SECURITIES AND EXCHANGE COMMISSION

17 CFR PARTS 200, 230, 239, 240, 249, 270 and 275

Release Nos. 33-10238; 34-79161; File No. S7-22-15

RIN 3235-AL80

Exemptions to Facilitate Intrastate and Regional Securities Offerings

AGENCY: Securities and Exchange Commission.

ACTION: Final rules.

SUMMARY: We are adopting amendments to modernize Rule 147 under the Securities Act of 1933, which provides a safe harbor for compliance with the Section 3(a)(11) exemption from registration for intrastate securities offerings. We are also establishing a new intrastate offering exemption under the Securities Act, designated Rule 147A, which will be similar to amended Rule 147, but will have no restriction on offers and will allow issuers to be incorporated or organized outside of the state in which the intrastate offering is conducted provided certain conditions are met. The amendments to Rule 147 and new Rule 147A are designed to facilitate capital formation, including through offerings relying upon intrastate crowdfunding provisions under state securities laws, while maintaining appropriate investor protections and providing state securities regulators with the flexibility to add additional investor protections they deem appropriate for offerings within their state.

We also are adopting amendments to Rule 504 of Regulation D under the Securities Act to facilitate issuers' capital raising efforts and provide additional investor protections. The amendments to Rule 504 will 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. In light of these amendments to Rule 504, we are also repealing Rule 505.

DATES: Amended Rule 147 and new Rule 147A will be effective on [INSERT DAY 150 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. Amended Rule 504 will be effective on [INSERT DAY 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. The repeal of Rule 505 will be effective on [INSERT DAY 180 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. Comments regarding the collection of information requirements within the meaning of the Paperwork Reduction Act of 1995 should be received on or before [INSERT DAY 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

FOR FURTHER INFORMATION CONTACT: With regard to the final rules, Anthony G. Barone, Special Counsel, Jenny Riegel, Special Counsel, or Ivan Griswold, Attorney-Advisor, Division of Corporation Finance, at (202) 551-3460, and with regard to guidance on broker-dealer registration, Timothy J. White, Senior Special Counsel, Division of Trading and Markets, at (202) 551-5550, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

SUPPLEMENTARY INFORMATION: We are adopting new Rule 147A and are adopting amendments to Rule 147[1] and Rule 504[2] of Regulation D[3] under the Securities Act of 1933 (the "Securities Act").[4] We are repealing Rule 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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I. INTRODUCTION AND BACKGROUND

On October 30, 2015, we proposed amendments to Rule 147 and Rule 504 under the Securities Act to assist smaller companies with capital formation consistent with other public policy goals, including investor protection.[6] In developing final rules, we considered recommendations by the Advisory Committee on Small and Emerging Companies ("ACSEC")[7] and the most recent SEC Government-Business Forum on Small Business Capital Formation ("Small Business Forum")[8] and comment letters received on the Proposing Release.[9] Today we are amending Rule 147 and establishing a new Securities Act exemption, designated Rule 147A. We are also amending Rule 504 of Regulation D. We believe the final rules will facilitate capital formation by smaller companies by increasing the utility of the current Securities Act exemptive

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6 *See* SEC Rel. No. 33-9973 [80 FR 69786] (Nov. 10, 2015) ("Proposing Release").

7 *See* Recommendation to the Commission by the Advisory Committee on Small and Emerging Companies to Modernize Rule 147 under the Securities Act of 1933 (Sept. 23, 2015) ("2015 ACSEC Recommendation"), *available at http://www.sec.gov/info/smallbus/acsec/acsec-recommendation-modernize-rule-147.pdf*. The Commission established the ACSEC in 2011 with the objective of providing the Commission with advice on its rules, regulations and policies with regard to its mission of protecting investors, maintaining fair, orderly and efficient markets and facilitating capital formation, as they relate to: (1) capital raising by emerging privately-held small businesses (emerging companies) and publicly traded companies with less than $250 million in public market capitalization (smaller public companies) through securities offerings, including private and limited offerings and initial and other public offerings; (2) trading in the securities of emerging companies and smaller public companies; and (3) public reporting and corporate governance requirements of emerging companies and smaller public companies. Advisory Committee on Small and Emerging Companies, SEC Rel. No. 33-9258 (Sept. 12, 2011) [76 FR 57769 (Sept. 16, 2011)].

8 *See* Final Report of the 2015 SEC Government Business Forum on Small Business Capital Formation (April 2016) ("2015 Small Business Forum Recommendations"), *available at http://www.sec.gov/info/smallbus/gbfor34.pdf.* The Small Business Investment Incentive Act of 1980 directed the Commission to conduct an annual government-business forum to undertake an ongoing review of the financing problems of small businesses. 15 U.S.C. 80c-1. The Small Business Forum has met annually since 1982 to provide a platform to highlight perceived unnecessary impediments to small business capital formation and address whether they can be eliminated or reduced. Each forum seeks to develop recommendations for government and private action to improve the environment for small business capital formation, consistent with other public policy goals, including investor protection. Information about the Small Business Forum is *available at http://www.sec.gov/info/smallbus/sbforum.shtml*.

9 The comment letters received in response to the Proposing Release are *available at http://www.sec.gov/comments/s7-22-15/s72215.shtml*.

framework for smaller offerings while maintaining appropriate protections for investors. The final rules complement recent efforts by the U.S. Congress,[10] state legislatures,[11] and state securities regulators[12] to modernize existing federal and state securities laws and regulations to assist smaller companies with capital formation. We believe our amendment to Rule 504 to increase its aggregate offering ceiling from $1 million to $5 million will significantly diminish the utility of Rule 505 and we are therefore repealing that rule.

