

**MEMO# 31922**

August 27, 2019

## **Draft ICI Comment Letter on SEC's Concept Release on Securities Offering Exemptions; Member Comments Due on September 10**

[31922]

August 27, 2019 TO: Closed-End Investment Company Committee

ICI Securities Regulation Advisory Group

SEC Rules Committee

Small Funds Committee RE: Draft ICI Comment Letter on SEC's Concept Release on Securities Offering Exemptions; Member Comments Due on September 10

As previously reported, the Securities and Exchange Commission recently issued a concept release requesting comment on ways to simplify, harmonize, and improve the regulatory framework for exempt securities offerings.<sup>[1]</sup> The Commission seeks to expand investment opportunities and promote capital formation, while maintaining appropriate investor protections. ICI's draft comment letter responding to the release is attached for your review.

**Please provide any written comments to Ken Fang at [kenneth.fang@ici.org](mailto:kenneth.fang@ici.org) or Bridget Farrell at [bridget.farrell@ici.org](mailto:bridget.farrell@ici.org) by close of business on Tuesday, September 10.** Comments on the proposal are due to the SEC by September 24, 2019.

ICI's draft letter supports the SEC's initiative to examine the regulatory framework for exempt securities offerings. It cautions the Commission, however, that any changes expanding retail investor access to the private markets be coupled with fundamental investor protections. It states that regulated funds (*i.e.*, business development companies and registered funds) already provide investors with both access to the private markets and strong investor protections, and recommends that the Commission modify regulations and certain SEC staff positions to encourage private market investment through these vehicles.

The draft letter consists of five parts. We summarize each below.

**I. Background (pages 2-5).** The draft letter stresses the difference between public and private market offerings. It discusses various risks that retail investors may face when

investing in private offerings, including investment risk, disclosure risk, and liquidity risk. It also describes the various protections the Investment Company Act of 1940 provides to investors that address these and other risks. The draft letter reiterates that the Commission should encourage retail investment in private market offerings through regulated funds to provide appropriate exposure and protection.

**II. Accredited Investor Standard (pages 5-12).** The draft letter provides various statistics demonstrating the erosion of the “accredited investor” standard over time.<sup>[2]</sup> It cautions the Commission not to alter the definition with a goal “to expand the pool of sophisticated investors,”<sup>[3]</sup> rather the guiding principle for the Commission must be modernizing the definition consistent with investor protection. It also expresses concern about expanding the standard to include investors that receive advice from financial professionals, as financial professional advice has not historically been viewed as a substitute for protections under the securities laws.

**III. General Solicitation for Exempt Offerings (pages 12-14).** The draft letter states that the premise for allowing general solicitation for exempt offerings has been that those offerings are limited to sophisticated investors. Especially if general solicitation is allowed for exempt offerings not limited to sophisticated investors, the letter recommends that the Commission put in place measures to reduce the potential for investor confusion and even misleading solicitations. These recommendations include:

- prohibiting exempt offerings from using sales literature that is materially misleading;
- developing a standardized performance requirement for private fund advertisements; and
- requiring plain-English legends distinguishing private funds from regulated funds.

The letter requests member feedback on whether these recommendations are necessary or whether Global Investment Performance Standards (GIPS) fill these gaps.

**IV. Investments Through Pooled Vehicles (pages 15-41).** The draft letter reiterates that the Commission should encourage retail exposure to exempt offerings through regulated funds. It recommends several changes to provide closed-end funds (*i.e.*, business development companies and registered closed-end funds, including interval funds<sup>[4]</sup> and tender offer funds<sup>[5]</sup>) with flexibility. These recommendations include:

- A. Eliminating staff positions that limit closed-end fund investments in private funds and other exempt offerings. Specifically, the letter recommends that:
  1. *Investment in private funds.* Each closed-end fund that invests in private funds be permitted to sell its securities to any retail investors (*i.e.*, not just to accredited investors who make a minimum initial investment of \$25,000) and, in doing so, not be required to limit its investments in private funds to 15 percent of its net assets; and
  2. *Investment in private funds and other exempt offerings.* Each closed end fund that invests more than 15 percent of its net assets in private funds and other exempt offerings be permitted to sell their shares to any retail investor and to list on public stock exchanges.
- B. Amending regulations to permit interval funds and tender offer funds additional investment opportunities by:
  1. Permitting interval funds to:
    - a. use flexible intervals from at least one month up to one year;
    - b. eliminate the maximum repurchase amount;

- c. conduct more frequent discretionary repurchases;
  - d. modify the elements of a repurchase policy that must be “fundamental;” and
  - e. employ a more efficient notification system.
- 2. Permitting tender offer funds to:
  - a. meet their filing and notification requirements using the interval fund rule; and
  - b. file post-effective amendments to registration statements that become effective automatically.
- 3. Permitting both interval funds and tender offer funds to:
  - a. issue multiple share classes;
  - b. utilize multi-series trusts;
  - c. engage in additional types of affiliated transactions with “downstream” affiliates; and
  - d. rely on transitory relief from diversification requirements for two years after launch.
- C. Maintaining current restrictions on target date funds, which include limits on their ability to invest in illiquid investments. The letter recommends that target date funds not be differentiated from other open-end funds.
- D. Recommending that the Commission evaluate whether there is a need to create special purpose vehicles for crowdfunding issuers before permitting issuers to use them. Given existing market solutions, there may be no need to make legislative or regulatory changes to accommodate such vehicles.

**V. Investment Company Reliance on Regulation A and Rule 504 of Regulation D (pages 41-42).** The draft letter recommends that the Commission permit small, regulated funds to rely on the offering exemptions set forth in Regulation A and Rule 504 of Regulation D. Extending eligibility to small regulated funds would promote small and emerging business capital formation.

Our draft letter discusses each of these items in greater detail.

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## [Attachment](#)

### **endnotes**

[1] See ICI Memorandum 31837 (July 5, 2019) (summarizing the concept release), *available at* [https://www.ici.org/my\\_ici/memorandum/memo31837](https://www.ici.org/my_ici/memorandum/memo31837). See also Concept Release on Harmonization of Securities Offering Exemptions, Securities Act Release No. 10649 (June 18, 2019), *available at* <https://www.sec.gov/rules/concept/2019/33-10649.pdf>.

[2] Regulation D under the Securities Act of 1933 permits “accredited investors” to invest in exempt securities offerings. It establishes a bright-line test for individuals to qualify as accredited investors based on their income or net worth as follows:

- Any natural person who had individual income in excess of \$200,000 in each of the two most recent years or joint income with that person’s spouse in excess of \$300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year.
- Any natural person whose individual net worth, or joint net worth with that person’s spouse, exceeds \$1 million.

[3] See, e.g., concept release at 57, Question 27.

[4] Interval funds are continuously offered closed-end funds that redeem shares by making periodic repurchase offers at net asset value. See Rule 23c-3 under the Investment Company Act.

[5] Tender offer funds are continuously offered closed-end funds that periodically repurchase shares at the discretion of the fund’s board.

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