to invest in intrastate crowdfunding offerings. The relatively low offering amount limits, in-state investor residency requirements, and low investment limits for crowdfunding investors under state laws[226] may make these offerings less attractive for professional investors, including VCs and angel investors.[227] While an intrastate crowdfunding offering can bring an issuer to the attention of these investors, it is possible that professional investors would prefer to invest in offerings relying on Rule 506, which are not subject to the investment limitations applicable to crowdfunding.

c. Intermediaries

Issuers of private offerings may use broker-dealers to help them with various aspects of the offering and to help ensure compliance with the ban on general solicitation and advertising

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[226] Most state crowdfunding provisions allow up to $2 million offering size, and a maximum investment of $10,000 by non-accredited investors.

[227] An observer suggests that, unlike angels, VCs may be less interested in crowdfunding because, if VCs rely on crowdfunding sites for their deal flow, it would be difficult to justify charging a 2% management fee and 20% carried interest to their limited partners. *See* Ryan Caldbeck, *Crowdfunding – Why Angels,*

that exists for most private offerings. Private offerings can also involve finders and investment advisers who connect issuers with potential investors for a fee.[228] We do not have information on the extent of intermediary use in Rule 147 offerings; however, an analysis of Form D filings indicates that intermediaries are used less frequently in Rule 504 offerings than in registered offerings. Approximately 20% of Rule 504 offerings reported using an intermediary during the period 2009−2014. The average commissions and fees paid by Rule 504 issuers that reported using an intermediary was approximately 6% of the offer amount.

Although we are unable to predict the use of broker-dealers, transfer agents, investment advisers and finders in private offerings as a result of the proposed rules, data on the use of broker-dealers and finders in the Rule 506 market suggests that they may not currently play a large role in private offerings. Form D filings indicate that approximately 21% of Rule 506 offerings, including 15% of Rule 506 offerings initiated by non-fund issuers, used an intermediary during 2009−2014.[229] The use of a broker-dealer or a finder increased with offering size, while the average total fee declined with offering size.[230] We base these estimates, however, only on available data from the Regulation D market. It is possible that issuers engaging in other types of private offerings, for which data is not available to us, may use broker-dealers and finders more frequently.[231]

Venture Capitalists And Private Equity Investors All May Benefit, FORBES, Aug. 7, 2013.

228 Depending on their activities, these persons may need to be registered as broker-dealers.

229 *See* Section IV(c) in Unregistered Offerings White Paper.

230 *Id*. Intermediaries participated in 16% of Rule 506 offerings of up to $1 million and 30% of offerings of more than $50 million. The average total fee (commission plus finder fee) paid by issuers conducting offerings of up to $1 million was 6.5% while the average total fee paid by issuers conducting offerings of more than $50 million was 1.9%.

231 A number of states that have enacted crowdfunding provisions require that the offer and sale of securities by means of intrastate crowdfunding be conducted through a funding portal or a broker-dealer. Some intrastate crowdfunding provisions require the offering portals to be registered generally with the state, or as a broker-dealer. Based on FOCUS Reports filed with the Commission, as of December 2014, there were

2. Alternative Methods of Raising up to $5 Million of Capital

The potential economic impact of the proposed amendments, including their effects on efficiency, competition and capital formation, will depend primarily on the extent of use of the amended Rule 147 and Rule 504 exemptions, and how these methods compare to alternative methods that startups and small businesses can use for raising capital.

As the proposed amendments to Rule 504 would permit offerings up to $5 million by all types of issuers, the analysis below discusses alternatives available for startups and small businesses to access up to $5 million in capital. Current state crowdfunding provisions, most of which require issuers to rely on Rule 147 for federal exemption, have offering limits up to $4 million and restrict private funds and investment companies from utilizing crowdfunding provisions. Our analysis below, therefore, also subsumes a discussion of alternative sources for non-fund issuers to raise capital up to $4 million.[232]

Startups and small businesses can potentially access a variety of external financing sources in the capital markets through, for example, registered or unregistered offerings of debt, equity or hybrid securities and bank loans. Issuers seeking to raise capital must register the offer and sale of securities under the Securities Act or qualify for an exemption from registration under the federal securities laws. Registered offerings, however, are generally too costly to be viable alternatives for startups and small businesses. Issuers conducting registered offerings

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4,267 registered broker-dealers, with average total assets of approximately $1.1 billion per broker-dealer. The aggregate assets of these registered broker-dealers totaled approximately $4.9 trillion. *See* Crowdfunding Adopting Release for a more detailed discussion of intermediaries in crowdfunding offerings.

232 While offerings greater than $5 million that are registered or exempt under state law, subject to certain conditions, could be raised under amended Rule 147, and fund issuers would not be excluded from using the exemption, we believe that the impact of the proposed amendments on larger offerings and fund offerings is not likely to be significant, given the local nature of offerings and also current state regulations for larger offerings. *See* Section V.0 (discussing the impact of the proposed rule amendments is analyzed more in detail).

must pay Commission registration fees, legal and accounting fees and expenses, transfer agent and registrar fees, costs associated with periodic reporting requirements and other regulatory requirements, and various other fees. Two surveys concluded that the average initial compliance cost associated with conducting an initial public offering is $2.5 million, followed by an ongoing compliance cost for issuers, once public, of $1.5 million per year.[233] Moreover, issuers conducting registered offerings usually pay underwriter fees, which average approximately 7% for initial public offerings, approximately 5% for follow-on equity offerings and approximately 1-1.5% for public bond issuances.[234] Hence, for an issuer seeking to raise less than $5 million, a registered offering typically may not be economically feasible.

a. Exempt Offerings

For startups and small businesses that can potentially access capital under the Rule 147 safe harbor and Rule 504 exemption, offerings under other existing exemptions from registration

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233 *See* IPO Task Force, *Rebuilding the IPO On-Ramp*, at 9 (Oct. 20, 2011) for the two surveys, *available at* http://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf ("IPO Task Force"). The estimates should be interpreted with the caveat that most firms in the IPO Task Force surveys likely raised more than $1 million. The IPO Task Force surveys do not provide a breakdown of costs by offering size. However, compliance related costs of an initial public offering and subsequent compliance related costs of being a reporting company likely have a fixed cost component that would disproportionately affect small offerings.

Title I of the JOBS Act provided certain accommodations to issuers that qualify as emerging growth companies (EGCs). According to a recent working paper, the underwriting, legal and accounting fees of EGC and non-EGC initial public offerings were similar (based on a time period from April 5, 2012 to April 30, 2014). For a median EGC initial public offering, gross spread comprised 7% of proceeds and accounting and legal fees comprised 2.4% of proceeds. *See* Susan Chaplinsky, Kathleen W. Hanley, and S. Katie Moon, 2014, "*The JOBS Act and the Costs of Going Public*," working paper, August 14, 2014, *available at* http://ssrn.com/abstract_id=2492241.

234 *See, e.g.*, Hsuan-Chi Chen and Jay R. Ritter, "*The Seven Percent Solution*," 55 J. FIN. 1105−1131 (2000); Mark Abrahamson, Tim Jenkinson, and Howard Jones, "*Why Don't U.S. Issuers Demand European Fees for IPOs?*" 66 J. FIN. 2055–2082 (2011); Shane A. Corwin, "*The Determinants of Underpricing for Seasoned Equity Offers*," 58 J. FIN. 2249−2279 (2003); Lily Hua Fang, "*Investment Bank Reputation and the Price and Quality of Underwriting Services*," 60 J. FIN. 2729−2761 (2005); Rongbing Huang and Donghang Zhang, "*Managing Underwriters and the Marketing of Seasoned Equity Offerings*," 46 J. FIN. QUANT. ANALYSIS 141–170 (2011); Stephen J. Brown, Bruce D. Grundy, Craig M. Lewis and Patrick Verwijmeren, "*Convertibles and Hedge Funds as Distributors of Equity Exposure*," 25 REV. FIN. STUD. 3077-3112 (2012).

may represent alternative methods of raising capital. For example, startups and small businesses could rely on current exemptions and safe harbors, such as Section 3(a)(11), Section 4(a)(2),[235] Regulation A,[236] and Rule 506 of Regulation D.[237]

Each of these exemptions, however, includes restrictions that may limit its suitability for startups and small businesses seeking to raise capital up to $5 million. Table 4 below lists the main requirements of these exemptions.

Table 4: Other Exemptions Currently Available for Capital Raising

Type of Offering	Offering Limit[238]	Solicitation	Issuer and Investor Requirements	Filing Requirement	Restriction on Resale	Blue Sky Law Preemption
Section 3(a)(11)	None	All offerees must be resident in state	All issuers and investors must be resident in state	None	No[239]	No
Section 4(a)(2)	None	No general solicitation	Transactions by an issuer not involving any public offering[240]	None	Restricted securities	No

235 Securities Act Section 4(a)(2) provides that the provisions of the Securities Act shall not apply to "transactions by an issuer not involving a public offering."

236 Regulation A provides a conditional exemption from registration for certain small issuances. We recently adopted amendments to Regulation A, which became effective on June 19, 2015. *See* 2015 Regulation A Release.

237 Rule 506(b) of Regulation D provides a nonexclusive safe harbor from registration for certain types of securities offerings. Rule 506(c) of Regulation D is a new exemption from registration that the Commission adopted to implement Section 201(a) of the JOBS Act.

238 Aggregate offering limit on securities sold within a twelve-month period.

239 Although Section 3(a)(11) does not have explicit resale restrictions, the Commission has explained that "to give effect to the fundamental purpose of the exemption, it is necessary that the entire issue of securities shall be offered and sold to, and come to rest only in the hands of residents within the state." *See* 1961 Release. State securities laws, however, may have specific resale restrictions. Securities Act Rule 147, a safe harbor under Section 3(a)(11), limits resales to persons residing in-state for a period of 9 months after the last sale by the issuer. [17 CFR 230.147]

240 Section 4(a)(2) of the Securities Act provides a statutory exemption for "transactions by an issuer not involving any public offering." *See SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953) (holding that an offering to those who are shown to be able to fend for themselves is a transaction "not involving any public offering.")

Type of Offering	Offering Limit[238]	Solicitation	Issuer and Investor Requirements	Filing Requirement	Restriction on Resale	Blue Sky Law Preemption
Regulation A	Tier 1: up to $20 million with $6 million limit on secondary sales by affiliates of the issuer; Tier 2: up to $50 million with $15 million limit on secondary sales by affiliates of the issuer	Testing the waters permitted both before and after filing the offering statement	U.S. or Canadian issuers, excluding investment companies, blank-check companies, reporting companies, and issuers of fractional undivided interests in oil or gas rights, or similar interests in other mineral rights[241]	File testing the waters materials, Form 1-A for Tiers 1 and 2 offerings; file annual, semi-annual, and current reports for Tier 2; file exit report for Tier 1 and to suspend or terminate reporting for Tier 2	No	Tier 1: No Tier 2: Yes
Rule 505 Regulation D	$5 million	No general solicitation	Unlimited accredited investors and up to 35 non-accredited investors	File Form D[242]	Restricted securities	No
Rule 506(b) Regulation D	None	No general solicitation	Unlimited accredited investors and up to 35 non-accredited investors	File Form D[243]	Restricted securities	Yes
Rule 506(c) Regulation D	None	General solicitation is permitted, subject to certain conditions[244]	Unlimited accredited investors; no non-accredited investors	File Form D[245]	Restricted securities	Yes

241 The Regulation A exemption also is not available to companies that have been subject to any order of the Commission under Exchange Act Section 12(j) entered within the past five years; have not filed ongoing reports required by the regulation during the preceding two years, or are disqualified under the regulation's "bad actor" disqualification rules.

242 Filing is not a condition of the exemption, but it is required under Rule 503.

243 Filing is not a condition of the exemption, but it is required under Rule 503.

244 General solicitation and general advertising is permitted under Rule 506(c). All purchasers must be accredited investors and the issuer must take reasonable steps to verify accredited investor status.

While we do not have complete data on offerings relying on an exemption under Section 3(a)(11) or Section 4(a)(2), certain data available from Regulation D and Regulation A filings allow us to gauge how frequently issuers seeking to raise up to $5 million use these exemptions. Based on Form D filings from 2009 to 2014, a substantial number of issuers chose to raise capital by relying on Rule 506(b), even though their offering size would qualify for an exemption under Rule 504 or Rule 505.[246] As shown below, in the upper part of Table 5 reporting the number of Regulation D offerings by all types of issuers, most of the issuers made offers for amounts of up to $1 million from 2009 to 2014. Most of the offerings up to $5 million rely on the Rule 506(b) exemption. The lower part of Table 5 shows a similar pattern for the number of offerings by non-fund issuers only. The overwhelming majority of non-fund issuers (approximately 78%) for offerings less than $5 million were five years or younger, and 68% of such issuers were two years or younger, with a median age of approximately one year. More than 93% of the non-fund issuers that made Regulation D offerings with offer sizes of $5 million or less during this period were organized as either a corporation or a limited liability company. Almost 23% reported no revenues, while approximately 21% had revenues of less than $5 million.[247]

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245 Filing is not a condition of the exemption, but it is required under Rule 503.

246 *See* Unregistered Offerings White Paper. This tendency could, in part, be attributed to two features of Rule 506: preemption from state registration ("blue sky") requirements and an unlimited offering amount. *See also* GAO Report.

247 These percentages could be higher because almost 45% of the Regulation D issuers declined to disclose their size.

Table 5: Number of Regulation D and Regulation A Offerings By Size, 2009−2014

	Offering size				
	<=$1 million	**$1-$2.5 million**	**$2.5-5 million**	**$5-50 million**	**>$50 million**
All offerings					
Rule 504	3,719	--	--	--	--
Rule 505	525	450	393	--	--
Rule 506(b)	29,751	15,805	13,562	26,847	11,942
Rule 506(c)	710	304	295	533	161
Total	34,705	16,559	14,250	27,380	12,103
Regulation A	5	4	29		
Non-fund offerings					
Rule 504	3,643	--	--	--	--
Rule 505	501	432	342	--	--
Rule 506(b)	27,106	14,113	11,633	18,670	2,733
Rule 506(c)	588	261	270	419	89
Total	31,838	14,806	12,245	19,089	2,822

Note: Data based on Form D and Form 1-A filings from 2009 to 2014. We consider only new offerings and exclude offerings with amount sold reported as $0 on Form D. Data on Rule 506(c) offerings covers the period from September 23, 2013 (the day the rule became effective) to December 31, 2014. We also use the maximum amount indicated in Form 1-A to determine offering size for Regulation A offerings.

The table above also includes the number of Regulation A offerings by size. From 2009 to 2014, 38 issuers relied on Regulation A for offerings of up to $5 million.[248] This data does not reflect the recent amendments to Regulation A adopted by the Commission on March 25, 2015. The amendments allow issuers to raise up to $50 million over a 12-month period and preempt state registration requirements for certain Regulation A offerings (Tier 2 offerings). As these amendments became effective only recently, more time is needed to assess how the changes in Regulation A will affect capital raising by small issuers.[249]

[248] We only consider offerings with offering statements that have been qualified by the Commission. For purposes of counting filings, we exclude amendments or multiple 1-A filings by the same issuer in a given year. For purposes of determining the offering size for Regulation A offerings, we use the maximum amount indicated on the latest pre-qualification Form 1-A or amended Form 1-A. We reclassify two offerings that are dividend reinvestment plans with uncertain offering amounts as having the maximum permitted offering amount.

[249] *See* 2015 Regulation A Adopting Release.

b. Regulation Crowdfunding

The analysis above does not include securities-based crowdfunding transactions under the Regulation Crowdfunding exemption. Under these rules, which are not yet in effect, offerings pursuant to Regulation Crowdfunding are limited to a maximum amount of $1 million over a 12-month period and are subject to ongoing disclosure requirements. Securities issued pursuant to these rules can be sold to an unlimited number of investors (subject to certain investment limits), are freely tradable after one year, and can be offered and sold across states without state registration. In addition to the existing regulatory scheme of exemptions and safe harbors described above, Regulation Crowdfunding will provide a new exemption from the registration requirements of the Securities Act. Once effective, this exemption will provide startups and small businesses with an alternate source for raising up to $1 million in capital in a 12-month period through certain securities-based crowdfunding transactions. Unlike intrastate crowdfunding provisions enacted at the state level, the new federal crowdfunding exemption would allow interstate offerings. Table 6 below presents a comparison of the provisions of Regulation Crowdfunding and intrastate crowdfunding that rely on current Rule 147 for federal exemption.