Consistent with commenters' suggestions[13] and the recommendations of the 2015 Small Business Forum,[14] we are retaining and modernizing Rule 147 under the Securities Act as a safe

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10 Congress enacted the Jumpstart Our Business Startups Act of 2012 ("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. *See* SEC Rel. No. 33-9741 (Mar. 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"). Congress also enacted the Fixing America's Surface Transportation Act of 2015 ("FAST Act"), which was signed into law by President Obama on December 4, 2015. Pub. L. No. 114-94, Sec 129 Stat. 1312 (2015). The FAST Act includes several amendments to the federal securities laws, including a new exemption to Section 4 of the Securities Act for secondary sales of securities that are purchased by an accredited investor, among other requirements (Section 76001), and changes to facilitate initial public offerings by emerging growth companies (Sections 71001 through 71003).

11 *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).

12 *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).

13 Letter from David M. Lynn, Chair, Federal Regulation of Securities Committee, Business Law Section, American Bar Association, April 8, 2016 ("ABA Letter"); Letter from Christopher D. Miller, Economic and Downtown Development Director, City of Adrian, Michigan, January 8, 2016 ("City of Adrian Letter"); Letter from Keith Paul Bishop, Former California Commissioner of Corporations, December 30, 2015 ("Bishop Letter"); Letter from Deborah L. Gunny and Cathryn S. Gawne, Co-Chairs, Corporations Committee, Business Law Section, State Bar of California, January 8, 2016 ("California Bar Letter"); Letter from Kim Wales, CEO, Wales Capital, and Executive Board Member, CrowdFund Intermediary Regulatory Advocates, January 11, 2016 ("CFIRA Letter"); Letter from Reps. Tom Emmer, Gwen Moore, Patrick McHenry, John Carney, Scott Garrett, Denny Heck, Randy Neugebauer, Terri Sewell, Luke Messer, Keith Ellison, Peter T. King, Robert Hurt, Robert Pittenger, Roger Williams and Stephen Fincher, U.S. House of Representatives, October 7, 2016 ("Congressional Letter"); Letter from Sara Hanks, CEO,

harbor for intrastate offerings exempt from registration pursuant to Securities Act Section 3(a)(11). These amendments will modernize the safe harbor, while keeping within the statutory parameters of Section 3(a)(11), so that issuers may continue to rely upon the rule for offerings pursuant to state law exemptions, including crowdfunding provisions, that are conditioned upon compliance with Section 3(a)(11) and Rule 147.

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."[15] 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).[16] 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

CrowdCheck, Inc., January 2, 2016 ("CrowdCheck Letter"); Letter from Samuel S. Guzik, Securities Attorney, Guzik Associates, January 18, 2016 ("Guzik Letter"); Letter from Brian Knight, Associate Director, Financial Policy, and Staci Warden, Executive Director; Center for Financial Markets, Milken Institute, January 11, 2016 ("Milken Letter"); Letter from Judith M. Shaw, President, North American Securities Administrators Association, Inc. ("NASAA") and Maine Securities Administrator, January 11, 2016 ("NASAA Letter"); Letter from Youngro Lee, Esq., Co-founder / CEO, NextSeed TX LLC, January 7, 2016 ("NextSeed Letter"); Letter from Amy E. Pearl, Founder and Executive Director, Hatch Innovation Inc., January 10, 2016 ("Pearl Letter"); Letter from Joe M. Wallin, Attorney, January 11, 2016 ("Wallin Letter"); Letter from Kristin Wolff, January 11, 2016 ("Wolff Letter"); Letter from Howard Orloff, CMO, ZacksInvest, November 19, 2015 ("Orloff Letter"); Letter from Anthony J. Zeoli, Partner, Freeborn & Peters LLP, November 5, 2016 ("Zeoli Letter"). No commenters supported the proposed elimination of Rule 147 as a safe harbor under Section 3(a)(11).

14 *See* 2015 Small Business Forum Recommendations.

15 15 U.S.C. 77c(a)(11).

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

financing of companies by investors within the company's state or territory.[17] Rule 147 reflects this Congressional intent and generally relies upon state regulation to effectively protect investors.

Notwithstanding the importance of these limitations, due to developments in modern business practices and communications technology in the years since Rule 147 was adopted, we have determined that it is necessary to update the requirements of Rule 147 to ensure its continued utility.[18] We are also establishing a new intrastate offering exemption under the Securities Act, designated Rule 147A, that will further accommodate modern business practices and communications technology and provide an alternative means for smaller companies to raise capital locally.

We are adopting new Rule 147A pursuant to our general exemptive authority under Section 28 of the Securities Act,[19] and therefore, new Rule 147A will not be subject to the statutory limitations of Section 3(a)(11). Accordingly, Rule 147A will have no restriction on offers, but will require that all sales be made only to residents of the issuer's state or territory to ensure the intrastate nature of the exemption. Rule 147A also will not require issuers to be incorporated or organized in the same state or territory where the offering occurs so long as issuers can demonstrate the in-state nature of their business, which we believe will expand the

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[17] *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").

[18] The Commission has not amended Rule 147 since its adoption, other than in 2013 when the Commission adopted technical amendments to Rules 145, 147, 152 and 155 to update references to Section 4(2) of the Securities Act, which was renumbered as Section 4(a)(2) by Section 201(c) of the JOBS Act, Pub. L. No. 112-106, sec. 201(c), 126 Stat. 306, 314 (Apr. 5, 2012). See SEC Rel. No. 33-9414 [78 FR 44730] (July 10, 2013). *See also* ABA Letter; Milken Letter.

