

MEMO# 31837

July 5, 2019

SEC Issues Concept Release on Securities Offering Exemptions; Call Scheduled for July 18 at 2 pm (ET)

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July 5, 2019 TO: ICI Members SUBJECTS: Closed-End Funds
Compliance

Distribution RE: SEC Issues Concept Release on Securities Offering Exemptions; Call
Scheduled for July 18 at 2 pm (ET)

The Securities and Exchange Commission recently issued a concept release seeking comment on several exemptions from registration for securities offerings with the Commission.^[1] The Concept Release is intended to provide the Commission with input to “assess whether [the] exempt offering framework, as a whole, is consistent, accessible, and effective for both issuers and investors or whether [the Commission] should consider changes to simplify, improve, or harmonize the exempt offering framework.”^[2] We summarize below the portions of the Concept Release that may be of particular interest to Institute members: (i) investor access to exempt offerings through pooled investment vehicles; (ii) the Regulation D definition of “accredited investor;” (iii) Rule 506 of Regulation D; and (iv) Regulation Crowdfunding.^[3]

Comments on the Concept Release are due by September 24, 2019. The Institute will be filing a comment letter on the Release. We will have a call to discuss the Release and potential Institute comments on **Thursday, July 18 at 2:00 pm (Eastern Time)**. If you would like to participate in the call, please contact Ruth Tadesse at rtadesse@ici.org to receive dial-in information. If you have any questions, please contact Bridget Farrell at bridget.farrell@ici.org or Kenneth Fang at kenneth.fang@ici.org.

Current Offering Exemptions Framework

The Concept Release provides an overview of the current exempt offering framework, including the investor and filing requirements for each type of exempt offering established by statute or Commission rules, as well as data concerning the use of exemptions. The Release notes that, over time, “the amount raised in exempt markets has increased both absolutely and relative to the public registered markets.”^[4] However, “[a] significant number of attractive investment opportunities in the exempt market ... may be available only to investors with certain characteristics.”^[5]

The Release seeks comment on the existing framework as a whole, including its effects on public markets and how to best measure those effects on capital formation, competition, and investor protection.^[6] Among other issues, the Release asks whether the exemptions framework should focus on investor protection at the time of sale rather than, as currently, at the time of offering. Notably, the Release also asks whether the availability of any exemptions should be conditioned on the involvement of a registered financial intermediary (such as a broker-dealer) or a lead investor with particular characteristics.

Although the Concept Release covers a broad scope of offering exemptions, we discuss below the portions of the Release that will be of most interest to Institute members.

Pooled Investment Vehicles, Including Closed-End Funds, Interval Funds, and Business Development Companies

The Concept Release provides background on the different ways investors currently can access exempt offerings through robo-advisers^[7] and pooled investment vehicles, including private funds and venture capital funds as well as closed-end funds (including interval funds and tender offer funds) and BDCs.^[8]

The Release notes that closed-end funds and BDCs do not have liquidity and valuation related constraints on their ability to invest in exempt offerings, as open-end funds do. The Release recognizes that because closed-end funds and BDCs retain profits from their holdings as reflected in the net asset value of the fund, investors in those funds may be able to convert their interests to cash only by selling their interests, possibly at a discount, in the secondary market, to the extent one exists. The Release broadly asks whether there are Commission rules or other regulations that discourage BDCs and closed-end funds from participating in exempt offerings. Further, the Release questions whether issues concerning secondary market liquidity for closed-end funds and BDCs affect investors' decisions to invest in those vehicles, and whether the Commission should consider changes to its rules to improve secondary market trading opportunities.

The Release draws attention to interval funds and tender offer funds as vehicles that can pursue less-liquid strategies but that currently compose a small portion of the registered investment company market.^[9] The Release requests comment on whether changes to interval fund rules, such as allowing funds to determine the period of intervals or allowing multiple share classes, would decrease compliance costs for those funds, and asks similar questions about changes to closed-end tender offer funds rules. The Release asks whether relief for affiliated transactions would be useful to interval funds pursuing a private equity or venture capital strategy. Finally, the Release requests comment on whether the Commission should provide a transitory exemption from the diversification requirements under the Investment Company Act during the initial stages of an interval fund, and whether changes to the Internal Revenue Code also would be required.

The Release also considers whether investment companies that are designed for long-term holdings, such as target date funds, forgo exposure to issuers making exempt offerings because of the redemption and other requirements for open-end funds. The Release asks what measures might allow target date funds to gain exposure to exempt offerings.

A complete list of the questions the Commission poses with respect to pooled investment vehicles is attached as Appendix A.