Table 6: Intrastate Crowdfunding and Regulation Crowdfunding Provisions

	State Level Crowdfunding + Current Rule 147[250]	**Regulation Crowdfunding**[251]
Investor Base	All investors, resident in- state	All investors, all states
State Registration	Exemption provided by state	Preemption
Issuer Incorporation/ Residency Limitations	Issuer should be incorporated and "doing-business" in state	Excludes foreign private issuers
Excluded Issuers	Exchange Act reporting companies, investment companies and blank check companies (under most state provisions)	Exchange Act reporting companies, investment companies, pooled investment funds, and blank check companies
Offering Size Limits	$250,000 - $4 million, depending on state. Average (median) limit: $1.6 ($2) million	Up to $1 million
Security Type	Equity and debt in some states; equity only in other states; any security in some other states	Any security
Audited Financials Requirement	Most states, if offer greater than $1 million	Required for offerings greater than $500,000 with the exception of first-time crowdfunding issuers offering more than $500,000 but not more than $1,000,000, who are permitted to provide financial statements reviewed by an independent accountant, unless the issuer has audited statements otherwise available. Reviewed financial statements are required for offerings greater than $100,000 but not more than $500,000, unless the issuer has audited statements otherwise available.
General Solicitation	Allowed but only to investors resident in state	Allowed with limitations on advertising
Investment Limits	$2,500-$10,000, depending on state, for non-accredited investors. None, in most states, for accredited investors	(a) the greater of $2,000 or 5% of the lesser of the investor's annual income or net worth if either annual income or net worth is less than $100,000, or (b) 10% of the lesser of the investor's annual income or net worth if both annual income and net worth are $100,000 or more, subject to

250 Information based on provisions reflective of most states that have enacted crowdfunding provisions. *See* http://www.nasaa.org/industry-resources/corporation-finance/instrastate-crowdfunding-resource-center/intrastate-crowdfunding-directory/.

251 *See* Regulation Crowdfunding Adopting Release.

	State Level Crowdfunding + Current Rule 147[250]	Regulation Crowdfunding[251]
		investment cap of $100,000
Restrictions on Resale	Interstate resales restricted for nine months[252]	12-month resale limitation; resale within one year to issuer and certain investors
Exemption from Section 12(g) Registration Requirements	No exemption	Exempted, provided that the issuer is current in its ongoing annual reports required pursuant to Rule 202 of Regulation Crowdfunding, has total assets as of the end of its last fiscal year not in excess of $25 million, and has engaged the services of a transfer agent registered with the Commission pursuant to Section 17A of the Exchange Act

c. Private Debt Financing

While equity-based financing, including principal owner equity, accounts for a significant proportion of the total capital of a typical small business, other sources of capital for startups and small businesses include loans from commercial banks, finance companies and other financial institutions, business credit cards and credit lines.[253]

For example, a 2014 study reports that startups frequently resort to bank financing early in their lifecycle.[254] The study finds that businesses rely heavily in the first year after formation on external debt sources such as bank financing, mostly in the form of personal and commercial

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252 Rule 147(e), 17 CFR 230.147(e). States may impose additional resale restrictions.

253 Using data from the 1993 Survey of Small Business Finance, one study indicates that financial institutions account for approximately 27% of small firms' borrowings. *See* Allen N. Berger and Gregory F. Udell, *The Economics of Small Business Finance: The Roles of Private Equity and Debt Markets in the Financial Growth Cycle*, 22 J. BANKING & FIN. 613 (1998). *See also* 1987, 1993, 1998 and 2003 Surveys of Small Business Finances, *available at* http://www.federalreserve.gov/pubs/oss/oss3/nssbftoc.htm. The Survey of Small Business Finances was discontinued after 2003. Using data from the Kauffman Foundation Firm Surveys, one study finds that 44% of startups use loans from financial institutions. *See* Rebel A. Cole and Tatyana Sokolyk, *How Do Start-Up Firms Finance Their Assets? Evidence from the Kauffman Firm Surveys* (2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2028176.

254 *See* Robb, A., and D. Robinson, 2014, *The Capital Structure Decisions of New Firms*, Review of Financial Studies 27(1), pp. 153–179 ("*Robb*").

bank loans, business credit cards, and credit lines. Another recent report, however, shows a decline in bank lending to small businesses, which fell by $100 billion from 2008 to 2011.[255] This report also shows that less than one-third of small businesses reported having a business bank loan by 2012. Similarly, an FDIC report shows that, as of June 2014, small business lending, specifically business loans of up to $1 million, by FDIC-insured depository institutions amounted to approximately $590 billion, which is 17% lower than the 2008 level.[256]

An earlier study by Federal Reserve Board staff covering the pre-recessionary period suggests that 60% of small businesses had outstanding credit in the form of a credit line, a loan or a capital lease.[257] These loans were borrowed from two types of financial institutions: depositary and non-depositary institutions (*e.g.*, finance companies, factors or leasing companies).[258] Lines of credit were the most widely used type of credit.[259] Other types included mortgage loans, equipment loans, and motor vehicle loans.[260]

Small businesses may also receive funding from various loan guarantee programs of the Small Business Administration ("SBA"), which makes credit more accessible to small businesses by either lowering the interest rate of the loan or enabling a market-based loan that a lender

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255 *See* The Kauffman Foundation, *2013 State of Entrepreneurship Address* (Feb. 5, 2013), *available at* http://www.kauffman.org/~/media/kauffman_org/research%20reports%20and%20covers/2013/02/soe%20report_2013pdf.pdf. The report cautions against prematurely concluding that banks are not lending enough to small businesses as the sample period of the study includes the most recent recession.

256 We define small business loans to include commercial and industrial loans of up to $1 million and loans secured by nonfarm nonresidential properties and commercial and industrial loans of up to $1 million to U.S. addressees. *See* Federal Deposit Insurance Corporation, *Statistics on Depository Institutions Report*, *available at* http://www2.fdic.gov/SDI/SOB/ ("*FDI Statistics*").

257 *See* Federal Reserve Board, *Financial Services Used by Small Businesses: Evidence from the 2003 Survey of Small Business Finances* (October 2006), *available at* http://www.federalreserve.gov/pubs/bulletin/2006/smallbusiness/smallbusiness.pdf ("2003 Survey").

258 *See* Rebel Cole, *What Do We Know About the Capital Structure of Privately Held Firms? Evidence from the Surveys of Small Business Finance* (Working Paper) (Feb. 2013), *available at* http://onlinelibrary.wiley.com/doi/10.1111/fima.12015/pdf.

259 *See* 2003 Survey, note 257 (estimating that 34% of small businesses use lines of credit).

would not be willing to provide, absent a guarantee.[261] SBA loan programs include 7(a) loans,[262] and CDC/504 loans.[263] For example, in fiscal year 2014, the SBA supported approximately $28.7 billion in 7(a) and CDC/504 loans distributed to approximately 51,500 small businesses.[264] SBA guaranteed loans, however, currently account for a relatively small share (18%) of the balances of small business loans outstanding.[265]

Borrowing from financial institutions is, however, relatively costly for many early-stage issuers and small businesses as they may have low revenues, irregular cash-flow projections, insufficient assets to offer as collateral, and high external monitoring costs.[266] Many startups and small businesses may find loan requirements imposed by financial institutions difficult to meet and may not be able to rely on these institutions to secure funding. For example, financial

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260 *Id.*

261 Numerous states also offer a variety of small business financing programs, such as Capital Access Programs, collateral support programs and loan guarantee programs. These programs are eligible for support under the State Small Business Credit Initiative, *available at* http://www.treasury.gov/resource-center/sb-programs/Pages/ssbci.aspx.

262 15 U.S.C. 631 *et seq*. 7(a) loans provide small businesses with financing guarantees for a variety of general business purposes through participating lending institutions.

263 15 U.S.C. 695 *et seq*. The CDC/504 loans are made available through "certified development companies" or "CDCs", typically structured with the SBA providing 40% of the total project costs, a participating lender covering up to 50% of the total project costs and the borrower contributing 10% of the project costs.

264 *See* U.S. Small Business Administration, *FY 2016 Congressional Budget Justification and FY 2014 Annual Performance Report*, available at https://www.sba.gov/content/fiscal-year-2016-congressional-budget-justificationannual-performance-report ("2014 Annual Performance Report"). SBA also offers the Microloan program, which provides funds to specially designated intermediary lenders that administer the program for eligible borrowers. The maximum loan amount is $50,000, but the average is about $13,000. *See* Microloan Program, U.S. Small Business Administration, *available at* http://www.sba.gov/content/microloan-program.

265 As of the end of fiscal year 2014, the SBA guaranteed business loans outstanding (including 7(a) and 504 loans) equaled $107.5 billion. *See Small Business Administration Unpaid Loan Balances by Program, available at* https://www.sba.gov/sites/default/files/files/WDS_Table1_UPB_Report.pdf. This comprises approximately 18% of the approximately $590 billion in outstanding small business loans for commercial real estate and commercial and industrial loans discussed above. In 2014, the SBA expanded eligibility for loans under its business loan programs. *See* SBA *504 and 7(a) Loan Programs Updates* (Mar. 21, 2014) [79 FR 15641 (Apr. 21, 2014)]. In addition to loan guarantees, the SBA program portfolio also includes direct business loans, which are mainly microloans (outstanding direct business loans equaled $137.1 billion), and disaster loans.

institutions generally require a borrower to provide collateral and/or a guarantee,[267] which startups, small businesses and their owners may not be able to provide. Collateral may also be required for loans guaranteed by the SBA.

Other sources of debt financing for startups and small businesses include peer-to-peer and peer-to-business lending,[268] microfinance,[269] and other alternative online lending channels.[270] According to some industry estimates, the global volume of "lending-based crowdfunding," which includes peer-to-peer lending to consumers and businesses, had risen to approximately $11.08 billion in 2014.[271] Technology has facilitated the growth of alternative models of small

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266 *See* Robb.

267 Approximately 92% of all small business debt to financial institutions is secured, and owners of the firm guarantee about 52% of that debt. *See* Berger, A., and G. Udell, 1995, Relationship Lending and Lines of Credit in Small Firm Finance, Journal of Business 68(3), pp. 351–381. Some studies of small business lending also document the creation of local captive markets with higher borrowing costs for small, opaque firms as a result of strategic use of soft information by local lenders. S*ee* Agarwal, Sumit, and Robert Hauswald, 2010, Distance and Private Information in Lending, Review of Financial Studies 13(7), pp. 2757–2788.

268 Such debt transactions are facilitated by online platforms that connect borrowers and lenders and potentially offer small businesses additional flexibility with regard to pricing, repayment schedules, collateral or guarantee requirements, and other terms. *See* Ian Galloway, *Peer-to-Peer Lending and Community Development Finance*, Federal Reserve Bank of San Francisco (Working Paper) (2009), *available at* http://www.frbsf.org/publications/community/wpapers/2009/wp2009-06.pdf.

269 *See* Craig Churchill and Cheryl Frankiewicz, *Making Microfinance Work: Managing for Improved Performance*, Geneva International Labor Organization (2006). Microfinance consists of small, working capital loans provided by microfinance institutions that are invested in microenterprises or income-generating activities. According to one report, in fiscal year 2012, the U.S. microfinance industry was estimated to have disbursed $292.1 million across 36,936 microloans, and was estimated to have $427.6 million in outstanding microloans (across 45,744 in microloans). *See* FIELD at the Aspen Institute, *U.S. Microenterprise Census Highlights*, FY 2012, *available at* http://fieldus.org/Publications/CensusHighlightsFY2012.pdf.

270 Several models of online small business lending have emerged: online lenders raising capital from institutional investors and lending on their own account (for example, short-term loan products similar to a merchant cash advance); peer-to-peer platforms; and "lender-agnostic" online marketplaces that facilitate small business borrower access to various loan products, from term loans and lines of credit to merchant cash advances and factoring products, from traditional and alternative lenders. *See* Karen Gordon Mills and Brayden McCarthy, *The State of Small Business Lending: Credit Access during the Recovery and How Technology May Change the Game*, Harvard Business School Working Paper 15-004 (2014), *available at* http://ssrn.com/abstract=2470523 ("Mills-McCarthy 2014).

271 *See* Massolution, *2015CF Crowdfunding Industry Report: Market Trends, Composition and Crowdfunding Platforms*, *available at* http://reports.crowdsourcing.org/index.php?route=product/product&product_id=54 ("Massolution 2015") at 56. The Massolution 2015 report refers to peer-to-peer lending to consumers and

business lending. According to one academic study,[272] the outstanding portfolio balance of online alternative lenders has doubled every year, albeit this market represents less than $10 billion in outstanding loan capital. According to the 2014 Small Business Credit survey,[273] 18% of all small businesses surveyed applied for credit with an online lender.[274]

Family and friends are also sources through which startups and small businesses can raise capital. This source of capital is usually available early in the lifecycle of a small business, before the business engages arm's-length, more formal funding channels.[275] Among other things, family and friends may donate funds, loan funds or acquire an equity stake in the business. A recent study finds that most of the capital supplied to startups by friends and family is in the form of loans.[276] Family and friends, however, may be able to provide only a limited amount of capital compared to other sources. We do not have data available on these financing sources that could allow us to quantify their magnitude and compare them to other current sources of capital.

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peer-to-business lending to small businesses as "lending based" crowdfunding. Our discussion refers to peer-to-peer lending more broadly in a sense synonymous with "lending-based" crowdfunding.

272 *See* Mills McCarthy 2014.

273 The survey was conducted by the Federal Reserve Banks of New York, Atlanta, Cleveland, and Philadelphia between September and November of 2014. It focused on credit access among businesses with fewer than 500 employees in Alabama, Connecticut, Florida, Georgia, Louisiana, New Jersey, New York, Ohio, Pennsylvania, and Tennessee. The survey authors note that since the sample is not a random sample, results were reweighted for industry, age, size, and geography to reduce coverage bias. *See* Federal Reserve Banks of New York, Atlanta, Cleveland and Philadelphia, *Joint Small Business Credit Survey Report* (2014), *available at* http://www.newyorkfed.org/smallbusiness/SBCS-2014-Report.pdf.

274 *Id*. The survey also showed differences in the use of online lenders by type of borrower: 22% of small businesses categorized in the survey as "startups" (i.e. businesses that have been in business for less than five years) applied for credit with online lenders. By comparison, 8% of small businesses categorized in the survey as "growers" (i.e. businesses that were profitable and experienced an increase in revenue) applied with online lenders, and 3% of small businesses categorized in the survey as "mature firms" (i.e. businesses that have been in business for more than five years, had over ten employees, and had prior debt), applied with an online lender. The latter two categories of small businesses were more likely to apply for credit with bank lenders than with online lenders.

275 *See* Paul Gompers and Josh Lerner, The Venture Capital Cycle (MIT Press 2006).

276 *See* Robb at 1219.

B. Analysis of Proposed Rules

1. Introduction

In general, the proposed amendments to Rule 147 and Rule 504 are intended to expand the capital raising options available to startups and small businesses, including through the use of intrastate and regional securities offering provisions that have been enacted or could be enacted by various states, and thereby promote capital formation within the larger economy.

Securities-based crowdfunding is a relatively new and evolving capital market which provides startups and small businesses an alternative mechanism of raising funds using the Internet, by selling small amounts of securities to a large number of investors. Title III of the JOBS Act directed the Commission to establish rules for an exemption that would facilitate this market at the federal level. Around the same time, some states began enacting intrastate crowdfunding statutes and rules that provide issuers with exemptions from state registration. Most state crowdfunding rules require issuers to comply with the requirements of Section 3(a)(11) and Rule 147, while one state currently provides issuers with the option of utilizing Rule 504 or another Regulation D exemption.

By modernizing the existing requirements under Rule 147, the proposed amendments would facilitate capital formation through intrastate crowdfunded offerings as well as through other state registered or state exempt offerings. By raising the offering amount limit under Rule 504 from $1 million to $5 million, the proposed amendments may facilitate offerings, including those registered or exempt in a state, or regional offerings made pursuant to the implementation of regional coordinated review programs.[277] Such programs, when implemented, may enable

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[277] *See* http://www.nasaa.org/industry-resources/corporation-finance/coordinated-review/. *See also* the "Reciprocal Crowdfunding Exemption" proposed by the Massachusetts Securities Division *available at*

Rule 504 issuers to register their offering in any one of the several states where they make the offering, instead of registering in all the states of solicitation, thereby saving time and money for issuers.

As discussed below, the effects of the proposed amendments on capital formation would depend, first, on whether issuers that currently raise or plan to raise capital would choose to rely on securities offerings pursuant to amended Rules 147 and 504 in lieu of other methods of raising capital, such as Regulation Crowdfunding and Rule 506 of Regulation D. To assess the likely impact of the proposed amendments on capital formation, we consider the features of amended Rules 147 and 504 that potentially could increase the use of securities offerings by new issuers and by issuers that already rely on other private offering options.

Second, to the extent that securities offerings under amended Rule 147 and Rule 504 provide capital raising options for issuers that currently do not have access to capital, the proposed amendments could enhance the overall level of capital formation in the economy in addition to any reallocation of demand for capital amongst the various capital raising options that could arise from issuers changing their capital raising methods.