[19] 15 USC 77z-3. For the reasons discussed throughout this release, we find that the Rule 147A exemption being adopted today is necessary and appropriate in the public interest and consistent with the protection of investors.

number of businesses that will be able to seek intrastate financing under Rule 147A, as compared to amended Rule 147. Certain provisions of existing Rule 147 concerning legends and mandatory disclosures to purchasers and prospective purchasers will apply to offerings conducted pursuant to amended Rule 147 and Rule 147A.[20]

As in current Rule 147, nothing in either amended Rule 147 or new Rule 147A will obviate the need for compliance with any applicable state law relating to the offer and sale of securities. Thus, states will retain the flexibility to adopt requirements that are consistent with their respective interests in facilitating capital formation and protecting their resident investors in intrastate securities offerings, including the authority to impose additional disclosure requirements regarding offers and sales made to persons within their state or territory, or the authority to limit the ability of certain bad actors from relying on applicable state exemptions. In addition, both federal and state antifraud provisions will continue to apply to offers and sales made pursuant to amended Rule 147 and new Rule 147A.

The staff will seek to collaborate with state regulators in gathering information about intrastate crowdfunding offerings and, based on the sharing of this information and other relevant inputs, the staff will undertake to study and submit a report to the Commission, no later than three years following the effective date of amended Rule 147 and new Rule 147A, on capital formation and investor protection in offerings under these rules. The report will include, but not be limited to, a review of information about:

(1) the use of amended Rule 147 and new Rule 147A;

(2) repeat use by the same issuers of amended Rule 147 or new Rule 147A;

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20 *See* Rules 147(f) and 147A(f).

(3) the use by issuers of alternative federal offering exemptions concurrently or close in time to an offer or sale under amended Rule 147 or new Rule 147A;

(4) fraud associated with, or issuer non-compliance with provisions of, amended Rule 147 or new Rule 147A;

(5) the role of intrastate broker-dealers and other intermediaries in offerings conducted pursuant to amended Rule 147 or new Rule 147A; and

(6) the application of state bad actor disqualification provisions in offerings conducted pursuant to amended Rule 147 or new Rule 147A to inform whether the Commission should consider including bad actor disqualification provisions in amended Rule 147 and new Rule 147A.

We also are amending 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 higher offering ceiling amount will promote capital formation by increasing the flexibility of state securities regulators to implement coordinated review programs to facilitate regional offerings.[21] The bad actor disqualification provisions will provide for greater consistency across Regulation D. We believe these amendments to Rule 504

[21] The state registration of securities offerings under coordinated review programs is an example of the efforts being 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. 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. More information on coordinated review programs is available at *http://www.nasaa.org/industry-resources/corporation-finance/coordinated-review/.*

will significantly diminish the utility of Rule 505, which historically has been little utilized in comparison to Rule 506 of Regulation D.[22] We, therefore, are repealing Rule 505.

II. AMENDMENTS TO RULE 147 AND NEW RULE 147A

A. Explanation of Amendments to Rule 147 and New Rule 147A

Numerous commenters[23] and the 2015 Small Business Forum[24] recommended retaining Rule 147 as a safe harbor under Section 3(a)(11). Many of these commenters also recommended adopting a substantially similar new exemption pursuant to the Commission's general exemptive authority under Section 28 as an alternative to the Section 3(a)(11) exemption and safe harbor for companies that wish to conduct intrastate offerings under slightly broader conditions than contemplated by Section 3(a)(11). After considering the comments, we are amending Rule 147 to modernize the rule to incorporate most of our proposed amendments, except for the two proposed amendments that do not fit within the statutory limits of Section 3(a)(11)—allowing issuers to make offers accessible to out-of-state residents and to be incorporated out-of-state. These two provisions are the distinguishing features of the new Rule 147A exemption that we are establishing pursuant to our general exemptive authority under Section 28. Aside from these

[22] For the period 2009 through 2015, 132,091 Forms D were filed. Of these Forms D, 3,758 reported an offering made in reliance upon Rule 505 of Regulation D, representing approximately 3% of all offerings made in reliance upon Regulation D and 5% of all Regulation D offerings raising less than $5 million. During this time period, 1,548 Forms D reported reliance only on Rule 505, and 2,210 Forms D reported reliance on Rule 505 and another Regulation D exemption. By contrast, for the period 2009 through 2015, 5,532 filings reported an offering made in reliance upon Rule 504, representing approximately 4% of all offerings made in reliance upon Regulation D and 13% of all Regulation D offerings raising less than $1 million. During this time period, 4,308 Forms D reported reliance only on Rule 504, and 1,224 Forms D reported reliance on Rule 504 and another Regulation D exemption. All other Form D filings during this period reported an offering made in reliance on Rule 506.

[23] ABA Letter; City of Adrian Letter; Bishop Letter; California Bar Letter; CFIRA Letter; Congressional Letter; CrowdCheck Letter; Guzik Letter; Milken Letter; NASAA Letter; NextSeed Letter; Pearl Letter; Wallin Letter; Wolff Letter; Orloff Letter; Zeoli Letter. No commenters supported the proposed elimination of Rule 147 as a safe harbor under Section 3(a)(11).

[24] 2015 Small Business Forum Recommendations.

two provisions, the remaining provisions of new Rule 147A are substantively the same as the provisions of amended Rule 147.