Definition of Accredited Investor

A substantial part of the Concept Release examines the roles of accredited investors^[10] within the exempt offering framework.^[11] As the Commission previously stated, the term “accredited investor” is “intended to encompass those persons whose financial sophistication and ability to sustain the risk of loss of investment or ability to fend for themselves render the protections of the Securities Act registration process unnecessary.”^[12] The financial thresholds for individuals to qualify for accredited investor status have not changed in decades,^[13] and currently permit a greater percentage of US households to qualify as accredited investors than when the Commission adopted the thresholds.^[14]

Several reports and committees have recommended changes to the accredited investor standard, including a 2015 Commission staff report and a 2017 report from the US Treasury Department^[15] as well as recommendations from the Commission’s Investor Advisory Committee, Advisory Committee on Small and Emerging Companies, and Small Business Forum.^[16] The Institute has submitted comment letters about the accredited investor definition on a number of occasions, notably in connection with JOBS Act rulemakings.^[17]

The Concept Release requests comment on several of the recommendations mentioned above, including requests for comment about whether the current financial thresholds for qualifying for accredited investor status should be changed or removed,^[18] and whether there are other criteria that should be used, such as requiring individuals to have certain professional credentials or experience investing in exempt offerings. The Release further asks whether the rules defining accredited investor should be changed to permit an individual advised by a registered financial professional^[19] to qualify as an accredited investor. The Release broadly requests comment on how these changes might affect investors, issuers, and other market participants.

Rule 506 of Regulation D

The Concept Release discusses exempt offerings under Rule 506(b) and (c), which provide conditions for issuers to meet the requirements of a Section 4(a)(2) exemption for “transactions by an issuer not involving any public offering.”^[20] Overall, the Release asks whether the requirements for 506(b) and 506(c) offerings should be combined, and whether the Commission should consider any other changes to Rule 506.

Regarding Rule 506(b) in particular, the Release asks whether it is important to allow non-accredited investors to purchase those offerings, and whether the information requirements for non-accredited investors should be modified. Regarding Rule 506(c), the Release requests comment on whether data shows any increase or decrease in fraudulent activity as a result of the adoption of that rule. The Release also asks whether non-accredited investors should be allowed to purchase securities in an offering that involves general solicitation, and whether the Rule 506(c) requirement for verifying accredited investor status has had an impact on issuers’ use of that exemption.

Regulation Crowdfunding

Regulation Crowdfunding is a statutory exemption from registration under the JOBS Act for crowdfunding transactions subject to a number of requirements, including that the transactions are conducted through registered broker-dealers or funding portals. Individual investors in Regulation Crowdfunding offerings are not required to be accredited investors but are subject to income and net worth-based investment limits.^[21]

The crowdfunding exemption generally excludes investment companies and issuers excluded from the definition investment company under Sections 3(b) and 3(c) of the Investment Company Act as issuers who are eligible to use the exemption. The Concept Release discusses that, as a result of this exclusion, special purpose vehicles^[22] have not been eligible to raise funds through Regulation Crowdfunding.^[23] Both the Commission's Small Business Forum and the 2017 Treasury Report have considered recommendations from commenters that, without special purpose vehicles, issuers fundraising under Regulation Crowdfunding face "unwieldy" capitalization tables.

The Concept Release requests comment on several ideas for changing Regulation Crowdfunding, including by permitting issuers to offer securities through special purpose vehicles and what the effect of doing so may be on investor protection. Further, the Release asks whether there are other ways to modify the regulation to allow investors to invest in "pooled crowdfunding vehicles" that investment advisers manage.

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[Attachment](#)

endnotes

^[1] See *Concept Release on Harmonization of Securities Offering Exemptions*, Securities Act Release No. 10649 (June 18, 2019) (the "Concept Release" or "Release"), available at: <https://www.sec.gov/rules/concept/2019/33-10649.pdf>.

^[2] See *Concept Release* at pp. 6-7 (summarizing goals for the Release).

^[3] The Concept Release also discusses further offering exemptions, including those available under Regulation A, intrastate offerings, integration, and secondary trading of securities. In addition, the Release discusses Regulation D Rule 504 offering exemptions and requests comment on whether eligibility to rely on Rule 504 should be extended to investment companies as issuers. *Concept Release* at pp. 112-118.

^[4] *Concept Release* at p. 16.

^[5] *Concept Release* at pp. 22-23.

^[6] *Concept Release* at pp. 24-31.

^[7] Some asset allocation services currently permit investors to access exempt offerings subject to purchaser eligibility requirements, such as accredited investor status and, if applicable, qualified purchaser status. See *Concept Release* at p. 185.

^[8] *Concept Release* at pp. 172-192.