Third, to the extent that states currently have residency and eligibility requirements in addition to prescriptive threshold requirements that correspond to existing Rule 147 provisions, the impact of the proposed amendments to Rule 147 on capital formation would significantly depend on whether states choose to modernize their provisions to align with the amended Rule 147. Any changes to the intrastate and regional securities offering provisions that may be enacted would, in turn, affect the expected use of amended Rule 504. For instance, while current

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http://www.sec.state.ma.us/sct/crowdfundingreg/Reciprocal%20Crowdfunding%20Exemption%20-%20MA.PDF.

intrastate crowdfunding provisions in most states require issuers to rely on Rule 147 for the federal exemption, to the extent the amended state provisions require the offerings to comply with either Rule 147 or Rule 504 in the future, the choice between reliance on these two exemptions could depend on issuers' preferences with respect to general solicitation, target investor base, and investor location. For example, while Rule 147 offerings would be restricted to in-state investors, Rule 504 offerings would be available to investors in more than one state, thus making regional offerings feasible. At the same time, there is no limit on the maximum offering amount under proposed Rule 147 for an offering that is registered with a state, while the proposed amendments under Rule 504 limit the maximum amount that can be sold over a twelve-month period to $5 million.[278]

Finally, the impact of the proposed amendments on aggregate capital formation also would depend on whether new investors are attracted to the Rule 147 and Rule 504 markets or whether investors reallocate existing capital among various types of offering options. For example, if the amended exemptions allow issuers to reach a category of potential investors significantly different from those that they can reach through other offering methods, capital formation, in aggregate, could increase. However, if the amended exemptions are viewed by investors as substantially similar to alternate exemptions, investors may simply reallocate their capital from other markets to the Rule 147 or Rule 504 markets. Investor demand for securities offered under amended Rule 147 and Rule 504 could, in particular, depend on the extent to which expected risk, return and liquidity of the offered securities compare to what investors can

[278] While the proposed amendments to Rule 147 would limit the availability of the federal exemption to offerings of $5 million or less that are conducted pursuant to an exemption under state law, we believe the impact of this provision may not be significant given that existing crowdfunding state exemptions do not permit offerings greater than $4 million. States may have non-crowdfunding exemptions for larger

obtain from securities in other exempt offerings and in registered offerings.

Investor demand also would depend on whether state offering reporting requirements are sufficient to enable investors to evaluate the aforementioned characteristics of Rule 147 and Rule 504 offerings. For example, investors may be less willing to participate in intrastate crowdfunding or regional offerings that are made in reliance on exemptions from both state registration under state crowdfunding provisions and registration with the Commission under Rule 147 and Rule 504 and that are subject to lower reporting requirements. Alternatively, the state registration requirement for using general solicitation in Rule 504 offerings, the proposed amendment to disqualify certain bad actors from participation in Rule 504 offerings, the maximum offering amount for state exempt offerings that rely on Rule 147, and the reporting requirements for larger intrastate crowdfunding offerings under state provisions may mitigate some of these investor protection concerns. For example, in a number of states, current intrastate crowdfunding provisions require issuers for offerings greater than $1 million to submit audited financial statements.[279]

The proposed amendments to Rule 147 and Rule 504 would remove or reduce certain burdens identified by market observers.[280] We believe that the potential use of amended Rule 147 and Rule 504 depends largely on how issuers perceive the trade-off between the costs of disclosure requirements, if any under state regulation, and the benefits of access to accredited and non-accredited investors. Some issuers may prefer to offer securities under amended Rule 147 or Rule 504 because of the potentially limiting features associated with other exemptions.

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offerings and issuers seeking to rely on any such state exemption could continue to conduct the offering pursuant to Section 3(a)(11) or find an alternate federal exemption.

[279] *See* NASAA's Intrastate Crowdfunding Resource Center at http://www.nasaa.org/industry-resources/corporation-finance/instrastate-crowdfunding-resource-center/, retrieved in June 2015.

For instance, relative to Regulation Crowdfunding, the use of amended Rule 147 and Rule 504 in intrastate crowdfunding offerings would depend on whether the benefits of a larger offering size and fewer reporting requirements outweigh the costs of a more geographically limited investor base, compliance with issuer residency provisions under state crowdfunding laws and the potential for registration under Section 12(g) of the Exchange Act. Compared to amended Rules 147 and 504, other exemptions could remain attractive to issuers. For example, securities sold pursuant to the exemptions from registration under Rule 506 of Regulation D, which account for a significant amount of exempt offerings,[281] are subject to limits on participation by non-accredited investors. In contrast, issuers relying on amended Rule 147 or amended Rule 504 could sell securities to an unlimited number of non-accredited investors at the federal level, which would allow for a more diffuse investor base. General solicitation is currently permitted under Rule 506(c) of Regulation D, and issuers relying on Rule 506(c) can more easily reach institutional and accredited investors, making it less necessary for them to seek capital from a broader non-accredited investor base, especially if trading platforms aimed at accredited investors in privately placed securities continue to develop.[282] In addition, offerings under Rule 506 that are limited only to accredited investors have no disclosure requirements, except for a notice filing. Finally, relative to the Regulation A exemption, amended Rules 147 and 504 would have fewer disclosure and other regulatory requirements at the federal level. However, unlike Regulation A securities, which are freely resalable, Rule 147 and Rule 504 securities

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280 *See* ABA Letter.

281 *See* discussion in Section 0 above.

282 For example, "NASDAQ Private Market's affiliated marketplace is an electronic network of Member Broker-Dealers who provide accredited institutions and individual clients with access to the market. Companies use a private portal to enable approved parties to access certain information and transact in its securities." *See* NASDAQ Private Market overview, *available at*: https://www.nasdaqprivatemarket.com/market/overview.

could be less liquid due to their resale restrictions.

Overall, the proposed amendments to Rule 147 and Rule 504 could increase the aggregate amount of capital raised in the economy if used by issuers that have not previously conducted offerings using the provisions or other exemptions, or registered offerings. The impact of the proposed amendments on capital formation could also be redistributive in nature by encouraging issuers to shift from one to another capital raising method. This potential outcome may have a significant net positive effect on capital formation and allocative efficiency by providing issuers with access to capital at a lower cost than alternative capital raising methods and by providing investors with additional investment opportunities. The net effect also would depend on whether investors find the rules' disclosure requirements and investor protections to be sufficient to evaluate the expected return and risk of such offerings and to choose between offerings reliant on Rule 147, Rule 504 and other exempt offerings.

As these proposed amendments are not currently in effect, the data does not exist to estimate the effect of the proposed rules on the potential rate of substitution between alternative methods of raising capital and the overall expansion (or decline, if any) in capital raising by potential issuers affected by the proposed amendments. However, we anticipate that the proposed amendments would result in an increased use of the Rule 147 exemption for intrastate offerings, including for intrastate crowdfunding as more states enact provisions facilitating such offerings. Similarly, we expect the proposed amendments would increase the use of the Rule 504 exemption, especially by facilitating efforts among state securities regulators to implement regional coordinated review programs that would enable regional offerings. Although it is not possible to predict the extent of such increase or the type and size of the issuers that would conduct intrastate crowdfunding offerings, the current number of businesses

pursuing similar levels of financing through alternative capital raising methods, as discussed in the baseline section, provide an upper bound for Rule 147 and Rule 504 usage.[283] Nevertheless, the baseline data show that the potential number of issuers that might seek to offer and sell securities in reliance on amended Rules 147 and 504 is large, particularly when compared to the current number of approximately 9,000 reporting companies.[284]

We recognize that the proposed amendments to Rules 147 and 504 could raise investor protection concerns. For instance, as we discuss in detail further in this section, allowing Rule 147 issuers to have more dispersed assets and revenues could reduce oversight of issuers by in-state securities regulators. However, we believe such concerns are mitigated by the continuing applicability of state regulatory requirements that may impose additional eligibility conditions, as well as the residency requirements for investors and issuers under the amended rule provisions.[285] As discussed above, in adopting Rules 147 and 504, the Commission placed substantial reliance upon state securities laws and regulations on the rationale that the size and local nature of smaller offerings conducted pursuant to these exemptions does not warrant imposing extensive regulation at the federal level.[286] State legislators and securities regulators could determine the specific additional rule requirements, if any, that should be required to

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283 We believe the numbers in the baseline provide an upper bound because unlike Rule 147 offerings, investors from multiple states are permitted to invest in Regulation D offerings, which attracts more issuers, especially those that want to raise larger amounts. Similarly, unlike Rule 504, Rule 506 provides state preemption and permits unlimited offer amounts, which appears to make Rule 506 offerings more attractive for issuers.

284 *See* U.S. Securities and Exchange Commission, *FY 2016 Congressional Budget Justification, 2016 Annual Performance Plan, FY 2014 Annual Performance Report*, *available at* http://www.sec.gov/about/reports/secfy16congbudgjust.pdf.

285 By requiring offerings to be sold only to residents of the state in which the issuer has its principal place of business, amended Rule 147 would help ensure that issuers and investors are sufficiently local in nature so as to allow effective oversight by state regulators. Further, most states require Rule 504 offerings to be registered under state securities laws, which enables states to regulate capital raising activity in this market.

regulate local offerings and provide additional investor protections.[287] In this regard, the proposed amendments could provide greater flexibility to states in designing regulations that would work best for issuers and investors in their state. We believe that such latitude could improve the efficiency of local capital markets and could lead to competition between states for attracting issuers to locate in their jurisdictions.

In addition to state regulations, the proposed amendments that condition the availability of the amended Rule 147 exemption on states having an exemption that limits the maximum offering size and includes investment limits, and the proposed amendments to Rule 504 to disqualify certain bad actors from participation in Rule 504 offerings, could help to address such investor protection concerns. Finally, it should be noted that the Commission would retain authority under the antifraud provisions of the federal securities laws to pursue enforcement action against issuers and other persons involved in such offerings. Nevertheless, if investors demand higher returns because of a perceived increase in the risk of fraud as a result of less extensive federal regulation, issuers may face a higher cost of capital. We are unable to predict if or how the proposed amendments would affect the incidence of fraud in Rules 147 and 504 offerings.

In the sections below, we analyze in more detail the potential costs and benefits stemming from the specific amendments proposed today, as well as their impact on efficiency, competition and capital formation, relative to the baseline discussed above.

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286 *See* Seed Capital Release, Executive Summary and Rule 147 Adopting Release. *See also* discussion in Sections 0 and 0 above.

287 According to the NASAA Enforcement Report for 2013, securities violations related to unregistered securities sold by unlicensed individuals, including fraudulent offerings marketed through the Internet, remain an important enforcement concern. The report does not detail the number and category of violations by type of exemption from registration. *See* NASAA Enforcement Report, *available at*: http://www.nasaa.org/wp-content/uploads/2011/08/2014-Enforcement-Report-on-2013-Data_110414.pdf.

2. Analysis of Proposed Amendments to Rule 147

The proposed amendments to Rule 147 would facilitate intrastate offerings of securities by local companies, including offerings relying upon crowdfunding provisions under state securities laws. The proposed amendments seek to modernize Rule 147 to align with contemporary business practices, while retaining the underlying intrastate character of Rule 147 that permits local issuers to raise money from investors within their state without having to register the securities at the federal level.

a. Elimination of Limitation on Manner of Offering

Currently, offers pursuant to Rule 147 must be limited to state residents only. The proposed amendments to Rule 147 would allow an issuer to make offers to out-of-state residents, as long as sales are made only to residents of the issuer's state or territory.[288] In addition, the proposed amendments would require issuers to include disclosure on all offering materials stating that sales will be made only to residents of the same state or territory as the issuer, while also disclosing that the securities being sold are unregistered securities and have resale restrictions for a nine-month period.[289]

The proposed amendments would enable Rule 147 issuers to engage in broad-based solicitations, including on publicly accessible websites, in order to successfully locate potential in-state investors. For example, for a New Jersey-based Rule 147 offering, issuers would be permitted under proposed Rule 147 to advertise and disseminate offering information through online media to reach New Jersey residents that work in New York, even though such information can be viewed by New York residents. This is not permitted under the current rule.

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[288] *See* Proposed Rule 147(b).

[289] *See* Proposed Rule 147(f).

Hence, the proposed amendments to Rule 147 would provide issuers with the flexibility to utilize a wider array of options to advertise their offerings, taking advantage of modern communication technologies such as the Internet and other social media platforms that allow investors inside and outside the issuer's state of residence to openly access offering information. In this regard, we expect the proposed amendments to be particularly effective at facilitating state-based crowdfunding offerings that rely heavily on online platforms to bring issuers and investors together.[290]

The proposed amendments would thus make it easier for issuers to rely upon Rule 147 to conduct their offerings. Online advertising provides a cheaper and more efficient means of communicating with a more diffused base of prospective investors. Consequently, the elimination of offering limitations to residents should result in lower search costs for issuers. The amended provisions also may reduce issuers' uncertainty about compliance as they would not need to limit advertising or take additional precautions to ensure that only in-state residents could view the offering.

The inclusion of legends on certificates or other documents evidencing the security and other mandatory disclosures in offering materials would inform investors, especially out-of-state investors, about the intrastate nature of the offering. At the same time, as a greater number of investors become aware of a larger and more diverse set of investment opportunities in private offerings, the proposed amendments may enable investors to diversify their investment portfolio and allocate their capital more efficiently. Further, such broadly advertised Rule 147 offerings would be able to more effectively compete for potential investors with Rule 504, Rule 506(c), and Regulation A offerings, where general solicitation is also permitted. The proposed

[290] *See* Massolution 2015.

amendments could thus heighten competition between unregistered capital markets, which may result in a more optimal flow of capital between investors and issuers, thereby enhancing the overall allocative efficiency of those markets.

However, as issuers utilizing amended Rule 147 advertise more widely and freely, the likelihood of out-of-state investors purchasing into the offering could increase. The inclusion of legends and other mandatory disclosures may mitigate this concern and provide a certain measure of investor protection, although out-of-state investors in their desire to avail themselves of an attractive investment opportunity may overlook the legends or disclosures or may even disregard them. While issuers are required to have a reasonable belief that all their purchasers are resident within the state, the probability of violating the intrastate sale provisions could increase (relative to the baseline), at least in resale transactions that occur within the restrictive period for intrastate resales. Broader advertising of Rule 147 offerings could also impact the effectiveness of state oversight as regulators may not have adequate resources to track the conduct of such offerings on mass media.

b. Ease of Eligibility Requirements for Issuers

i. Incorporation and Residency Requirements

The proposed amendments to Rule 147 would eliminate the requirement that issuers need to be incorporated in the state where the offering is conducted and would revise the current residency requirement to focus on the issuer's "principal place of business" rather than its "principal office." The former would be defined as the location from which officers, partners, or managers of the issuer primarily direct, control and coordinate the activities of the issuer.[291]

[291] Proposed Rule 147(c)(1). *See also* note 55 above.

The proposed elimination of the requirement that the issuer be registered or incorporated in the state where the offering is being conducted would align the rule's provisions with modern business practices, thereby making it easier for a greater number of issuers to utilize the exemption. A significant number of companies are incorporated in states other than where their principal place of business is located.[292] Most of these companies have chosen to incorporate in places where corporate laws, including corporate tax laws, comport with modern business practices or are more permissive. For example, according to one academic study, corporate laws affect firm value, even after controlling for firm size, diversification, profitability, investment opportunities and industry.[293] Thus, firms have strong incentives to select favorable local regimes such as Delaware.[294] These studies and industry practices indicate that firms' choice of state of incorporation depends on the economic benefits derived from the regulatory environment in which the firm is organized, and as such the choice of legal home state may not be substantially related to where the business operations of the firms are located.

The practice of incorporating in certain states extends beyond public companies to private and smaller companies. As discussed in our baseline analysis above, data from Form D filings for the period 2009−2014 indicates that a significant percentage of Rule 504 and Rule 505 issuers were incorporated in Delaware and had separate states of incorporation and principal

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292 Based on an analysis of data from Thomson Reuters' Compustat North America, approximately 74% of Exchange Act reporting companies indicated that, in 2014, they had separate state of location of headquarters and state of incorporation.

293 Daines, Robert, "Does Delaware Law Improve Firm Value?" *Journal of Financial Economics*, Volume 62, Issue 3 (2001): 525-558.

294 *See* Scott D. Dyreng, Bradley P. Lindsey, Jacob R. Thornock, "Exploring the Role Delaware Plays as a Domestic Tax Haven," *Journal of Financial Economics*, Volume 108, Issue 3, (2013):751-772 (explaining that Delaware's tax laws play an economically important role in U.S. firms' decision to locate in Delaware).

places of business.[295] While smaller firms are less likely than larger firms to have separate states of incorporation and primary places of business, the Form D data described in the baseline indicates that a considerable number of small businesses are currently unable to meet the state of incorporation requirement in order to use the existing Rule 147 safe harbor. Since geography of investment and employment is aligned more closely with the principal place of business of a firm than with place of incorporation, replacing the current incorporation and residency tests with a principal place of business test would be consistent with the intrastate objective of Rule 147 and make it easier for more issuers to utilize the exemption.

Eliminating the requirement to be incorporated in-state also would enable foreign incorporated issuers that have their principal place of business in a U.S. state to access the Rule 147 capital market. This would create a uniform basis for firms that are operating in similar local fashion, irrespective of their country or state of incorporation, to utilize the Rule 147 exemption. Form D filings for the period 2009−2014 reported that approximately 3% of Regulation D offerings (approximately 3,000 offerings) were initiated by issuers that were incorporated outside of the United States and had their principal place of business in a U.S. state.