1. Manner of Offering

a. Proposed Amendments

Rule 147, as proposed, would have required issuers to limit sales to in-state residents, but would no longer have limited offers by the issuer to in-state residents.[25] Accordingly, under our proposal, amended Rule 147 would have permitted 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 Internet websites, to advertise their offerings, so long as all sales of securities so offered were made to residents of the state or territory in which the issuer has its principal place of business. In the Proposing Release, the Commission noted that market participants and commenters have indicated that the combined effect of the statutory limitation on offers in Section 3(a)(11) and the prescriptive threshold requirements of Rule 147 unduly limits the availability of the exemption for local companies that would otherwise conduct intrastate offerings.[26]

Given that proposed Rule 147 would have allowed offers to be made to or be accessible by out-of-state residents, including advertising offers on publicly-available Internet websites, the proposal would have required 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.[27] This proposed disclosure requirement was

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

[26] *See* Proposing Release at text accompanying note 18

[27] *See* proposed Rule 147(f)(3).

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.

As proposed, Rule 147 would no longer have remained a safe harbor for conducting a valid intrastate exempt offering under Section 3(a)(11). An issuer that attempted to comply with Rule 147, as proposed to be amended, but failed to do so, could rely on any other available exemption. Failure to satisfy the requirements of Rule 147, as proposed to be amended, however, would also have likely resulted 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) would be more restrictive than under Rule 147, as proposed to be amended.

b. Comments on Proposed Amendments

All commenters that addressed the issue expressed support for eliminating the limitation on offers to in-state residents while continuing to require that all sales be made to in-state residents.[28] Many of these commenters also expressed support for retaining existing Rule 147 as a safe harbor under Section 3(a)(11), in order to allow issuers to take advantage of existing state crowdfunding provisions.[29] As explained by one commenter, if the Commission eliminated the Rule 147 safe harbor, state legislative and/or rulemaking action would be required, since almost

[28] ABA Letter; NASAA Letter; Letter from Kurt N. Schacht, CFA, Managing Director, Standards and Advocacy, and Linda L. Rittenhouse, Director, Capital Markets Policy, CFA Institute, January 11, 2016 ("CFA Letter"); CrowdCheck Letter; CFIRA Letter; Guzik Letter; NextSeed Letter; Milken Letter; Zeoli Letter; Bishop Letter; Wolff Letter; City of Adrian Letter; Pearl Letter; Finn Terdal, Technology Coordinator, Hatch Innovation, January 11, 2016 ("Terdal Letter"); Letter from Simon R. Love, Managing Director, Hatch Lab, January 11, 2016 ("Love Letter"); Letter from John MacDougall, Founder & CEO, MacDougall & Sons Bat Co. Inc., January 10, 2016 ("MacDougall Letter"); Letter from Erin Ely, January 10, 2016 ("Ely Letter"); Letter from Jim Newcomer, Ph.D., 4mation Advisers, January 10, 2016 ("Newcomer Letter"); Brandon P. Romano, Content Director, Brelion, LLC, January 6, 2016 ("Brelion Letter"); Letter from Sean Shepherd, CrwdCorp LLC, December 30, 2015 ("CrwdCorp Letter"). *See also* Congressional Letter (expressing general support for the proposed amendments to Rule 147).

[29] *See* ABA Letter; CFIRA Letter; Congressional Letter; CrowdCheck Letter; NASAA Letter; California Bar Letter; Guzik Letter; Milken Letter; NextSeed Letter; Zeoli Letter; Bishop Letter; Wolff Letter; Pearl Letter; City of Adrian Letter; Orloff Letter; Wallin Letter.

all of the state crowdfunding exemptions are premised on the offering qualifying under Section 3(a)(11) and its Rule 147 safe harbor.[30] The commenter noted that eliminating the Rule 147 safe harbor would leave these state crowdfunding exemptions unavailable until states modified their exemptions to accommodate the removal of Rule 147 as a safe harbor to Section 3(a)(11).[31] In order to avoid this problem, some commenters recommended that the Commission interpret Section 3(a)(11) and Rule 147 to allow for offers to be viewed by out-of-state residents.[32] A few of these commenters stated that Section 3(a)(11) should be interpreted to allow for offers to be viewed by out-of-state residents, so long as such offers indicate that they are being made to residents of a single state.[33]

One commenter also noted that issuers currently rely on Section 3(a)(11) and Rule 147 to conduct forms of intrastate offerings other than pursuant to state crowdfunding provisions.[34] In the view of this commenter, removal of Rule 147 as a safe harbor under Section 3(a)(11) would also present problems for these exempt offerings, thereby severely restricting other local capital raising options.[35]

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30 NASAA Letter. According to the NASAA Letter, as of January 2016, of the 29 states plus the District of Columbia that adopted or were finalizing rulemaking implementing crowdfunding exemptions, 29 were premised on the offering qualifying under Section 3(a)(11) and its Rule 147 safe harbor: Alabama, Arizona, Colorado, District of Columbia, Georgia, Florida, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Montana, Nebraska, New Jersey, New Mexico, Oregon, South Carolina, Tennessee, Texas, Vermont, Virginia, Washington, and Wisconsin. As of January 2016, the exemptions were effective in 27 of the 30 jurisdictions: Minnesota and New Jersey were finalizing rulemaking, and New Mexico was working on draft regulations. Of the states with state crowdfunding exemptions, only Iowa and Vermont do not explicitly reference Rule 147, and Maine relies on Rule 504 rather than Section 3(a)(11).

31 *Id*.