^[9] Unlike many other registered funds, interval funds and tender offer funds are excluded

from liquidity rules and the requirement for written liquidity procedures under Rule 22e-4 under the Investment Company Act. See *Investment Company Liquidity Risk Management Programs*, Investment Company Act Release No. 32315 (Oct. 13, 2016) at pp. 51-52, available at <https://www.sec.gov/rules/final/2016/33-10233.pdf>. Interval funds and tender offer funds are available to retail investors. In addition, the Release notes that interval funds are not subject to the ERISA “plan assets” rule and are eligible for tax treatment under Subchapter M of the Internal Revenue Code.

[10] “Accredited investors” are defined in Rule 501(a) of Regulation D. 17 CFR 230.501(a).

[11] Concept Release at pp. 32-59.

[12] See *Regulation D Revisions; Exemptions for Certain Employee Benefit Plans*, Securities Act Release No. 6683 (Jan. 16, 1987).

[13] The Commission adopted its most recent change to the financial threshold for individuals to qualify as accredited investors in 2011, when it kept the net worth standard at \$1 million but, as required by Dodd-Frank, excluded the value of the investor’s primary residence when calculating net worth. See *Net Worth Standard for Accredited Investors*, Securities Act Release No. 9287 (Dec. 21, 2011), available at <https://www.sec.gov/rules/final/2011/33-9287.pdf>.

[14] See *Report on the Review of the Definition of “Accredited Investor”* (Dec. 18, 2015) (“Accredited Investor Staff Report”), at pp. 40-42, 48, available at <https://www.sec.gov/files/review-definition-of-accredited-investor-12-18-2015.pdf>.

[15] See Accredited Investor Staff Report; *A Financial System that Creates Economic Opportunities: Capital Markets* (Oct. 2017) (“2017 Treasury Report”), available at <https://www.treasury.gov/press-center/press-releases/documents/a-financial-system-capital-markets-final-final.pdf>.

[16] See *Recommendations of the Investment Advisory Committee: Accredited Investor Definition* (Oct. 9, 2014), available at <https://www.sec.gov/spotlight/investor-advisory-committee-2012/accredited-investor-definition-recommendation.pdf>; *Advisory Committee on Small and Emerging Companies: Recommendations Regarding the Accredited Investor Definition* (Feb. 17, 2015), available at <https://www.sec.gov/info/smallbus/acsec/acsec-accredited-investor-definition-recommendation-030415.pdf>; *Final Report on Small Business Capital Formation* (May 2015), available at <https://www.sec.gov/info/smallbus/gbfor33.pdf>.

[17] See, e.g., Letter from Paul Schott Stevens, President and CEO of the Investment Company Institute, dated September 23, 2013, available at <https://www.sec.gov/comments/s7-06-13/s70613-398.pdf> (recommending that the “Commission could modernize these tests in any one of several different ways” including using a threshold test of demonstrated investment experience or increasing the thresholds for the income and net worth tests); Letter from Paul Schott Stevens, President and CEO of the Investment Company Institute, dated May 21, 2012, available at <https://www.sec.gov/comments/265-27/26527-25.pdf>.

[18] Relatedly, the Concept Release also requests comment on whether the quantitative thresholds for “qualified purchaser” under the Investment Company Act should include a

periodic reassessment, and whether the definitions of “accredited investor” and “qualified purchaser,” as well as “qualified client” under the Investment Advisers Act, should undergo periodic reassessment at the same time. Concept Release at p. 192.

[\[19\]](#) The 2017 Treasury Report included a recommendation to broaden the definition of “accredited investor” to include financial professionals, such as registered representatives and investment adviser representatives, who would be considered qualified to recommend Regulation D investments to others.

[\[20\]](#) Concept Release at pp. 60-64. In general, issuers under Rule 506(b) can sell to an unlimited number of accredited investors and up to 35 non-accredited investors to whom the issuer provides some additional information, but issuers are not permitted to engage in general solicitation. Under Rule 506(c), issuers are permitted to engage in general solicitation, but all purchasers must be accredited investors. Offerings under Rule 506 in general are subject to a number of restrictions, including a disqualification for offerings if the issuer or other covered persons are “bad actors” and limitations on resales. The Release notes that Rule 506(b) continues to dominate the market for exempt securities offerings and even exceeds the amounts raised in the registered market. Concept Release at p. 78.

[\[21\]](#) Concept Release at pp. 132-133.

[\[22\]](#) The Concept Release defines special purpose vehicles as “funds organized to invest in, or lend money to, a single company.” Concept Release at p. 129.

[\[23\]](#) Concept Release at pp. 127-154.