We recognize the potential for issuers to switch their principal place of business to a different state in order to conduct Rule 147 offerings in multiple states. To mitigate such concerns, the proposed amendments limit issuers that change their principal place of business from utilizing the exemption to conduct another intrastate offering in a different state for a period of nine months from the date of last sale of securities under the prior Rule 147 offering. This would be consistent with the duration of the resale limitation period during which sales to out-of-

[295] The data indicates that approximately 66% of all Rule 506 offerings initiated during 2009−2014 reported different states of incorporation and operations.

state residents are not permitted. As we discuss in detail below, such a provision should help to deter issuers from misusing the amended residency requirements to change their principal place of business in order to sell to residents in multiple states.

ii. "Doing Business" In-State Requirements

The proposed amendments to Rule 147 would modify the current "doing business" in-state tests for issuers by requiring them to have a principal place of business in-state and to satisfy one of four specified tests. The proposed amendments would include a new alternative test whereby issuers can qualify if a majority of their employees are located in the state. Consequently, under proposed Rule 147, in order to be deemed "doing business" in a state, issuers would have to have a principal place of business in-state and satisfy at least one of the following requirements:

- 80% of the issuer's consolidated assets are located within such state or territory;
- 80% of the issuer's consolidated gross revenues are derived from the operation of a business or of real property located in or from the rendering of services within such state or territory;
- 80% of the net proceeds from the offering are intended to be used by the issuer, and are in fact used, in connection with the operation of a business or of real property, the purchase of real property located in, or the rendering of services within such state or territory; or
- A majority of the issuer's employees are in such state or territory.

The proposed modifications to the existing "doing business" in-state tests would provide greater flexibility to potential Rule 147 issuers and thereby ease their burden in complying with

the exemption, while also better aligning the regulation with modern business practices. Issuers could use the test that best reflects the local nature of their business operations.

As currently required, satisfying all the existing "doing business" in-state tests may be burdensome even for small businesses that are largely located in one state. For example, by restricting issuers' operations and capital investments substantially to one state, the existing requirement to qualify under all these tests may have adverse effects on the growth and survival of startups and early stage ventures that rely on the exemption.[296] Moreover, in recent years new business models have emerged that may make satisfying all the eligibility tests ill-suited for relying on the Rule 147 exemption as a capital raising option. For example, businesses that use new technologies (*e.g.*, *e*-businesses) to make their operations more efficient tend to be more geographically distributed in their operations or revenues than what is permitted under current Rule 147. According to an academic study, advances in computing and communications have fundamentally changed how information can be stored, distributed, modified or assimilated, which has enabled businesses to become more geographically dispersed and modular rather than centralized into discrete units.[297] Similarly, the growth of modern technologies has made it easier for firms, through *e*-commerce and shared logistical networks, to reach a larger and more diffused customer base, leading to more dispersed revenue streams.

Requiring an issuer to own a majority of its assets in one state, invest most of the capital raised in one state, and obtain revenue mostly from in-state sales could create inefficient constraints for startups and small businesses to operate and grow. While the original intent of

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[296] For example, an e-commerce company may need to invest in distribution facilities outside their state to meet needs of customers who are more likely to be resident outside the state. Under current rule provisions, they may be able to invest only a small part (less than 20%) of the capital raised in a Rule 147 offering outside their principal state of business.

[297] *See* Mohanbir Sawhney and Deval Parikh, "Where Value Lives in A networked World," Harvard Business

Section 3(a)(11) and Rule 147 was to ensure that investors and issuers are located in the same state so that they are potentially familiar with each other,[298] current business practices of issuers, consumption habits of customers, and the set of available investment opportunities of investors have expanded greatly since Rule 147 was adopted in 1974. In view of these economic and social changes, we believe that the proposed principal place of business requirement and the modification to require an issuer to satisfy at least one additional test that demonstrates that that issuer does business in-state would more effectively establish the local nature of an offering pursuant to Rule 147.

The proposed amendments, by easing the eligibility and residency requirements for issuers, would enable a greater number of firms to use Rule 147 to raise capital. Such new issuers could be those entities that are currently accessing capital through an alternate private capital market, or they could be issuers that could not previously raise capital in any market but would be able to use amended Rule 147 to meet their funding needs. In addition, to the extent raising capital in the Rule 147 market is cheaper than raising capital in alternate capital markets, issuers would benefit from such lower costs. Easier access to local capital would enable issuers to finance investment opportunities in a timely manner, thereby accelerating firm growth, which could consequently promote state employment and economic growth.

As more firms become eligible or are willing to raise capital pursuant to amended Rule 147, the set of investment opportunities for investors would also increase in a corresponding manner, resulting in greater allocative efficiency and higher capital formation. To the extent the use of Rule 147 increases because of substitution out of other capital markets, the

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Review, 2001.

[298] *See* Rule 147 Adopting Release.

economy-wide increase in capital formation may not be significant while competition amongst private capital markets would be higher.[299] To the extent that amended Rule 147 attracts new issuers, capital formation levels would increase in the economy. We also believe that, by facilitating intrastate crowdfunding, amended Rule 147 would likely finance new firm growth and consequently would lead to an overall increase in capital formation. Further, amended Rule 147 could also lead to higher capital formation by facilitating offerings, including those with offer sizes greater than what is allowed for intrastate crowdfunding offerings, under other state exempted or state-registered offerings. However, since we do not have data on the existing use of Rule 147, we are unable to quantify or predict the extent of any increase in offering activity in non-crowdfunding offerings under amended Rule 147.

At the same time, allowing issuers with a different state of incorporation to raise capital in another state under amended Rule 147 could result in fewer incorporations for the state where the offering is being conducted, if this proposed amendment results in more issuers relocating to jurisdictions with perceived legal and tax advantages. Moreover, if issuers with widely-distributed assets and operations over more than one state make use of amended Rule 147, state oversight of such issuers could weaken, with a consequent decrease in investor protection. For example, if a majority or a significant proportion of an issuer's assets is located out-of-state, it could be more difficult for state regulators to assess whether any disclosures to investors about such assets are fair and accurate. However, state enforcement actions for protecting in-state investors can extend to issuers whose assets are located beyond the boundaries of the state, which could potentially deter issuers from engaging in fraudulent intrastate offerings. We also

[299] We note that issuers that meet current requirements under existing Rule 147 would also be eligible to rely on amended Rule 147.

believe that qualifying under any one of the four "doing business" in-state tests and requiring an issuer to have an in-state principal place of business, such that the officers and managers of the issuer primarily direct, control and coordinate the activities of the issuer in the state, would provide a state regulator with a sufficient basis from which to regulate an issuer's activities and enforce state securities laws for the protection of resident investors. In addition, if the proposed amendments to Rule 147 are adopted, state regulators may choose to amend their state regulations to comport with amended Rule 147, which would allow them to consider any additional requirements, including qualification tests, for issuers to comply with state securities offerings regulations.

At the same time, even under the proposed amendment requiring issuers to qualify under one of the specified "doing business" in-state tests, the high threshold levels specified in such tests may preclude certain issuers that use modern business models (*e.g.*, some *e*-commerce entities) from relying on the exemption, as such issuers could have widely distributed operations that may not allow them to qualify under any of the four tests.[300]

Additionally, the proposed amendment to limit the ability of issuers for a period of nine months from the date of last sale of securities under a Rule 147 offering to conduct a new Rule 147 offering in a different state would discourage issuers from altering their principal place of business to raise capital through multiple state offerings. The duration of this proposed restriction is consistent with the period in which resales to out-of-state investors would not be permitted. In this regard, the proposed amendment could help mitigate some of the concerns relating to investor protection that may arise from the amended residency requirements. To the extent a change in principal place of business to a new state is motivated by business needs, this

amendment could affect the capital raising prospects of firms by forcing them to delay their intrastate offerings. For example, certain start-ups and small businesses that could potentially change their principal place of business at lower costs could be affected by the proposed amendment. Issuers located in a greater metropolitan area (*e.g.*, New Jersey and New York City) that spans multiple states also may be likely to consider switching their principal place of business to raise capital from residents of another state, and may be also impacted by the proposed amendment.

We note that, under the integration provisions of current and proposed Rule 147, an issuer that conducts a Rule 147 offering in one state within six months of having offered or sold securities pursuant a Rule 147 offering in another state would have such offers and sales integrated for the purpose of compliance with the federal rule. In this respect, we believe that the proposed nine-month period during which an issuer would be prohibited from conducting an intrastate offering pursuant to the proposed rule after having completed sales of securities pursuant to the proposed rule in a different state would have the effect of extending by three months the six-month period of time during which issuers cannot make sales in another state or territory.

c. Maximum Offering Amount and Investment Limitations for Offerings with Exemption from State Registration

The proposed amendments would limit the availability of the exemption at the federal level to offerings that are either registered in the state in which all of the purchasers are resident or conducted pursuant to an exemption from state law registration in such state that limits the amount of securities an issuer may sell pursuant to such exemption to no more than $5 million in

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[300] Market participants, state regulators and other commenters have expressed similar concerns about the prescriptive threshold requirements for these tests. *See* note 11.

a twelve-month period and imposes an investment limitation on investors. These proposed limits would provide additional protections at the federal level and could mitigate investor protection concerns that may arise from the proposed modernization of Rule 147. Specifically, the proposed availability of amended Rule 147 to exempt offerings of up to $5 million in a twelve-month period could provide greater investor protection by reducing the scale of fraudulent offerings, especially those that may be directed towards non-accredited investors and do not have significant state oversight. Similarly, the proposed limitation on the availability of the amended rule, as it relates to offerings that are exempt from state registration, to offerings that are conducted pursuant to a state law exemption that includes investment limitations could reduce the individual exposure of investors to potential fraud or loss of investment in a state-exempt offering pursuant to amended Rule 147.

The proposed amendments would not alter existing state provisions that rely on, or the ability of states to adopt provisions that require issuers to comply with, Section 3(a)(11) and that may not impose a limitation on the maximum aggregate offering amount an issuer can raise or include investment limitations. As Rule 147 would no longer be a safe harbor for compliance with Section 3(a)(11), however, some states would need to update their existing provisions in order to effectively realize the benefits of the proposed amendments to Rule 147. These updates could be limited to removing existing references to Section 3(a)(11) and/or adopting additional provisions that comport with the proposed rule. In the interest of expanding capital raising opportunities, some state regulations may be overly permissive, leading to a "race-to-the-bottom" that could ultimately impair investor protection. Given that state regulators have economic and reputational incentives to provide local issuers and investors with capital markets that are viable over the long run, it is unclear how significant this "race-to-the-bottom" would be.

Current intrastate crowdfunding provisions provide exemptions for offerings of less than $5 million and most of these state provisions have investment limits for non-accredited investors. For example, the highest maximum offering limit that any intrastate crowdfunding provisions currently permit is in Illinois, for crowdfunded offerings up to $4 million. As shown in the baseline, the median (average) offering size limit is $2 million ($1.6 million) in all the states that currently permit crowdfunding transactions. The impact of the proposed amendments on states regulatory flexibility is therefore moderated by the current absence of an intrastate crowdfunding exemption that permits offerings greater than $5 million. In addition, while the proposed amendment relating to investment limits only permits issuers to conduct their offerings pursuant to the proposed rule in states that have included investment limitations, it does not specify what such limitations should be.

However, such limitations at the federal level could unduly restrict capital raising options of issuers, especially those issuers that sell primarily to accredited investors. A limit on the maximum offering amount could also restrict legitimate state interests in permitting larger offerings within their jurisdictions that otherwise rely on Rule 147 at the federal level. To the extent competition between states to enact securities laws to attract issuers to their territories results in better regulations that promote effective functioning of local financial markets, the proposed amendments would limit state regulators' opportunities to customize provisions that better suit the interests of issuers and investors in their state, rather than using a "one-size fits all," or uniform, approach at the federal level that may work better for issuers and investors in some states than others.

3. Additional Amendments to Rule 147

The proposed rules would include a number of additional amendments to Rule 147,

including removing the requirement that an issuer obtain investor representations as to residency status and establishing a reasonable belief standard for determining whether a purchaser is a state resident at the time of the sale of the securities. This proposed amendment would be conceptually consistent with similar requirements in Regulation D offerings and would provide greater certainty to issuers as to their compliance with the conditions of the exemption, potentially encouraging greater reliance on the amended rule. In addition, providing a reasonable belief standard for ascertaining the in-state residency of investors would provide greater flexibility for Rule 147 issuers who currently are required to obtain a written representation from investors about their residency, and who are provided no relief under the rules for sales to persons that are not, in fact, in-state residents. This, in turn, could increase the number of issuers that rely on the amended Rule 147 exemption. At the same time, such provisions may result in issuers selling to investors who are not, in-fact, residents of the state, with a corresponding decline in investor protection. We believe this decline would be somewhat mitigated by any additional requirements that state securities laws may prescribe, as well as the reasonable belief standard and the mandatory disclosures and legends required under the proposed rule amendments.

Moreover, the proposed rules would add a provision to define the residence of a purchaser that is a legal entity—such as a corporation, partnership, trust or other form of business organization—as the location where, at the time of the sale, the entity has its principal place of business. This definition would create consistency in defining the place of residence of entity investors with that of the issuer while also helping to ensure that investors are sufficiently local by nature. Such uniformity would also help to alleviate the rule's compliance burden by providing greater certainty.

The proposed rule also would include a provision to amend the limitation on resales in Rule 147(e) to provide that resales can be made only to in-state residents during the nine-month period from the date of sale by the issuer. By amending the start date for the restricted period from "date of *last* sale" to "date of sale" for the particular security in question, investors will be able to sell before the entire offering is completed, while preserving the intent of restricting resales during a nine-month holding period to provide assurance that the securities have come to rest in-state before out-of-state sales begin to occur. The amendment would thus provide greater liquidity for Rule 147 securities, making them more attractive to investors, which could lead to greater investor participation and an increase in the supply of capital available in the Rule 147 market. Further, it could improve price discovery and lead to lower capital raising costs for issuers.

Additionally, the proposed approach not to condition the availability of the exemption on the issuer complying with provisions relating to resale restrictions would provide greater certainty to issuers. For example, issuers would not need to be concerned about potentially losing the exemption when the resale provisions are violated under circumstances that are beyond their control. At the same time, given that issuers would continue to be subject to other compliance conditions such as in-state sales limitations, mandatory offeree and purchaser disclosures, and stop transfer instructions, as well as federal antifraud and civil liability provisions, we believe, that this proposed amendment would not significantly increase risk of investor harm.

The proposed amendment to Rule 147(f) to require disclosure regarding the limitations on resale to every offeree, in the manner in which the offering is communicated, would provide greater flexibility to issuers and ease compliance burdens in cases of oral offerings. Similarly,

the proposed amendments to remove the requirement to disclose to offerees and purchasers the stop transfer instructions provided by an issuer to its transfer agent and the provisions of Rule 147(f)(2) regarding the issuance of new certificates during the Rule 147(e) resale period, would also ease compliance burdens for issuers. These changes together would lower the regulatory burden for issuers, especially smaller issuers, but may adversely impact the information provided to potential investors (offerees), who may not receive such information in writing, prior to making their investment decision. This impact is somewhat mitigated by the continuing requirement to provide the disclosure regarding resale restrictions, in writing, to every purchaser.

Finally, the proposed rule would expand the current Rule 147 integration safe harbor such that offers and sales pursuant to Rule 147 would not be integrated with: (i) any prior offers or sales of securities, (ii) any offers or sales made more than six months after the completion of the offering, or (iii) any subsequent offer or sale of securities that is either registered under the Securities Act, exempt from registration pursuant to Regulation A, Regulation S, Rule 701, or Section 4(a)(6) or made pursuant to an employee benefit plan. The expansion of the integration safe harbor would provide issuers with greater certainty that they can engage in other exempt or register offerings either prior to or near in time with an intrastate offering without risk of becoming ineligible to rely on the Rule 147 exemption. Similarly, the addition of Section 4(a)(6) to the list of exempt offerings which will not be integrated with a Rule 147 offering would provide certainty to issuers that they can conduct concurrent crowdfunding offerings as per the provisions of the respective exemptions. This flexibility and ensuing certainty would be especially beneficial for small issuers who likely face greater challenges in relying on a single financing option for raising the desired amount of capital. However, such expansion of the

integration safe harbor could result in fewer investor protections than if the offerings were integrated. The proposed rule, however, provides for non-integration only to the extent that the issuer meets the requirements of each of the other offering exemptions that are used to raise capital. Furthermore, requiring an issuer to wait at least 30 calendar days between its last offer made in reliance on Rule 147 and the filing of a registration statement with the Commission would provide additional protection to investors in registered offerings who might otherwise be influenced by an earlier intrastate offering. Therefore, we do not believe that the proposed adoption of the integration safe harbor would result in a significantly increased risk to investors.

4. Analysis of Proposed Amendments to Rule 504

The proposed amendments to Rule 504 would raise the maximum aggregate amount that could be raised under a Rule 504 offering, in a 12-month period, from $1 million to $5 million and would disqualify certain bad actors from participation in Rule 504 offerings. Additionally, in order to account for the proposed increased to the Rule 504 aggregate offering amount limitation, we propose technical amendments to the notes to Rule 504(b)(2) that would update the current illustrations in the rule regarding how the aggregate offering limitation is calculated in the event that an issuer sells securities pursuant to Rule 504 and Rule 505 within the same twelve-month period.[301] All other provisions of current Rule 504 of Regulation D would remain unchanged.