32 ABA Letter; Guzik Letter; Zeoli Letter; Milken Letter; Pearl Letter.

33 ABA Letter; Guzik Letter; Zeoli Letter.

34 NASAA Letter. For example, issuers may rely upon Section 3(a)(11) and Rule 147 for offerings registered under state securities laws, or pursuant to exemptions from state registration other than state crowdfunding provisions.

35 *Id*.

Although commenters overwhelmingly supported retaining existing Rule 147 as a safe harbor to Section 3(a)(11), many commenters also supported adopting a substantially similar new exemption under the Commission's general exemptive authority under Section 28 for companies that conduct an intrastate offering but may not qualify for the Section 3(a)(11) exemption.[36] Similarly, the 2015 Small Business Forum recommended that the Commission take a "side-by-side" approach in introducing a new Rule 147—as it did with Rule 506 and Regulation A[37]—keeping old Rule 147 in place as a safe harbor under Section 3(a)(11) (but amending it to the extent permissible given the statutory limitations of Section 3(a)(11)) while also adopting a new exemption.[38] Several commenters stated that establishing a new exemption under Section 28, in addition to retaining existing Rule 147, would afford the states time to amend their existing state crowdfunding provisions, as well as to adopt new state crowdfunding provisions.[39] One commenter supported leaving the existing Rule 147 as a safe harbor to Section 3(a)(11) while adopting the proposed new exemption as new Rule 505.[40]

Several commenters supported our proposal to require 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] One commenter supported the proposed prominent disclosure requirement, but only to the extent it is required on all general

[36] ABA Letter; City of Adrian Letter; Bishop Letter; California Bar Letter; CFIRA Letter; Congressional Letter; CrowdCheck Letter; Guzik Letter; Milken Letter; NASAA Letter; NextSeed Letter; Pearl Letter; Wallin Letter; Orloff Letter; Zeoli Letter.

[37] For example, pursuant to Title II of the JOBS Act, the Commission adopted the Rule 506(c) exemption that permits an issuer to engage in general solicitation under certain circumstances while retaining Rule 506(b) as a safe harbor, which prohibits general solicitation. Pursuant to Title IV of the JOBS Act, the Commission also adopted Tier 1 and Tier 2 categories under Regulation A.

[38] 2015 Small Business Forum Recommendations.

[39] *See, e.g.*, Pearl Letter; Orloff Letter.

[40] Orloff Letter.

solicitation and advertising materials.[42] Two other commenters noted that appropriate accommodations should be made to permit use of space-constrained social media communications such as Twitter.[43] Two commenters noted that the Commission's efforts to modernize these requirements should preserve state authority over intrastate offerings, including the authority to impose additional disclosure requirements.[44]

c. Final Rules

After considering these comments and the recommendations of the 2015 Small Business Forum, we are adopting new Rule 147A to allow issuers to make offers accessible to out-of-state residents, so long as sales are limited to in-state residents. We are also retaining amended Rule 147 as a safe harbor under Section 3(a)(11) to preserve the continued availability of existing state exemptive provisions that are specifically conditioned upon issuer reliance on Section 3(a)(11) and Rule 147. Issuers relying on amended Rule 147 as a safe harbor under Section 3(a)(11) must continue to limit all offers and sales to in-state residents.[45]

We believe offers made over the Internet that can be viewed by a significant number of out-of-state residents are not consistent with Section 3(a)(11) and Rule 147, even if such offers include prominent disclosure stating that sales will be made only to residents of the same state or territory as the issuer.[46] When Section 3(a)(11) was enacted in 1934, Congress noted, 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

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41 CFA Letter; CFIRA Letter; CrowdCheck Letter; NASAA Letter.

42 NASAA Letter.

43 CFIRA Letter; CrowdCheck Letter.

44 Congressional Letter; NASAA Letter.

45 *See* Rule 147(b).

interstate commerce, does not thereby lose the benefits of the exemption."[47] Further, in 1937 the Commission released guidance on the nature of the Section 3(a)(11) exemption in the form of a letter from the Commission's General Counsel.[48] The letter stated 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)."[49] 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."[50] We do not read the legislative history for Section 3(a)(11) and the prior Commission statements as envisioning widespread out-of-state offers, but rather as recognition that some media of communication, such as a local newspaper or periodical, could only be imperfectly targeted to residents of a particular state. The Internet, however, is not similarly targeted to residents of a particular state, making it difficult for issuers to keep the distribution of such offers local in nature.

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46 *Cf.* ABA Letter; Guzik Letter; Zeoli Letter; Milken Letter; Pearl Letter.

47 *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 redesignating Section 5(c) as Section 3(a)(11).

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

49 *Id.*

50 1961 Release; *see also* 1937 Letter of General Counsel (stating that Section 3(a)(11) is "limited to cases in which the entire issue of securities is offered and sold exclusively to residents of the state in question").

Given the foregoing, we believe that the most appropriate means to permit the offer and sale of securities on Internet websites, or using any other form of mass media likely to reach significant numbers of out-of-state residents, is to adopt a new intrastate offering exemption pursuant to the Commission's general exemptive authority under Section 28. Accordingly, new Rule 147A will require issuers to limit sales to in-state residents, but will not limit offers by the issuer to in-state residents. New Rule 147A thereby will permit issuers to engage in general solicitation and general advertising of their offerings, using any form of mass media, including unrestricted, publicly-available Internet websites, so long as sales of securities so offered are made only to residents of the state or territory in which the issuer is resident.