As shown in our baseline analysis above, use of Rule 504 offerings has been declining over the past decade, in absolute terms as well as relative to Rule 506 of Regulation D. Relative to Rule 504 offerings, Rule 506 offerings have the advantage of preemption from state registration. Thus, even though Rule 506(b) offerings, unlike Rule 504 offerings, are limited to

[301] *See* Notes 1 and 2 to Rule 504(b)(2). [17 CFR 230.504(b)(2)].

accredited investors and up to only 35 non-accredited investors, capital raising activity during the last two decades suggests that the benefits of state preemption outweigh unrestricted access to non-accredited investors. With the adoption of Rule 506(c), which allows for general solicitation, the comparative advantage of current Rule 504 has further diminished.

The current $1 million maximum amount was set by the Commission in 1988 and was meant to provide "seed capital" for small and emerging businesses.[302] Given the costs of raising capital from public sources, the unregistered offerings market has expanded significantly in the past twenty-five years. The growth of angel investors and VCs, who invest primarily through unregistered offerings, has also increased seed capital available for investment at the initial stages of a firm. Angel investments in 2014 amounted to approximately $24 billion in 2014 and the average angel deal size was approximately $328,500.[303] According to PWC MoneyTree, in 2008, U.S. VCs made $1.5 billion of seed investments in 440 companies.[304] That is an average seed investment of $3.5 million per company. While the involvement of VCs at the seed stage has been increasing over the years, it is reported that some angel deals at the seed stage have included investments as large as $2.5 million per entity.[305] Given these changes, amending the Rule 504 offer size from $1 million to $5 million would better comport regulation with market

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302 *See* "Seed Capital" Release.

303 According to a recent report, angel investments amounted to $24.1 billion in 2014, with approximately 73,400 entrepreneurial ventures receiving angel funding and approximately 316,600 active angel investors. Seed/startup stage deals accounted for approximately 25% of the $24 billion. *See* Jeffrey Sohl, *The Investor Angel Market in 2014: A Market Correction in Deal Size*, *Center for Venture Research*, May 14, 2015, *available at* https://paulcollege.unh.edu/sites/paulcollege.unh.edu/files/webform/2014%20Analysis%20Report.pdf.

304 *See* PricewaterhouseCoopers, Investment by Stage of Development, available at: https://www.pwcmoneytree.com/CurrentQuarter/BySoD.

305 *See* Fenwick & West Survey 2012 (March 2013), available at https://www.fenwick.com/publications/Pages/Seed-Finance-Survey-2012.aspx. The survey defines a "seed" financing as the first round of financing by a company in which the company raises between $250,000 and $2,500,000, and in which professional investors play a lead role.

trends that indicate larger seed capital infusions.

Four parallel developments may further change the regulatory landscape surrounding existing Rule 504. First, the use of current Rule 504 could be overshadowed by interstate crowdfunding offerings pursuant to Section 4(a)(6), which also allows issuers to raise up to $1 million over a 12-month period with unlimited access to non-accredited investors and unrestricted use of general solicitation, in addition to preemption from state regulation and exemption from the registration requirements under Section 12(g). Second, at least 29 states and the District of Columbia have enacted and several other states are in the process of enacting their own crowdfunding exemptions where the maximum amount that can be raised in a 12-month period ranges from $250,000 to $4 million, depending on the state (up to $2 million for all but three states). The maximum offering amounts for intrastate crowdfunding thus exceed the current offer limit under Rule 504. While most state crowdfunding exemptions require use of Rule 147, currently two states allow issuers to conduct their intrastate crowdfunding under the Rule 504 exemption. Third, state regulators have been working to implement regional coordinated review programs in order to facilitate regional offerings that could potentially save issuers time and money. Additionally, at least one state is in the process of enacting reciprocal crowdfunding provisions, which may allow issuers to conduct interstate crowdfunding under state regulation.[306] Since Rule 147 is restricted to intrastate offerings, Rule 504 would be the most likely federal exemption that could be used for such regional offerings. Fourth, Tier 1 of amended Regulation A, which became effective in June 2015 and has a similar eligible issuer universe as Rule 504, allows offerings up to $20 million without any restrictions on resale of

[306] *See* http://www.nasaa.org/industry-resources/corporation-finance/coordinated-review/. See also, the 'Reciprocal Crowdfunding Exemption' proposed by the Massachusetts Securities Division.

securities.

In light of these developments, the increase in the maximum amount that can be raised in Rule 504 offerings to $5 million could help make this market more attractive for startups and small businesses while also facilitating intrastate and regional offerings greater than $1 million.

A higher offering amount limit for Rule 504 offerings could increase the number of issuers that seek to utilize the exemption. To the extent that amended Rule 504 permits issuers to raise larger amounts of capital at lower costs than other unregistered capital markets, the proposed amendment could also lower issuer cost of capital and facilitate intrastate crowdfunding and the regional offerings market as it evolves. In addition to new issuers raising capital for the first time, it is likely that some issuers currently using other unregistered capital markets may switch to the amended Rule 504 market. Such movement would increase competition for supply of and demand for capital between the different unregistered markets, especially exemptions pursuant to amended Rule 147, Rule 506 of Regulation D, Regulation A, Regulation Crowdfunding, and other Section 4(a)(2) and Section 3(a)(11) exemptions. Further, modernizing our exemptive scheme in order to provide issuers, and especially small businesses, with more options for capital raising could foster an environment that encourages new market participants to enter the capital markets, thereby enhancing the overall level of capital formation in the economy.

The proposed increase in the Rule 504 offering amount limit could also increase the number of investors, including non-accredited investors that can access a wider array of investment opportunities to diversify their investment portfolios with positive effects on the

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http://www.sec.state.ma.us/sct/crowdfundingreg/Reciprocal%20Crowdfunding%20Exemption%20-%20MA.PDF.

supply of capital and the allocative efficiency of unregistered capital markets. At the same time, increased access by non-accredited investors to Rule 504 offerings could raise investor protection concerns. Incidence of fraud could be higher under regional offerings relying on the Rule 504 exemption due to reduced oversight by states that may rely on reciprocal registration or coordinated review programs in the alternate state. The Commission's experience with the elimination of the prohibition against general solicitation for Rule 504 offerings in 1992[307] and its subsequent reinstatement in 1999 as a result of heightened fraudulent activity[308] illustrates the potential for fraud in the Rule 504 market. It should be noted, however, that in 1999 we concluded that the increase in fraud occurred as a result of the prohibition on *unrestricted* general solicitation being removed and because securities issued under Rule 504 offerings were unrestricted.[309] As a result, a non-reporting company could sell up to $1 million of unrestricted securities in a 12-month period and be subject only to the antifraud and civil liability provisions of the federal securities laws. In contrast, the proposed amendments would only increase the aggregate offering amount limitation of Rule 504, thereby leaving existing restrictions on general solicitation and the restricted securities status of the securities unchanged. State registration requirements may also mitigate the risk for investor abuse in Rule 504 offerings.

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307 *See* Adoption of Small Business Initiatives, SEC Release No. 33-6949 (July 30, 1992).

308 *See* Seed Capital Release.

309 *Id.* As the Commission noted at the time it proposed to eliminate the unrestricted nature of securities issued under Rule 504, securities issued in these Rule 504 offerings may have facilitated a number of fraudulent secondary transactions in the over-the-counter markets. The Commission also noted that these securities were issued by "microcap" companies, characterized by thin capitalization, low share prices and little or no analyst coverage. As the freely-tradable nature of the securities facilitated the fraudulent secondary transactions, we proposed to "implement the same resale restrictions on securities issued in a Rule 504 transaction as apply to transactions under the other Regulation D exemptions," in addition to reinstating the prohibition against general solicitation. Although we recognized that resale restrictions would have "some impact upon small businesses trying to raise 'seed capital' in bona fide transactions," we believed at the time that such restrictions were necessary so that "unscrupulous stock promoters will be less likely to use Rule 504 as the source of the freely tradable securities they need to facilitate their fraudulent activities in the secondary markets." *See* Proposed Revision of Rule 504 of Regulation D, the "Seed Capital"

Recent enforcement cases involving Rule 504 offerings could also raise concerns regarding the potential for increased incidence of fraud under the proposed amendments. Most of these cases have involved promoters who engaged in secondary market sales of unrestricted securities that were previously issued in reliance on Rule 504(b)(1)(iii), defrauding investors and in some cases unsophisticated issuers.[310] Securities issued in reliance on Rule 504(b)(1)(iii) are exempt from state registration, and are permitted to use general solicitation. While the incidence of enforcement cases in this market has since declined, we recognize that an increase in the maximum offering size could increase the risk of investor harm, at least in offerings that are exempt from state registration.

Some of these investor concerns could be mitigated by the proposed amendments to Rule 504(b)(2) and the proposed amendment to extend bad actor disqualification provisions to Rule 504, consistent with other rules under Regulation D. As described above, the proposed amendment to Rule 504(b)(2) would update the current illustrations of how the aggregate offering limitation is calculated in the event that an issuer sells securities pursuant to Rule 504 and Rule 505 within the same twelve-month period. By enabling market participants to calculate more easily the amounts permitted to be sold, this amendment would provide greater clarity as to issuer compliance with the proposed increased aggregate offering limitation.

The proposed amendments to Rule 504 would include bad actor disqualification provisions that are substantially similar to related provisions in Rule 506 of Regulation D.[311] Consistent with Rule 506(d), the proposed amendments would require that the covered person's

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Exemption, No. 33-7541 (May 21, 1998) [63 FR 29168 (May 28, 1998)], Executive Summary.

310 *See*, *e.g.*, SEC v. Stephen Czarnik, Case No. 10-cv-745 (S.D.N.Y.), Litigation Release No. 21401 (Feb. 2, 2010); SEC v. Yossef Kahlon, a/k/a Jossef Kahlon and TJ Management Group, LLC, Case No. 4:12-cv-517 (E. D. Tex.) (Aug. 14, 2012).

status be assessed at the time of the first sale of securities. As in Rule 506(d), the proposed disqualification provisions would not preclude the participation of bad actors whose disqualifying events occurred prior to the effective date of the final amendments, which could expose investors to the risks that arise when bad actors are associated with an offering. However, issuers would be required to disclose disqualification events that occurred prior to the effectiveness of the proposed amendments. The risks to investors from participation of covered persons with prior disqualifying events may therefore be partly mitigated as investors would have access to relevant information that could inform their investment decisions. Disclosure of prior disqualifying events may make it more difficult for issuers to attract investors, and issuers may experience some or all of the impact of disqualification as a result. Some Rule 504 issuers may accordingly choose to exclude involvement by prior bad actors to avoid such disclosures.

We expect that the bad actor disqualification provisions could help reduce the potential for fraud in these types of offerings and thus strengthen investor protection. If disqualification standards lower the risk premium associated with the risk of fraud due to the presence of bad actors in securities offerings, they could also reduce the cost of capital for issuers that rely on the amended Rule 504 exemption. In addition, the requirement that issuers determine whether any covered persons are subject to disqualification might reduce the need for investors to conduct their own due diligence and could therefore increase efficiency. While fraud can still occur without prior incidence of disqualification on the part of the issuer or covered persons, these provisions could mitigate some of the concerns relating to incidence of fraud in offerings pursuant to amended Rule 504, including offerings pursuant to regional coordinated review

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[311] *See* Rules 505(b)(2)(iii) and 506(d) of Regulation D, 17 CFR 230,505(b)(2)(iii), 230.506(d).

programs, that could be registered in one jurisdiction but offered and sold in multiple jurisdictions.

The disqualification provisions could also impose costs on issuers and covered persons. Issuers that are disqualified from using amended Rule 504 may experience an increased cost of capital or a reduced availability of capital, which could have negative effects on capital formation. In addition, issuers may incur costs related to seeking disqualification waivers from the Commission and replacing personnel or avoiding the participation of covered persons who are subject to disqualifying events. Issuers also might incur costs to restructure their share ownership to avoid beneficial ownership of 20% or more of the issuer's outstanding voting equity securities by individuals subject to disqualification.

As discussed above, the proposed amendments would provide, by reference to Rule 506(d), a reasonable care exception as applicable for other exemptive rules under Regulation D. A reasonable care exception could facilitate capital formation by encouraging issuers to proceed with Rule 504 offerings in situations in which issuers otherwise might have been deterred from relying on Rule 504 if they risked potential liability under Section 5 of the Securities Act for unknown disqualifying events. At the same time, this exception also could increase the potential for fraud, by limiting issuers' incentives to determine whether bad actors are involved with their offerings. We also recognize that some issuers might incur costs associated with conducting and documenting their factual inquiry into possible disqualifications. The rule's flexibility with respect to the nature and extent of the factual inquiry required could allow an issuer to tailor its factual inquiry as appropriate to its particular circumstances, thereby potentially limiting costs. Finally, we note that extending the disqualification provisions to Rule 504 would create a more

consistent regulatory regime under Regulation D that would simplify due diligence requirements and thereby benefit issuers and investors that participate in different types of exempt offerings.

C. Alternatives

1. Rescind Rule 505 Exemption

As discussed in our baseline analysis above, over the past 20 years, the use of the Rule 505 exemption has declined steadily and to a greater extent than the decline in the use of the Rule 504 exemption, in terms of the number of new offerings and amount of capital raised. During 2014, Rule 505 offerings raised less than 0.02% of capital raised in the Regulation D market, and approximately 2% of all capital raised by Regulation D offerings of less than $5 million, Rule 506 which has state preemption clearly dominates the market due to the lower regulatory burden associated with this provision, relative to Rules 504 and 505.

Further, we believe that by allowing offerings up to $5 million, amended Rule 504 would be preferable to existing Rule 505 for issuers currently eligible for both exemptions because it would provide access to an unlimited number of non-accredited investors and restricted general solicitation. Other unregistered markets may also provide a comparable market for potential Rule 505 issuers to raise the desired capital.[312] Rescinding Rule 505 would therefore simplify the existing scheme of exemptive rules and regulations for unregistered offerings by making it easier for issuers and investors to choose between different capital markets.

To the extent that issuers are not able to switch to an alternate market or raise a sufficient amount of capital, however, rescinding Rule 505 could cause overall capital formation in the

[312] For example, Rule 506(b) enables issuers to raise unlimited amounts along with providing preemption from state regulation; however, Rule 506(b) offerings are limited to 35 non-accredited investors who must be sophisticated, either individually or through a purchaser representative. In contrast, while Regulation A offerings have greater disclosure requirements, they provide unlimited access to non-accredited investors with the added benefit of unrestricted resales of securities.

economy and allocative efficiency of capital markets to decline. For example, reporting companies and investment companies cannot utilize the Rule 504 exemption. However, very few reporting companies (8 out of 289) or fund issuers (11) used the Rule 505 exemption during 2014,[313] and these issuers can switch to a Rule 506 offering with little or no costs. We, therefore, believe that most Rule 505 issuers would likely be able to utilize other exemptions.

The impact of repealing Rule 505 would also depend on investor willingness and ability to switch from an investment in a Rule 505 offering to an investment in an alternate unregistered capital market. Overall, we believe that repealing Rule 505 would not have a significant, or any, impact on capital formation because issuers would likely be successful at finding commensurate capital supply in an alternate unregistered capital market.

[313] Based on an analysis of Form D filings. The numbers were similar during 2009-2013.

2. Lower Qualifying Thresholds under "Doing Business" In-State Tests

An alternative to the proposed amendments relating to the four alternative criteria an issuer must satisfy in order to demonstrate it is doing business in-state could be to lower the percentage thresholds for the current or proposed 80% threshold requirements. For example, compared with the current 80% threshold requirements, requiring issuers to have the majority of their assets, derive the majority of their revenue, or use the majority of their offering proceeds in-state could better comport with modern business practices, provide greater flexibility and make it less burdensome for issuers to satisfy these requirements. Such a change would also align Rule 147 with other tests, including the proposed majority employees test, and also those tests that use a majority threshold for determining issuer status, for example for determining foreign private issuers.[314]

Lowering the prescriptive threshold requirements, while retaining the requirement to satisfy all or some of the criteria that provide indicia of in-state business, would help balance issuer compliance obligations with the need to align the locus of Rule 147 capital raising more closely with issuer operations. At the same time, if issuers with widely-distributed operations over more than one state are able to make greater use of amended Rule 147 under such lower thresholds, state oversight of such issuers could weaken, with a consequent decrease in investor protection. Some of these concerns could be mitigated by continuing to restrict sales to in-state residents and the inclusion of the principal place of business requirement, by the ability of states to extend their enforcement activities to issuers whose assets are located beyond state borders, and by the availability of federal authority to pursue enforcement action under the antifraud provisions of the federal securities laws.

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[314] *See* Securities Act Rule 405 and Exchange Act Rule 3b.

3. Eliminate "Doing Business" In-State Tests

As another alternative to the proposed rules we considered eliminating the proposed requirement to qualify under any of the "doing business" tests. This alternative would significantly ease the burden for potential Rule 147 issuers in complying with the exemption, while also modernizing regulations to align with modern business practices. As described above, in recent years new business models have emerged that may make the eligibility tests ill-suited for relying on the Rule 147 exemption as a capital raising option. Requiring an issuer to own a significant proportion of its assets, have a majority of its employees in one state, invest most of the capital raised in one state, or derive revenue mostly from in-state sales could create inefficient constraints for startups and small businesses to operate and grow. In view of these broad changes in business practices, the principal place of business requirement may be sufficiently effective in establishing the local nature of an offering pursuant to Rule 147 for purposes of compliance with the "doing business" in-state requirement at the federal level. Relative to the proposed approach, this alternative approach would provide more flexibility to state regulators to enact their own eligibility and residency requirements that better suit the interests of issuers and investors in their state, rather than using a "one-size-fits all," or uniform, approach at the federal level that may work better for issuers and investors in some states than others.

At the same time, under such alternative, as issuers with widely-distributed assets and operations over more than one state make use of amended Rule 147, state oversight of such issuers could weaken, with a consequent decrease in investor protection. For example, if a majority or a significant proportion of an issuer's assets is located out-of-state, it could be more difficult for state regulators to assess whether any disclosures to investors about such assets are

fair and accurate. At the same time, state enforcement actions for protecting in-state investors can extend to issuers whose assets are located beyond the boundaries of the state. Additionally, under this alternative, the principal place of business requirement would replace the prescriptive "doing business" in-state requirements and could help mitigate investor protection concerns related to the local nature of the offering.

4. Decreasing or Increasing Rule 504 Maximum Offering Limit

The offer limit under Rule 504 was last increased from $500,000 to $1 million in 1988. Adjusted for inflation, the $1 million in 1988 would be worth approximately $2 million today.[315] Additionally, offering amount limits under various state crowdfunding provisions generally are set around $2 million for most jurisdictions, with $4 million being the highest offering limit in one state. As an alternative to the proposed rule, the offering limit under Rule 504 could be raised to less than $5 million. Increasing the maximum Rule 504 offering to an amount less than $5 million could help alleviate concerns about a decrease in investor protection from unlimited access to non-accredited investors. At the same time, this alternative would restrict capital raising options for issuers, especially if Rule 505 (which permits offering amounts up to $5 million) is rescinded.

Alternately, the maximum offering limit under amended Rule 504 could be raised to an amount greater than $5 million. One example could be to align the maximum offering limit to that of the Tier I offer limit ($20 million) under amended Regulation A. This could allow for more cost-effective state registration, while also providing a competitive alternative to eligible issuers in Tier 1 of the Regulation A market. However, unlike the Regulation A market, non-

[315] Annual inflation rates (1988-2014) based on consumer price index data, for all urban consumers, obtained from the Bureau of Labor Statistics.

accredited investors have no investment limits under the Rule 504 provisions. Moreover, recent enforcement cases have highlighted instances of investor abuse in offerings that are sold only to accredited investors in reliance on Rule 504(b)(1)(iii). A higher maximum offering amount would thus lead to greater investor protection concerns.

5. Additional Amendments to Rule 504

In light of concerns about potential abuses involving securities issued in reliance on Rule 504(b)(1)(iii),[316] imposing resale restrictions on such securities could increase investor protection by helping to ensure that securities initially sold pursuant to the exemption are only resold by initial purchasers after the passage of a fixed period of time. However, these restrictions would reduce the liquidity of Rule 504(b)(1)(iii) securities, which could increase the cost of capital for issuers seeking to raise capital in reliance on this rule provision. At the same time, increasing investor protection through resale restrictions could attract greater investor interest and lower the expected risk premium, which would mitigate, to some extent, the higher costs arising from less liquid securities.

Additionally, Rule 504 could be amended to include additional disclosures to address investor protection concerns arising from the increase in the maximum offering size. While such disclosures could mitigate some of these concerns, they would increase the compliance burden for Rule 504 issuers and may also overlap or extend similar requirements under state law provisions in the jurisdiction in which such Rule 504 offering is registered.

D. Request for Comment

We request comments regarding our analysis of the potential economic effects of the proposed amendments and other matters that may have an effect on the proposed rule. We

[316] *See* note 182 and related discussion in Section 0 and SectionV.B.0 above.

request comment from the point of view of issuers, investors and other market participants. With regard to any comments, we note that such comments are of particular assistance to us if accompanied by supporting data and analysis of the issues addressed in those comments. For example, we are interested in receiving estimates and data on all aspects of the proposal and, in particular, on the expected size of the Rule 147 and Rule 504 markets (number of offerings, number of issuers, size of offerings, number of investors, etc., as well as information comparing these estimates to our baseline), overall economic impact of the proposed amendments, and any other aspect of this economic analysis. We also are interested in comments on the benefits and costs we have identified and any benefits and costs we may have overlooked as well as the impact of the proposed amendments on competition.

66. What type (size, industry, age, etc.) and how many issuers have relied on Rule 147 during the years 2013 and 2014? In what states were these offerings conducted? How many of these were state-registered offerings? How many claimed an exemption from registration under state laws?

67. What types of issuers (size, industry, age, etc.) would most likely rely on intrastate or regional offerings pursuant to amended Rules 147 and 504?

68. As proposed, would amended Rules 147 and 504 attract startups and small businesses that are considering an offering pursuant to Regulation Crowdfunding? What types of issuers (size, industry, age, etc.) would prefer to conduct an intrastate crowdfunding offering to an interstate crowdfunding offering?

69. How similar is a securities-based intrastate crowdfunding offering to a securities-based offering under Regulation Crowdfunding? How would the cost of an interstate crowdfunding offering compare with the cost of an intrastate crowdfunding offering?

How would the expected incidence of success, failure, fraud and other outcomes of an interstate crowdfunding offering compare to the cost of an intrastate crowdfunding offering?

70. Are issuers more likely to use the exemption under amended Rule 147 or the exemption under amended Rule 504 for intrastate offerings if they have a choice under state regulation? Would the cost of raising capital be lower under amended Rule 147 or under amended Rule 504?

71. As proposed, would the amended Rules 147 and 504 attract issuers that are considering offerings under Rule 506(b) or Rule 506(c) of Regulation D or Regulation A? What would the costs and benefits be from relying on the amended rules, compared to the costs and benefits from relying on Rule 506(b) or Rule 506(c) of Regulation D or Regulation A? Please provide estimates, where possible.

72. What would be the economic effect of the proposed modification of the "doing business" in-state tests on Rule 147 offerings? What types of issuers and investors are most likely to be affected by the proposed amendments to the "doing business" tests?

73. What would be the economic effect of the elimination of all "doing business" in-state tests on Rule 147 offerings? What types of issuers and investors are most likely to be affected by the existing "doing business" in-state requirements? Would the elimination of all "doing business" in-state tests decrease investor protection? What would be the economic effect of retaining some or all of the tests with lower qualifying thresholds?

74. What are the economic effects of requiring a maximum offering amount and investment limits for Rule 147 offerings that are exempt from state registration? Will issuers be likely to use Rule 147 if these proposed amendments relating to state-exempt offerings are adopted?

75. How would amended Rule 147 affect other state registered and state exempt offerings? What type of issuers (size, age, industry, etc.) would rely on amended Rule 147 pursuant to state registration or a state exemption other than intrastate crowdfunding? What would be the typical offering sizes?

76. Would the amended Rules 147 and 504 attract accredited and/or non-accredited investors to intrastate and regional offerings? How would the costs and benefits of the amended requirements compare to the costs and benefits of state preemption that currently exists for securities offered under Rule 506 of Regulation D? How would the costs and benefits compare to other exempt offering methods, such as Regulation A or Regulation Crowdfunding? Please provide estimates, where possible.

77. Would the amended Rule 147 and 504 exemptions attract intermediaries (*e.g.*, crowdfunding portals, broker-dealers or underwriters) to intrastate or regional offerings markets? How would the presence of intermediaries change the cost structure for Rule 147 and Rule 504 issuers? Would the presence of intermediaries likely increase the chances that a wider variety of investors would participate in Rule 147 and 504 offerings?

78. To what extent would additional resale restrictions on securities issued in reliance of Rule 504(b)(1)(iii) decrease the liquidity of such securities?

79. How would a decrease in the Rule 504 offering amount limitation to, for example, $2.5 million in a 12-month period affect the use of Rule 504 exemption? Would it be sufficient to efficiently address capital raising needs of issuers and effectively address investor protection concerns? Would the costs of state registration be feasible under a smaller Rule 504 offering limitation?

80. How would an increase in the Rule 504 offering amount limitation to, for example, $20 million in a 12-month period affect the use of Tier 1 of Regulation A? How would issuers benefit from the increased offering limitation? Would any such increase in the offering limitation have an adverse effect on investor protection?

81. In the case of a repeal of Rule 505, which alternate exemption would Rule 505 issuers be most likely to utilize? How would the costs of capital for such issuers be affected?

82. What would the cost be for an issuer that issues securities under state crowdfunding provisions and crosses the Section 12(g) thresholds for registering with the Commission? Please provide quantitative estimates, where available.

83. What would be the economic impact of alternatives to the proposed rule amendments that have been discussed above?

VI. PAPERWORK REDUCTION ACT

The proposed amendments to Rule 147 do not contain a "collection of information" requirement within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[317] Accordingly, the PRA is not applicable to the proposed amendments to Rule 147 and no PRA

[317] 44 U.S.C. 3501 *et seq*. Although amended Rule 147(f) would require a legend on stock certificates and certain other disclosures to be made to offerees and purchasers, the proposed rule would prescribe the precise form of disclosure to be provided to the public, and thus the proposed amendments would not require issuers to obtain or compile information for purposes of compliance with this provision. *See* 5 CFR 1320.3(c)(2).

analysis is required.

The proposed amendments to Rule 504 of Regulation D contain "collection of information" requirements within the meaning of the PRA. There are two titles for the collection of information requirements contemplated by the proposed amendments. The first title is: "Form D" (OMB Control No. 3235-0076), an existing collection of information.[318] The second title is: "Regulation D Rule 504(b)(3) Felons and Other Bad Actors Disclosure Statement," a new collection of information. Although the proposed amendments to Rule 504 do not alter the information requirements set forth in Form D, the proposed amendments are expected to increase the number of new Form D filings made pursuant to Regulation D. Additionally, the mandatory bad actor disclosure provisions that would be required under proposed Rule 504 would contain "collection of information" requirements within the meaning of the PRA. We are submitting the proposed amendments to the Office of Management and Budget ("OMB") for review and approval in accordance with the PRA and its implementing regulations.[319]

The information collection requirements related to the filing of Form D with the Commission are mandatory to the extent that an issuer elects to make an offering of securities in reliance on the relevant exemption. Responses are not confidential, and there is no mandatory retention period for the information disclosed. The hours and costs associated with preparing and filing forms and retaining records constitute reporting and cost burdens imposed by the collection of information requirements. We are applying for an OMB control number for the proposed new collection of information in accordance with 44 U.S.C. 3507(j) and 5 CFR 1320.13, and OMB has not yet assigned a control number to the new collection. Responses to

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[318] Form D was adopted pursuant to Sections 2(a)(15), 3(b), 4(a)(2), 19(a) and 19(c)(3) of the Securities Act (15 U.S.C. 77b(a)(15), 77c(b), 77d(a)(2), 77s(a) and 77s(c)(3)).

[319] 44 U.S.C. 3507(d); 5 CFR 1320.11.

the new collection of information would be mandatory. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information requirement unless it displays a currently valid OMB control number.

Form D (OMB Control No. 3235-0076)

The Form D filing is required for issuers as a notice of sales without registration under the Securities Act based on a claim of exemption under Regulation D or Section 4(a)(5) of the Securities Act. The Form D must include basic information about the issuer, certain related persons, and the offering. This information is used by the Commission to observe use of the Regulation D exemptions and safe harbor.

As we are not proposing to alter the information requirements of Form D, our proposed amendments will not affect the paperwork burden of the form, and the burden for responding to the collection of information in Form D will be the same as before the proposed amendments to Form D. However, we estimate that our proposed amendments to increase the aggregate amount of securities that may be offered and sold in any 12-month period in reliance on Rule 504 will increase the number of Form D filings that are made with the Commission.

The table below shows the current total annual compliance burden, in hours and in costs, of the collection of information pursuant to Form D. For purposes of the PRA, we estimate that, over a three-year period, the average burden estimate will be four hours per Form D. Our burden estimate represents the average burden for all issuers. This burden is reflected as a one hour burden of preparation on the company and a cost of $1,200 per filing. In deriving these estimates, we assume that 25% of the burden of preparation is carried by the issuer internally and that 75% of the burden of preparation is carried by outside professionals retained by the issuer at an average cost of $400 per hour. The portion of the burden carried by outside professionals is

reflected as a cost, while the portion of the burden carried by the issuer internally is reflected in hours.

Table 1. Estimated paperwork burden under Form D, pre-amendment to Rule 504

	Number of responses (A)[320]	Burden hours/form (B)	Total burden hours (C)=(A)*(B)	Internal issuer time (D)	External professional time (E)	Professional costs (F)=(E)*$400
Form D	25,300	4	101,200	25,300	75,900	$30,360,000

For the year ended 2014, 19,717 issuers made 22,004 new Form D filings. The annual number of new Form D filings rose from 13,764 in 2009 to 22,004 in 2014, an average increase of approximately 1,648 Form D filings per year, or approximately 10%. Assuming the number of Form D filings continues to increase by 1,648 filings per year for each of the next three years, the average number of Form D filings in each of the next three years would be approximately 25,300.

We estimate that the proposed amendments to Rule 504 would result in a much smaller annual increase in the number of new Form D filings than the average annual increase that has occurred over the past five years. To estimate how the proposed amendments to Rule 504 would impact the number of new Form D filings, we used as a reference point the impact of a past rule change on the market for Regulation D offerings. In 1997, the Commission amended

[320] Although the number of responses for Form D is reported as 21,824 in the OMB's Inventory of Currently Approved Information Collections, available at http://www.reginfo.gov/public/do/PRAMain;jsessionid=D37174B5F6F9148DB767D63DF6983A65, we are preparing a new estimate based on the historical trend of the annual number of new Form D filings. Based on an average increase of approximately 1,648 new Form D filings per year over the past five years, we believe that the average number of new Form D filings in each of the next three years would be approximately 25,300.

Rule 144(d) under the Securities Act[321] to reduce the holding period for restricted securities from two years to one year,[322] thereby increasing the attractiveness of Regulation D offerings to investors and to issuers. Prior to amending Rule 144(d), there were 10,341 Form D filings in 1996, which was followed by a 20% increase in the number of Form D filings in each of the subsequent three calendar years, reaching 17,830 by 1999. Although it is not possible to predict with any degree of certainty the increase in the number of Rule 504 offerings following the proposed amendments, we estimate for purposes of the PRA that there would be a similar 20% increase in the number of new Form D offerings that currently rely on either Rule 504 or 505.[323] In 2014, there were 544 new Form D filings reporting reliance on Rule 504 and 289 new Form D filings reporting reliance on Rule 505. We estimate that there will be an additional approximately 200 new Form D filings in each of the next three years attributable to the proposed amendments.[324]

Based on these increases, we estimate that the annual compliance burden of the collection of information requirements for issuers making Form D filings after amending Rule 504 to increase the aggregate offering amount from $1 million to $5 million would be an aggregate 25,500 hours of issuer personnel time and $30,600,000 for the services of outside professionals per year.

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321 17 CFR 230.144(d).

322 *See*, SEC Rel. No. 33-7390 (Feb. 20, 1997) [62 FR 9242].

323 We include the number of new Form D filings that rely on Rule 505 in these estimates since Rule 505 provides an alternative Regulation D exemption for an issuer to rely upon with a maximum offering limitation of no more than $5 million in a twelve month period.

324 We estimate the number of new Form D filings attributable to the proposed amendments over the next three years as follows: 833 new Form D filings in 2014 relying on either Rules 504 or 505, multiplied by 20% equals 166.6. Rounding 166.6 to the nearest hundredth provides us with an estimate of 200 new Form D filings attributable to the proposed amendments.

Table 2. Estimated paperwork burden under Form D, post-amendment to Rule 504

	Number of responses (A)[325]	Burden hours/form (B)	Total burden hours (C)=(A)*(B)	Internal issuer time (D)	External professional time (E)	Professional costs (F)=(E)*$400
Form D	25,500	4	102,000	25,500	76,500	$30,600,000

Regulation D Rule 504(b)(3) Felons and Other Bad Actors Disclosure Statement (a proposed new collection of information)

As proposed, the amendments to Rule 504 would disqualify issuers from reliance on Rule 504 if such issuer would be subject to disqualification under Rule 506(d) of Regulation D.[326] Consistent with the requirements of Rule 506(e), we proposed to require that the issuer in a Rule 504 offering furnish to each purchaser, a reasonable time prior to sale, a written description of any matters that occurred before effectiveness of any amendments to the rule that may be adopted and within the time periods described in the list of disqualification events set forth in Rule 506(d)(1) of Regulation D,[327] in regard to the issuer or any other "covered person" associated with the offering. For purposes of the mandatory disclosure provision described in the note to proposed Rule 504(b)(3),[328] issuers would be required to

[325] The information in this column is not based on the number of responses for Form D of 21,824, as reported in the OMB's Inventory of Currently Approved Information Collections, but rather on a new estimate of the average number of new Form D filings in each of the next three years. We prepared this estimate based on the historical trend of the annual number of new Form D filings. *See* text accompanying note 320 above. Based on an average increase of approximately 1,648 new Form D filings per year over the past five years, we estimate that the number of new Form D filings after the proposed amendment to Rule 504 would be the average number of new Form D filings we estimate in each of the next three years of 25,300, plus the additional 200 filings we estimate would be filed as a result of the proposed amendment to Rule 504.