Consistent with the proposal, both Rule 147A and amended Rule 147 will require issuers to include prominent disclosure with all offering materials stating that sales will be made only to residents of the same state or territory as the issuer.[51] We believe this disclosure will help alert potential investors that only residents of the state in which the issuer is located are eligible to participate in the offering. Nothing in this disclosure requirement, however, will prevent state authorities from imposing additional disclosure requirements or other requirements on offers or sales made to persons within their states.

Two commenters noted that appropriate accommodations should be made to permit use of space-constrained social media communications such as Twitter.[52] To accommodate space-constrained social media communication, when offering materials are distributed through a communications medium that has technological limitations on the number of characters or amount of text that may be included in the communication and including the required statements

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51 *See* Rules 147(f)(3) and 147A(f)(3).

52 CFIRA Letter; CrowdCheck Letter.

in their entirety, together with the other information, would cause the communication to exceed the limit on the number of characters or amount of text, an issuer could satisfy the disclosure requirement by including an active hyperlink to the required disclosure that otherwise would be required by the rules. The communication should prominently convey, through introductory language, that required information is provided through the hyperlink. We believe this guidance will accommodate advancements in social media, while still providing potential investors with the disclosure required by the rules. Where an electronic communication is capable of including the entirety of the required disclosure, along with the other information, without exceeding the applicable limit on the number of characters or amount of text, the use of a hyperlink to the required statements should not be used.

2. Elimination of Residence Requirement for Issuers

a. Proposed Amendments

For corporations, limited partnerships, trusts, or other forms of business organizations, we proposed to eliminate the current requirement in Rule 147 that limits the availability of the rule to issuers incorporated or organized in the state in which an offering takes place. Our proposed amendments would have expanded the universe of eligible issuers by eliminating the current "residence" requirement, while continuing to require that an issuer have a sufficient in-state presence determined by the location of the issuer's principal place of business.[53]

The proposed amendments also would have replaced the current rule's "principal office"[54] requirements for an issuer with a "principal place of business" requirement.[55] The

[53] *See* proposed Rule 147(c)(1). *See also* discussion on principal place of business in Section II.B.1below, 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.

[54] *See* 17 CFR 230.147(c)(1)(ii) and 17 CFR 230.147(c)(2)(iv).

proposed rule defined the term “principal place of business” to mean the location from which the officers, partners, or managers of the issuer primarily direct, control and coordinate the activities of the issuer.[56] As noted in the Proposing Release, an issuer would have been able to have a “principal place of business” within only one state or territory and would have therefore been able to conduct an offering pursuant to amended Rule 147 only within that particular state or territory. We also proposed to restrict the ability of an issuer that has changed its principal place of business from conducting an intrastate offering in a different state for a period of nine months from the date of the last sale in the prior state,[57] which was consistent with the duration of the resale limitation period specified in proposed Rule 147(e).[58]

b. Comments on Proposed Amendments

Commenters were divided on the proposal to eliminate the requirement in Rule 147 that entities be incorporated or organized under the laws of the state or territory in which the offering takes place. Several commenters supported eliminating this requirement and stated that the jurisdiction of entity formation should not affect the ability of an issuer to be considered resident for purposes of an intrastate offering and that there are valid business reasons for incorporating or organizing in states, such as Delaware, which do not detract from an issuer’s connection to the state in which its principal place of business is located.[59] Other commenters opposed eliminating

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

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

57 *See* Note 1 to proposed Rule 147(c)(1).

58 *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).

59 *See* Bishop Letter (“The application of state securities laws is not dependent upon the state of incorporation or organization of the issuer. Rather, the application of these laws depends upon whether an offer or sale is being made within the state.”); CFIRA Letter; CFA Letter (the proposed approach “continues the issuer-state connection through the actual business activities and employment aspects that accompany a principal

the requirement that entities be incorporated or organized under the laws of the state in which the offering takes place,[60] and some of these commenters stated that the intrastate exemption should promote state and local economic development goals in addition to capital formation—goals that, in their view, would be curtailed in the absence of an in-state organization requirement.[61]

Commenters also were divided on replacing the current in-state organization requirement in Rule 147(c)(1) with a principal place of business requirement. While two commenters viewed the principal place of business standard along with a "doing business" test as sufficiently demonstrating the in-state nature of an issuer's business,[62] two other commenters opposed the proposed principal place of business requirement.[63] One commenter noted that the jurisdictional reach of state securities laws is independent of whether an issuer is conducting any business within the state and indicated that a state's jurisdiction is established by the offer or sale of a security within the state.[64] Another commenter stated that the principal place of business

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place of business and recognizes the lack of connection between state of incorporation and actual business activities."); CrowdCheck Letter; NASAA Letter; NextSeed Letter.

60 Love Letter; MacDougall Letter; Newcomer Letter; Pearl Letter; Wolff Letter.

61 Love Letter ("If the company is incorporated in the state where sales occur, it is another way to encourage local funds to be retained locally"); MacDougall Letter (stating that incorporating out of state to avoid state taxes "goes against the 'spirit' of the law and sends the wrong message"); Pearl Letter ("intrastate laws are focused on state economic development *in addition to* capital formation for entrepreneurs and financial return for investors, and therefore the retention of capital within the state is a necessary component of the successful spread of benefits"); Wolff Letter (stating that local investing confers benefits that extend beyond financial return and seeks to encourage the spread of such social, economic, and other benefits while lifting the restriction on state incorporation entirely changes the nature of the intrastate crowdfunding).