[326] *See* proposed Rule 504(b)(3); *see also* 17 CFR 230.506(d).

[327] 17 CFR 230.506(d)(1).

[328] *See* note to proposed Rule 504(b)(3).

ascertain whether any disclosures are required in respect of covered persons involved in their offerings, prepare any required disclosures and furnish them to purchasers.

The Commission would adopt the proposed Regulation D Rule 504(b)(3) Felons and Other Bad Actors Disclosure Statement under the Securities Act. The Regulation D Rule 504(b)(3) Felons and Other Bad Actors Disclosure Statement that would be required to be furnished to investors does not involve submission of a form filed with the Commission and is not required to be presented in any particular format, although it must be in writing. The hours and costs associated with preparing and furnishing the Regulation D Rule 504(b)(3) Felons and Other Bad Actors Disclosure Statement to investors in the offering constitute reporting and cost burdens imposed by the collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

The disclosure or paperwork burden imposed on issuers appears in a note to proposed Rule 504(b)(3) and pertains to events that occurred before effectiveness of the final rules but which would have triggered disqualification had they occurred after effectiveness. Issuers relying on proposed Rule 504 would be required to furnish disclosure of any relevant past events that would have triggered disqualification under proposed Rule 504(b)(3) that relate to the issuer or any other covered person. If there are any such events, a disclosure statement would be required to be furnished, a reasonable time before sale, to all purchasers in the offering. The disclosure requirement would serve to protect purchasers by ensuring that they receive information regarding any covered persons that were subject to such disqualifying events.

The disclosure requirement would not apply to triggering events occurring after the effective date of the proposed rule amendments, if adopted, because those events would result in

disqualification from reliance on Rule 504 (absent a waiver or other exception provided in Rule 506(d)), rather than any disclosure obligation.

The steps that issuers would take to comply with the proposed disclosure requirement are expected to mirror the steps they would take to determine whether they are disqualified from relying on Rule 504. We expect that issuers planning or conducting a Rule 504 offering would undertake a factual inquiry to determine whether they are subject to any disqualification. Disqualification and mandatory disclosure would be triggered by the same types of events in respect of the same covered persons, with disqualification arising from triggering events occurring after the adoption and effectiveness of any amended rules and mandatory disclosure applicable to events occurring before that date. Therefore, we would expect that factual inquiry into potential disqualification could simply be extended to cover the period before any amended rules so adopted become effective. On that basis, we would expect that the factual inquiry process for the disclosure statement requirement would impose a limited incremental burden on issuers.

We expect that the size of the issuer and the circumstances of the particular Rule 504 offering would determine the scope of the factual inquiry and require tailored and offering-specific data gathering approaches. We do not anticipate that it would generally be necessary for any issuer or any compensated solicitor to make inquiry of any covered individual with respect to ascertaining the existence of events that require disclosure more than once, because the proposed period to be covered by the inquiry would end with the effective date of any new disqualification rules (so future events would be unlikely to affect the inquiry or change the disclosures that would have to be made). We do, however, expect that issuers may be required to revise their factual inquiry for each Rule 504 offering due to changes in management or

intermediaries, other changes to the group of covered persons or if questions arise about the accuracy of previous responses. We also would expect that the disclosure requirement may serve the additional function of helping issuers develop processes and procedures for the factual inquiry required to establish reasonable care under the disqualification provisions of Rule 506(d).

We anticipate that the Regulation D Rule 504(b)(3) Felons and Other Bad Actors Disclosure Statement would result in an incremental increase in the burdens and costs for issuers that rely on the Rule 504 exemption by requiring these issuers to conduct factual inquiries into the backgrounds of covered persons with regard to events that occurred before effectiveness of the final bad actor disqualification provisions. For purposes of the PRA, we estimate the total annual increase in paperwork burden for all affected Rule 504 issuers to comply with our proposed collection of information requirements would be approximately 830 hours of company personnel time and approximately $9,600 for the services of outside professionals. These estimates include the incremental time and cost of conducting a factual inquiry to determine whether the Rule 504 issuers have any covered persons with past disqualifying events. The estimates also include the cost of preparing a disclosure statement that issuers would be required to furnish to each purchaser a reasonable time prior to sale.

In deriving our estimates, consistent with those assumptions used in the PRA analysis for the Rule 506 bad actor disqualification provisions,[329] we assume that:

Approximately 750 Rule 504 issuers[330] relying on Rule 504 of Regulation D would spend on average one additional hour to conduct a factual inquiry to determine whether any covered

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329 *See* SEC Rel. No. 33-9414 (July 10, 2013).

330 Filing data reviewed by the staff of the Commission's Division of Economic and Risk Analysis indicate that for 2014, 544 issuers claimed Rule 504 and 289 issuers claimed Rule 505 in their Form D filings with the Commission. *See* Figure 1 in Section 0 above. For purposes of the PRA estimates, and based on the data provided for Rule 504 and Rule 505 offerings in 2014, we assume that approximately 750 issuers would

persons had a disqualifying event that occurred before the effective date of the rule amendments; and

On the basis of the factual inquiry, approximately eight issuers (or approximately 1%) would spend ten hours to prepare a disclosure statement describing matters that would have triggered disqualification under Rule 504(b)(3) of Regulation D had they occurred on or after the effective date of the rule amendments; and

For purposes of the disclosure statement, approximately eight Rule 504 issuers would retain outside professional firms to spend three hours on disclosure preparation at an average cost of $400 per hour.

The increase in burdens and costs associated with conducting the proposed factual inquiry for the disclosure statement requirement should pose a minimal incremental effort given that issuers are simultaneously required to conduct a similar factual inquiry for purposes of determining disqualification from the Rule 506 exemption.

It is difficult to provide any standardized estimates of the costs involved with the factual inquiry. There is no central repository that aggregates information from all federal and state courts and regulators that would be relevant in determining whether a covered person has a disqualifying event in his or her past. In this regard, we are currently unable to accurately estimate the burdens and costs for issuers in a verifiable way. We expect, however, that the costs to issuers may be higher or lower depending on the size of the issuer and the number and roles of covered persons. We realize there may be a wide range of issuer size, management structure, and

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file a Form D indicating reliance on Rule 504 after the effectiveness of any rule amendments proposed today. This figure includes issuers that, before the adoption of any potential amendments to Rule 504 proposed today, would have conducted offerings pursuant to Rule 505, but that after the adoption of any such amendments would likely conduct their offerings pursuant to Rule 504.

offering participants involved in Rule 504 offerings and that different issuers may develop a variety of different factual inquiry procedures.

Where the issuer or any covered person would be subject to an event covered by Rule 504(b)(3) that existed before the effective date of these rules, the issuer would be required to prepare disclosure for each relevant Rule 504 offering. The estimates include the time and the cost of data gathering systems, the time and cost of preparing and reviewing disclosure by in-house and outside counsel and executive officers, and the time and cost of delivering or furnishing documents and retaining records.

Issuers conducting ongoing or continuous offerings would be required to update their factual inquiry and disclosure as necessary to address additional covered persons. The annual incremental paperwork burden, therefore, depends on an issuer's Rule 504 offering activity and the changes in covered persons from offering to offering. For example, some issuers may only conduct one Rule 504 offering during a year while other issuers may have multiple, separate Rule 504 offerings during the course of the same year involving different financial intermediaries, may hire new executive officers or may have new 20% shareholders, any of which would result in a different group of covered persons. In deriving our estimates, we recognize that the burdens would likely vary among individual companies based on a number of factors, including the size and complexity of their organizations. We believe that some companies would experience costs in excess of this estimated average and some companies may experience less than the estimated average costs.

Request for Comment

We request comment on our approach and the accuracy of the current estimates. Pursuant to 44 U.S.C. 3506(c)(2)(A), the Commission solicits comments to: (1) evaluate

whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) evaluate the accuracy of the Commission's estimate of burden of the collection of information; (3) determine whether there are ways to enhance the quality, utility and clarity of the information to be collected; and (4) evaluate whether there are ways to minimize the burden of the collection of information on those who are required to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and send a copy to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-22-15. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-22-15, and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street, NE, Washington, DC 20549-1090. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is assured of having its full effect if OMB receives it within 30 days of publication.

VII. INITIAL REGULATORY FLEXIBILITY ACT ANALYSIS

The Regulatory Flexibility Act ("RFA")[331] requires the Commission, in promulgating rules under Section 553 of the Administrative Procedure Act,[332] to consider the impact of those

[331] 5 U.S.C. 601 *et seq.*

[332] 5 U.S.C. 553.

rules on small entities. The Commission has prepared this Initial Regulatory Flexibility Analysis ("IRFA") in accordance with Section 603 of the RFA.[333] This IRFA relates to the proposed amendments to Securities Act Rules 147 and 504.

A. Reasons for, and Objectives of, the Action

The primary reason for, and objective of, the proposed amendments to Rule 147 is to establish a new Securities Act exemption for intrastate offerings of securities by local companies, including offerings relying upon newly adopted and proposed crowdfunding provisions under state securities laws. Market participants and state regulators have indicated that the combined effect of Section 3(a)(11)'s statutory limitation on offers and the prescriptive issuer eligibility requirements of Rule 147 unduly restrict the availability of the exemption for local companies that would otherwise conduct intrastate offerings in a manner that is consistent with the original intent of Section 3(a)(11). These commenters have also indicated that the current requirements of Rule 147 make it difficult for issuers to take advantage of recently adopted state crowdfunding provisions. The proposed amendments to Rule 147 would ease these limitations in the rule and would allow an issuer to engage in any form of general solicitation or general advertising, including the use of publicly accessible Internet websites, to offer and sell its securities, so long as all purchasers of such securities are residents of the same state or territory in which the issuer's principal place of business is located. We propose to amend Rule 147 pursuant to our general exemptive authority under Section 28 of the Securities Act.

The primary reason for, and objective of, the proposed amendments to Rule 504 is to facilitate capital formation by increasing the flexibility of state securities regulators to implement regional coordinated review programs that would facilitate regional offerings. The proposed

[333] 5 U.S.C. 603.

amendments to Rule 504 would raise the aggregate amount of securities an issuer may offer and sell in any 12-month period from $1 million to $5 million and disqualify certain bad actors from participating in Rule 504 offerings. We believe that raising the aggregate offering limitation and disqualifying certain bad actors would maximize the flexibility of state securities regulators to implement regional coordinated review programs and provide for greater consistency across Regulation D.

B. Legal Basis

We are proposing the amendments pursuant to Sections 3(b)(1), 4(a)(2), 19 and 28 of the Securities Act.

C. Small Entities Subject to the Proposed Amendments

For purposes of the RFA, under our rules, an issuer, other than an investment company, is a "small business" or "small organization" if it has total assets of $5 million or less as of the end of its most recent fiscal year and is engaged or proposing to engage in an offering of securities which does not exceed $5 million.[334] For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[335]

While we lack data on the number and size of Rule 147 offerings[336] or the type of issuers currently relying on the Rule 147 safe harbor, the nature of the eligibility requirements and other restrictions of the rule lead us to believe that it is currently being used by U.S. incorporated businesses that are likely small businesses seeking to raise small amounts of capital without

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[334] 17 CFR 230.157.

[335] 17 CFR 270.0-10(a).

incurring the costs of registering with the Commission.

Currently, issuers that intend to conduct intrastate crowdfunding offerings are required to use the Rule 147 exemption by most of the states that have enacted crowdfunding provisions. Since December 2011, when the first state enacted crowdfunding provisions, 106 state crowdfunding offerings have been reported to be filed with the respective state regulators.[337] Of these offerings, 91 were reported to be approved or cleared, as of June 2015. We expect that almost all of the entities conducting these offerings were small issuers.

The proposed amendments to Rule 504 would affect small issuers that rely on this exemption from Securities Act registration. All issuers that sell securities in reliance on Regulation D are required to file a Form D with the Commission reporting the transaction. For the year ended December 31, 2014, 19,717 issuers made 22,004 new Form D filings, of which 495 issuers relied on the Rule 504 exemption. Based on the information reported by issuers on Form D, there were 146 small issuers[338] relying on the Rule 504 exemption in 2014. This number likely underestimates the actual number of small issuers relying on the Rule 504 exemption, however, because 38% of issuers that are not pooled investment funds and 50% of issuers that are pooled investment funds declined to report on their Form D filed with the Commission their amount of revenues or assets.

D. Projected Reporting, Recordkeeping and Other Compliance Requirements

The proposed amendments to Rule 147 would not impose any reporting or recordkeeping

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336 *See* note 211 above.

337 Based on estimates provided by NASAA.

338 Of this number, 140 of these issuers are not pooled investment funds, and 6 are pooled investment funds. We also note that issuers that are not pooled investment funds disclose only revenues on Form D, and not total assets. Hence, we use the amount of revenues as a measure of issuer size for non-pooled investment funds and net asset value as a measure of issuer size for pooled investment funds.

requirements, but would require that issuers conducting offerings in reliance on the rule make certain specific disclosures to each offeree and purchaser in the offering. These disclosures would be made to each offeree in the manner in which any such offer is communicated and to each purchaser of a security in the offering in writing. The proposed amendments to Rule 147 would also require that issuers place a specific legend on the certificate or other document evidencing the securities that are being offered in reliance on the rule.

In order to comply with proposed Rule 147(d), issuers would need to have a reasonable belief that a prospective purchaser resides within the state or territory of which the issuer has its principal place of business. The steps required to establish reasonable belief would vary with the circumstances. For example, an issuer may need to consider facts and circumstances, such as the existence of a pre-existing relationship between the issuer and the prospective purchaser providing the issuer with insight and knowledge as to the primary residence of the prospective purchaser. An issuer may also consider other facts and circumstances establishing the residency of a prospective purchaser, such as evidence of the home address of the prospective purchaser, as documented by a recently dated utility bill, pay-stub, information contained in a state or federal tax returns, or any state-issued documentation, such as a driver's license or identification card.

The proposed amendments to Rule 504 would increase the aggregate offering ceiling from $1 million to $5 million and disqualify certain bad actors from participating in Rule 504 offerings. Issuers would need to comply with all the current requirements of Rule 504, including the filing of a Form D.[339] Also, as it is the case under current Rule 504, issuers relying on the rule that wish to engage in general solicitation and issue freely tradable securities may also be

[339] Rule 503 requires an issuer relying on any exemption under Regulation D to file a Form D within 15 calendar days after the first sale of securities in the offering.

required to register their offering with at least one state regulator. The proposed amendments to Rule 504 would also impose a disclosure requirement with respect to bad actor disqualifying events that occurred before the effective date of any of the proposed disqualification provisions, if adopted, and would have triggered disqualification had they occurred after that date.[340] Such disclosure would be required to be in writing and furnished to each purchaser a reasonable time prior to sale. There would be no prescribed form that such disclosure must take.

In addition, we would expect that issuers would exercise reasonable care to ascertain whether a disqualification exists with respect to any covered person, and document their exercise of reasonable care. The steps required would vary with the circumstances, but we anticipate would generally include making factual inquiry of covered persons and, where the issuer has reason to question the veracity or completeness of responses to such inquiries, further steps such as reviewing information on publicly available databases. In addition, issuers would have to prepare any necessary disclosure regarding preexisting events. We would expect that the costs of compliance would vary depending on the size and nature of the offering but that they would generally be lower for small entities than for larger ones because of the relative simplicity of their organizational structures and securities offerings and the generally smaller numbers of individuals and entities involved.

E. Overlapping or Conflicting Federal Rules

We believe that there are no federal rules that conflict with the proposed amendments to Rule 147 and Rule 504 of Regulation D. As discussed above,[341] Rule 147, as proposed to be amended, would encompass offerings that are exempt under Securities Act Section 3(a)(11).

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340 *See* proposed Rule 504(b)(3).

341 *See* discussion in Section 0 above.

Amended Rule 147, however, also would extend to certain other offerings that do not meet the requirements for the statutory exemption, such as those offered on publicly accessible Internet websites. As discussed above,[342] Rule 504, as proposed to be amended, would have the same offering limitation as current Rule 505 and include bad actor disqualification provisions, which would reduce the distinctions between these rules across Regulation D if the amendments to the rules are adopted as proposed.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objectives of our amendments, while minimizing any significant adverse impact on small entities. Specifically, we considered the following alternatives: (1) establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) clarifying, consolidating or simplifying compliance and reporting requirements for small entities under the rule; (3) using performance rather than design standards; and (4) exempting small entities from coverage of all or part of the proposed amendments.