62 NASAA Letter; NextSeed Letter.

63 Bishop Letter; Letter from David L. Sjursen, CEO & Founder, Exante Regulatory Compliance Consultants Inc., December 2, 2015 ("Exante Letter").

64 Bishop Letter ("[T]he Commission's proposed 'presence' requirements would not augment California's ability to enforce its securities laws for the protection of resident investors as assumed by the Commission. If a state believes that its existing qualification or exemption requirements inadequately protect offerees and purchasers, it can amend those requirements…. [I]t is far more logical to require only that the issuer be organized in the state or territory or qualified to transact intrastate business in the state or territory").

requirement is "anti-competitive in nature and disruptive in spurring economic growth for small businesses."[65]

Several commenters supported the proposed nine-month waiting period until the offering comes to rest, consistent with the requirements of proposed Rule 147(e), before an issuer may change its principal place of business to another state or territory and make a subsequent offering of securities in that new state or territory in reliance on proposed Rule 147.[66] No commenters opposed the proposed waiting period.

c. Final Rules

We are adopting changes to the residency requirements for issuers conducting exempt intrastate offerings largely as proposed, but with certain modifications to reflect our decision to retain existing Rule 147 as a safe harbor to the Section 3(a)(11) exemption. Since we are retaining Rule 147 as a safe harbor and since Section 3(a)(11) expressly requires that if the issuer is a corporation that it be "incorporated by and doing business within, such state or territory," we are not eliminating the "residence" requirement in current paragraph (c)(1) of Rule 147, as proposed. Instead, we are retaining the requirement that an issuer shall be deemed a resident of a state or territory in which it is incorporated or organized for issuers that are incorporated or organized under state or territorial law, such as corporations, limited partnerships and trusts.

In addition, for consistency between the provisions of Rule 147 and new Rule 147A,[67] throughout amended Rule 147, we are replacing the "principal office" requirement with the

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65 Exante Letter.

66 CFIRA Letter; CrowdCheck Letter; NASAA Letter.

67 *See* Rules 147(c)(1), 147(d)(1), 147A(c)(1) and 147A(d)(1). The 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

proposed "principal place of business" requirement.[68] Instead of "principal office," amended Rule 147 and new Rule 147A will refer to the term "principal place of business" to mean the location from which the officers, partners, or managers of the issuer primarily direct, control and coordinate the activities of the issuer.[69] We do not expect this change will significantly alter the scope of existing Rule 147 as we believe "principal place of business" is conceptually similar to principal office location.

Under amended Rule 147, issuers that are incorporated or organized under state or territorial law will be deemed a "resident" of a particular state or territory in which they are both incorporated or organized and have their "principal place of business."[70] Specifically, the "principal office" requirement contained in current Rule 147(c)(2)(iv)[71] will be updated and replaced with the "principal place of business" requirement in amended Rule 147(c)(1)(i). Similarly, issuers that are general partnerships, or in the form of another business organization not organized under any state or territorial law, shall be deemed to be a "resident" of the state or territory in which they have their "principal place of business."[72]

Consistent with the proposal, new Rule 147A(c)(1) will rely solely on the principal place of business requirement to determine the state or territory in which the issuer shall be deemed a "resident," not only for corporate issuers, but for all issuers, including issuers that are not

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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).

68 For example, as proposed, we are amending paragraph (d)(1) of Rule 147 to replace the "principal office" requirement with "principal place of business." *See also* Section II.B.3 below discussing the use of the "principal place of business" standard for the residence of entity purchasers.

69 *See* Rules 147(c)(1), 147(d)(1), 147A(c)(1) and 147A(d)(1).

70 *See* 17 CFR 230.147(c)(1)(i).

71 *See* 17 CFR 230.147(c)(1)(iv).

72 *See* 17 CFR 230.147(c)(1)(ii).

organized under any state or territorial law, such as general partnerships.[73] Although commenters were divided on whether to retain the requirement that entities be incorporated or organized under the laws of the state in which the offering takes place, we continue to believe that using a principal place of business requirement in lieu of an in-state formation requirement to establish the issuer's residency is more consistent with modern business practices in which issuers are permitted to 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.[74] We continue to believe that, outside the statutory requirements of Section 3(a)(11), the jurisdiction of entity formation should not affect the ability of an issuer to be considered "resident" for purposes of an intrastate offering exemption at the federal level. While we recognize that some commenters supported retaining an in-state formation requirement as a means of ensuring that the economic and social benefits of the offering remain within the state, the objectives of our rulemaking in this area are more broadly focused on facilitating capital formation by small businesses.[75] We believe that retaining an in-state formation requirement in new Rule 147A would be unnecessarily restrictive and limit the usefulness of the exemption, potentially to the detriment of local economic development.

We are, however, retaining the proposed principal place of business requirement, despite the views of several commenters that such a requirement is unnecessary or inappropriate.[76]

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[73] *See* note 56 above.

[74] For example, data provided by issuers in Form D filings with the Commission indicates that approximately 37% of Rule 504 offerings and 39% of Rule 505 offerings indicated in their Form D filings that they had different states of incorporation and principal places of business. Form D data also indicates that approximately 65% of all Rule 506 offerings initiated during 2009-2015 reported different states of incorporation and operations. *See* discussion in Section V.B.2.b.ii below.

[75] *See e.g.*, Rule 147 Adopting Release at text accompanying note 2.

[76] Bishop Letter; Exante Letter.

Although, as noted by one commenter, the jurisdictional reach of state securities laws is independent of whether an issuer is conducting any business within the state since a state's jurisdiction is established by the offer or sale of a security within the state,[77] we believe that states will have a particular interest in regulating intrastate offerings for the protection of investors where there is a meaningful nexus between the state, issuers and investors.