With respect to clarification, consolidation and simplification of the rule's compliance and reporting requirements for small entities, the proposed amendments to Rule 147 do not impose any new reporting requirements. To the extent the proposed amendments may be considered to create a new compliance requirement to have a reasonable belief that a prospective purchaser is a resident of the state or territory in which the issuer has its principal place of business, the precise steps necessary to meet that requirement will vary according to the circumstances, and this flexible standard will be applicable to all issuers, regardless of size. We

[342] *See* discussion in Section 0 above.

believe our proposals are designed to streamline and modernize the rule for all issuers, both large and small. Nevertheless, we request comment on ways to clarify, consolidate, or simplify any part of the proposed amendments to Rule 147, including whether we should retain the current safe harbor under Rule 147.

In connection with our proposed amendments to Rule 147, we do not think it feasible or appropriate to establish different compliance or reporting requirements or timetables for small entities. The proposed amendments are designed to facilitate access to capital for both large and small issuers, but particularly smaller issuers who may satisfy their financing needs by limiting the sales of their securities only to residents of the state or territory in which they have their principal place of business. The proposed amendments do not contain any reporting standards and the compliance requirements it does include are minimal and designed with the limited resources of smaller issuers in mind. For example, the proposed rule would eliminate the current requirement to obtain an investor representation as to residency status because we do not believe such a requirement would be necessary in all circumstances. Similarly, we do not believe it is necessary to clarify, consolidate or simplify reporting or compliance requirements for small entities as the proposed rule contains more streamlined requirements for all issuers, both large and small. For example, the proposed amendments simplify the doing business in-state determination by amending the current rule requirements so that an issuer's ability to rely on the rule would be based on the location of the issuer's principal place of business and its ability to satisfy an additional criterion that we believe would provide further assurance of the in-state nature of the issuer's business within the state in which the offering takes place. With respect to using performance rather than design standards, we note that our proposed amendment establishing a "reasonable belief" standard for the determination of a prospective purchaser's

residency status is a performance standard. Rather than prescribe specific steps necessary to meet such a standard, such as requiring written representations from investors, the proposed rules recognize that reasonable belief can be established in a variety of ways (*e.g.*, through pre-existing knowledge of the purchaser, obtaining supporting documentation, or using other appropriate methods). We believe that the use of a performance standard accommodates different types of offerings and purchasers without imposing overly burdensome methods that may be ill-suited or unnecessary to a particular offering or purchaser, given the facts and circumstances.

With respect to exempting small entities from coverage of the proposed amendments to Rule 147, we believe such changes would be impracticable. These proposed amendments are designed to facilitate an issuer's access to capital, regardless of the size of the issuer. We have endeavored throughout these proposed amendments to minimize the regulatory burden on all issuers, including small entities, while meeting our regulatory objectives. We believe exempting small entities from our proposals would increase, rather than decrease, their regulatory burden. Nevertheless, we request comment on ways in which we could exempt small entities from coverage of any unduly onerous aspects of our proposed amendments.

In connection with our proposed amendments to Rule 504 of Regulation D, we do not think it is feasible or appropriate to establish different compliance or reporting requirements or timetables for small entities. Our proposals are intended to facilitate issuers' access to capital and are particularly designed for smaller issuers who are not subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act and who are offering no more than $5 million of their securities in any twelve month period. The proposed amendments are also designed to exclude "felons and other `bad actors' " from involvement in Rule 504 securities

offerings, which we believe could benefit small issuers by protecting them and their investors from bad actors and increasing investor trust in such offerings. Increased investor trust could potentially reduce the cost of capital and create greater opportunities for small businesses to raise capital. Exempting small entities from our proposals would increase, rather than decrease, their regulatory burden. Nevertheless, we request comment on whether it is feasible or appropriate for small entities to have different requirements or timetables for compliance with our proposals.

With respect to clarification, consolidation and simplification of the compliance and reporting requirements for small entities, the proposed amendments do not impose any new reporting requirements. To the extent the proposed amendments may be considered to create a new compliance requirement to exercise reasonable care to ascertain whether a disqualification exists with respect to any offering and to furnish a written description of preexisting triggering events, the precise steps necessary to meet that proposed requirement would vary according to the circumstances. In general, we believe the requirement would more easily be met by small entities than by larger ones because we believe that their structures and securities offerings would be generally less complex and involve fewer participants. Nevertheless, we request comment on ways to clarify, consolidate, or simplify any part of our proposed rule amendments for small entities.

With respect to the use of performance or design standards, we note that our proposed amendments to Rule 504 relating to increasing the aggregate offering amount that may be offered and sold in any 12-month period from $1 million to $5 million would use design rather than performance standards. We note, however, that the “reasonable care” exception would be a performance standard. With respect to exempting small entities from coverage of these proposed amendments, we believe that such an approach would be impracticable. Regulation D was

designed, in part, to provide exemptive relief for smaller issuers. Exempting small entities from bad actor provisions could result in a decrease in investor protection and trust in the private placement and small offerings markets. We have endeavored to minimize the regulatory burden on all issuers, including small entities, while meeting our regulatory objectives, and have proposed to include a "reasonable care" exception and waiver authority for the Commission to give issuers and other covered persons additional flexibility with respect to the application of these amendments.

G. General Request for Comment

We encourage comments with respect to any aspect of this initial regulatory flexibility analysis. In particular, we request comments regarding:

- The number of small entities that may be affected by the proposals;
- The existence or nature of the potential impact of the proposals on small entities discussed in the analysis; and
- How to quantify the impact of the proposed amendments.

Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposals are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

VIII. SMALL BUSINESS REGULATORY ENFORCEMENT FAIRNESS ACT

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),[343] the Commission must advise the OMB as to whether a proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in:

- an annual effect on the economy of $100 million or more (either in the form of an increase or a decrease);
- a major increase in costs or prices for consumers or individual industries; or
- significant adverse effects on competition, investment or innovation.

If a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review.

We request comment on whether our proposed amendments would be a "major rule" for purposes of SBREFA. We solicit comment and empirical data on:

- the potential effect on the U.S. economy on an annual basis;
- any potential increase in costs or prices for consumers or individual industries; and
- any potential effect on competition, investment or innovation.

We request those submitting comments to provide empirical data and other factual support for their views to the extent possible.

IX. STATUTORY BASIS AND TEXT OF PROPOSED RULES

The amendments contained in this release are being proposed under the authority set forth in Sections 3(b)(1), 4(a)(2), 19 and 28 of the Securities Act of 1933, as amended.

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[343] Pub. L. No. 104-121, Tit. II, 110 Stat. 857 (1996).

TEXT OF PROPOSED AMENDMENTS

List of Subjects in 17 CFR Part 230

Reporting and recordkeeping requirements, Securities.

PART 230 – GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

1. The authority citation for part 230 continues to read in part as follows:

Authority: 15 U.S.C. 77b, 77b note, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78o-7 note, 78t, 78w, 78ll(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, and Pub. L. 112-106, sec. 201(a), sec. 401, 126 Stat. 313 (2012), unless otherwise noted.

* * * * *

2. Section 230.147 is revised to read as follows:

§ 230.147 Intrastate sales exemption

(a) *Scope of the exemption*. Offers and sales by or on behalf of an issuer of its securities made in accordance with all of the provisions of this section (§ 230.147) are exempt from section 5 of the Act (15 U.S.C. 77e) if the issuer:

(1) Registers the offer and sale of such securities in the state in which all purchasers of the securities are resident; or

(2) Conducts the offer and sale of such securities pursuant to an exemption from registration in the state in which all purchasers of the securities are resident that limits the amount of securities:

(i) An issuer may sell pursuant to such exemption to no more than $5 million in a twelve--month period; and

(ii) An investor may purchase in such offering (as determined by the appropriate authority in such state).

(b) *Manner of offers and sales.* An issuer, or any person acting on behalf of the issuer, may rely on this exemption to make offers and sales using any form of general solicitation and general advertising, so long as the issuer complies with the provisions of paragraphs (c), (d), and (f) through (h) of this section.

(c) *Nature of the issuer.* The issuer of the securities shall at the time of any offers and sales pursuant to this section:

(1) Have its principal place of business within the state or territory in which all purchasers of the securities are resident. The issuer shall be deemed to have its principal place of business in a state or territory in which the officers, partners or managers of the issuer primarily direct, control and coordinate the activities of the issuer; and

(2) Meet at least one of the following requirements:

(i) The issuer derived at least 80% of its consolidated gross revenues from the operation of a business or of real property located in or from the rendering of services within such state or territory;

(ii) The issuer had at the end of its most recent semi-annual fiscal period prior to an initial offer of securities in any offering or subsequent offering pursuant to this section, at least 80% of its assets and those of its subsidiaries on a consolidated basis located within such state or territory;

(iii) The issuer intends to use and uses at least 80% of the net proceeds to the issuer from sales made pursuant to this section (§ 230.147) in connection with the operation of a

business or of real property, the purchase of real property located in, or the rendering of services within such state or territory; or

(iv) A majority of the issuer's employees are based in such state or territory.

NOTE 1 TO PARAGRAPH (C)(1). An issuer that has previously conducted an intrastate offering pursuant to this section (§ 230.147) may not conduct another intrastate offering pursuant to this section (§ 230.147), based upon satisfaction of the principal place of business definition contained in paragraph (c)(1) of this section (§ 230.147(c)(1)) in a different state or territory, until the expiration of the time period specified in paragraph (e) of this section (§ 230.147(e)), calculated on the basis of the date of the last sale in such offering.

NOTE 1 TO PARAGRAPH (C)(2)(i). Revenues must be calculated based on the issuer's most recent fiscal year, if the first offer of securities pursuant to this section is made during the first six months of the issuer's current fiscal year, and based on the first six months of the issuer's current fiscal year or during the twelve-month fiscal period ending with such six-month period, if the first offer of securities pursuant to this section is made during the last six months of the issuer's current fiscal year.

(d) *Residence of purchasers.* Sales of securities pursuant to this section (§ 230.147) shall be made only to persons that the issuer reasonably believes at the time of sale are residents of the state or territory in which the issuer has its principal place of business. For purposes of determining the residence of purchasers:

(1) A corporation, partnership, limited liability company, trust or other form of business organization shall be deemed to be a resident of a state or territory if, at the time of sale to it, it has its principal place of business, as defined in paragraph (c)(1) of this section, within such state or territory.

(2) Individuals shall be deemed to be residents of a state or territory if such individuals have, at the time of sale to them, their principal residence in the state or territory.

(3) A corporation, partnership, trust or other form of business organization, which is organized for the specific purpose of acquiring securities offered pursuant to this section (§ 230.147), shall not be a resident of a state or territory unless all of the beneficial owners of such organization are residents of such state or territory.

(e) *Limitation on resales.* For a period of nine months from the date of the sale by the issuer of a security pursuant to this section (§ 230.147), any resale of such security by a purchaser shall be made only to persons resident within the purchaser's state or territory of residence, as determined pursuant to paragraph (d) of this section.

Instruction to Paragraph (e): In the case of convertible securities, resales of either the convertible security, or if it is converted, the underlying security, could be made during the period described in paragraph (e) only to persons resident within such state or territory. For purposes of this paragraph (e), a conversion in reliance on section 3(a)(9) of the Act (15 U.S.C. 77c(a)(9)) does not begin a new period.

(f) *Precautions against interstate sales.* (1) The issuer shall, in connection with any securities sold by it pursuant to this section:

(i) Place a prominent legend on the certificate or other document evidencing the security stating that: "Offers and sales of these securities were made under an exemption from registration and have not been registered under the Securities Act of 1933. For a period of nine months from the date of the sale by the issuer of these securities, any resale of these securities (or the underlying securities in the case of convertible securities) by a purchaser shall be made only to persons resident within the purchaser's state or territory of residence."; and

(ii) Issue stop transfer instructions to the issuer's transfer agent, if any, with respect to the securities, or, if the issuer transfers its own securities, make a notation in the appropriate records of the issuer.

(2) The issuer shall, in connection with the issuance of new certificates for any of the securities that are sold pursuant to this section (§ 230.147) that are presented for transfer during the time period specified in paragraph (e), take the steps required by paragraphs (f)(1)(i) and (ii) of this section.

(3) The issuer shall, at the time of any offer or sale by it of a security pursuant to this section (§ 230.147), prominently disclose to each offeree in the manner in which any such offer is communicated and to each purchaser of such security in writing the following: "Sales will be made only to residents of the same state or territory as the issuer. Offers and sales of these securities are made under an exemption from registration and have not been registered under the Securities Act of 1933. For a period of nine months from the date of the sale by the issuer of the securities, any resale of the securities (or the underlying securities in the case of convertible securities) by a purchaser shall be made only to persons resident within the purchaser's state or territory of residence."

(g) *Integration with other offerings.* Offers or sales made in reliance on this section will not be integrated with:

(1) Prior offers or sales of securities; or

(2) Subsequent offers or sales of securities that are:

(i) Registered under the Act, except as provided in paragraph (h) of this section;

(ii) Exempt from registration under Regulation A (§ 230.251 *et seq.*);

(iii) Exempt from registration under Rule 701 (§ 230.701);

(iv) Made pursuant to an employee benefit plan;

(v) Exempt from registration under Regulation S (§§ 230.901 through 230.905);

(vi) Exempt from registration under section 4(a)(6) of the Act (15 U.S.C. 77d(a)(6)); or

(vii) Made more than six months after the completion of an offering conducted pursuant to this section.

Note to Paragraph (g): If none of the safe harbors applies, whether subsequent offers and sales of securities will be integrated with any securities offered or sold pursuant to this section (§ 230.147) will depend on the particular facts and circumstances.

(h) *Offerings limited to qualified institutional buyers and institutional accredited investors*. Where an issuer decides to register an offering under the Securities Act after making offers in reliance on Rule 147 limited only to qualified institutional buyers and institutional accredited investors referenced in Section 5(d) of the Securities Act, such offers will not be subject to integration with any subsequent registered offering. If the issuer makes offers in reliance on Rule 147 to persons other than qualified institutional buyers and institutional accredited investors referenced in Section 5(d) of the Securities Act, such offers will not be subject to integration if the issuer (and any underwriter, broker, dealer, or agent used by the issuer in connection with the proposed offering) waits at least 30 calendar days between the last such offer made in reliance on Rule 147 and the filing of the registration statement with the Commission.

3. In § 230.504, the section heading and paragraph (b)(2) are revised, and paragraph (b)(3) is added, to read as follows:

§ 230.504 Exemption for limited offerings and sales of securities not exceeding $5,000,000.

* * * * *

(b) * * *

(2) The aggregate offering price for an offering of securities under this § 230.504, as defined in § 230.501(c), shall not exceed $5,000,000, less the aggregate offering price for all securities sold within the twelve months before the start of and during the offering of securities under this § 230.504, in reliance on any exemption under section 3(b)(1), or in violation of section 5(a) of the Securities Act.

Note 1 to paragraph (b)(2): The calculation of the aggregate offering price is illustrated as follows:

If an issuer sold $900,000 on June 1, 2013 under this § 230.504 and an additional $4,100,000 on December 1, 2013 under §230.505, the issuer could only sell $900,000 of its securities under this §230.504 on June 1, 2014. Until December 1, 2014, the issuer must count the December 1, 2013 sale towards the $5,000,000 limit within the preceding twelve months.

Note 2 to paragraph (b)(2): If a transaction under § 230.504 fails to meet the limitation on the aggregate offering price, it does not affect the availability of this §230.504 for the other transactions considered in applying such limitation. For example, if an issuer sold $5,000,000 of its securities on January 1, 2014 under this § 230.504 and an additional $500,000 of its securities on July 1, 2014, this § 230.504 would not be available for the later sale, but would still be applicable to the January 1, 2014 sale.

(3) *Disqualifications*. No exemption under this section shall be available for the securities of any issuer if such issuer would be subject to disqualification under § 230.506(d) of this section on or after [INSERT DAY 60 DAYS AFTER DATE OF PUBLICATION IN THE

FEDERAL REGISTER]; provided that disclosure of prior "bad actor" events shall be required in accordance with § 230.506(e).

NOTE TO PARAGRAPH (B)(3). For purposes of disclosure of prior "bad actor" events pursuant to § 230.506(e), an issuer shall furnish to each purchaser, a reasonable time prior to sale, a description in writing of any matters that would have triggered disqualification under this paragraph (b)(3) but occurred before [INSERT DAY 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

* * * * *

4. In § 230.505, paragraph (b)(2)(i) is revised to read as follows:

§ 230.505 Exemption for limited offers and sales of securities not exceeding $5,000,000.

* * * * *

(b) * * *

(2) *Specific conditions*—(i) *Limitation on aggregate offering price.* The aggregate offering price for an offering of securities under this § 230.505, as defined in § 230.501(c), shall not exceed $5,000,000, less the aggregate offering price for all securities sold within the twelve months before the start of and during the offering of securities under this section in reliance on any exemption under section 3(b)(1) of the Act or in violation of section 5(a) of the Act.

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By the Commission.

Jill M. Peterson
Assistant Secretary

Dated: October 30, 2015.

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