To ensure an appropriate connection between the state, issuers and investors, amended Rule 147(d) and Rule 147A(d) will require an issuer to be a resident of the same state where purchasers are resident or where the issuer reasonably believes they are resident.[78] Viewed together, paragraphs (c) and (d) of each of Rules 147 and 147A help to ensure the local intrastate character of the offering by requiring that both issuers and purchasers reside and have their principal place of business (for purchasers, the principal place of business requirement only applies to purchasers who are legal entities)[79] in the same state or territory where the offering takes place.

For situations where an issuer changes its principal place of business to another state after conducting an intrastate offering in reliance on Rule 147 or Rule 147A, we are adopting provisions in both rules that limit the ability of an issuer to conduct a subsequent intrastate offering pursuant to Rule 147 or Rule 147A until such time as securities sold in reliance on the exemption in the prior state have come to rest in that state.[80] This is consistent with the view that securities sold in an intrastate offering in one state should have to come to rest within such

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[77] Bishop Letter.

[78] *See* Rule 147A(c)(1).

[79] Under both amended Rule 147(d)(2) and Rule 147A(d)(2), the residence of an individual (natural person) is determined by the state or territory in which his or her principal residence is located at the time of the offer and sale to the individual.

[80] *See* Rules 147(e) and 147A(e).

state before purchasers may resell their securities to out-of-state residents.[81] Accordingly, both rules provide that issuers who have previously conducted an intrastate offering pursuant to Rule 147 or Rule 147A will not be able to conduct another subsequent intrastate offering pursuant to either rule in a different state for a period of six 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 our amendments to Rule 147(e) and new Rule 147A(e).[82] The use of a six-month period is a change from the proposed nine-month period, and aligns these provisions with changes being made to amended Rule 147(e) and new Rule 147A(e), consistent with commenters' suggestions to reduce the nine-month resale limitation period to six months.[83]

B. Common Requirements of the Amendments to Rule 147 and New Rule 147A

Our amendments to Rule 147 and the provisions of new Rule 147A are substantially identical, except that, as discussed above, new Rule 147A allows an issuer to make offers accessible to out-of-state residents and to be incorporated or organized out-of-state.[84] Under the rules we adopt today, both amended Rule 147 and new Rule 147A will include the following provisions:

- A requirement that the issuer satisfy at least one "doing business" requirement that will demonstrate the in-state nature of the issuer's business.
- A new "reasonable belief" standard for issuers to rely upon in determining the residence of the purchaser at the time of the sale of securities.

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81 *See* 1961 Release at 4.

82 *See* Instruction to Paragraph (c)(1) of Rule 147 and Instruction to Paragraph (c)(1) of Rule 147A.

83 *See* Section II.B.4.c below.

84 *See* Sections II.A.1and II.A.2 above.

- A requirement that issuers obtain a written representation from each purchaser as to his or her residency.
- The residence of a purchaser that is a non-natural person, such as a corporation, partnership, trust or other form of business organization, will be defined as the location where, at the time of the sale, the entity has its "principal place of business."
- A limit on resales to persons resident within the state or territory of the offering for a period of six months from the date of the sale by the issuer to the purchaser of a security sold pursuant to the exemption.
- An integration safe harbor that will 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 after the completion of the offering.
- Disclosure requirements, including legend requirements, to offerees and purchasers about the limits on resales.

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

a. Proposed Amendments

Under the proposed rules, an issuer would be required to meet at least one of the following requirements in order to be considered "doing business" in-state:

- 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;[85]

[85] *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.

- 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;[86]
- 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 property, the purchase of real property located in, or the rendering of services within such state or territory;[87] or
- A majority of the issuer's employees are based in such state or territory.[88]

b. Comments on the Proposed Amendments

Several commenters supported our proposed amendments to the current "doing business" requirements in Rule 147(c)(2).[89] One commenter specifically favored the proposed disjunctive approach, requiring an issuer to satisfy one of four threshold tests, thereby enabling different types of issuers (e.g., a brick-and-mortar business versus an online business) to confirm local residency and demonstrate the in-state nature of their business.[90] Another commenter, although noting that the proposed requirements and thresholds appropriately reflect characteristics that are in keeping with establishing a local presence, was concerned that having to meet only one requirement may not establish the local connection of the issuer to the state to the degree

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

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

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

89 CFA Letter; CFIRA Letter; CrowdCheck Letter; NASAA Letter.

90 NASAA Letter.

anticipated by Section 3(a)(11) and encouraged a close review of this issue in a Commission study.[91]

Two commenters supported our proposed amendment to the "doing business" test to add an alternative threshold requirement based on the location of a majority of an issuer's employees.[92] Several commenters supported using this additional criterion, but with different percentage thresholds.[93] Some of these commenters recommended requiring that at least 80% of the issuer's employees be based in the state,[94] while another commenter supported requiring that at least 75% of the issuer's employees be based in the state.[95]

Several commenters opposed our proposed "doing business" requirements in favor of alternative standards.[96] For example, some of these commenters supported the use of five alternative criteria in order for an issuer to be deemed a "state business," specifically: the issuer's main office be located in-state, and at least 80% of the funds raised be used in-state, work is done in-state, employees live in-state and owners reside in-state.[97] Another commenter supported generally these same criteria, but using 75% thresholds as opposed to 80%

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[91] CFA Letter ("If the Commission determines to adopt the proposed approach, however, we encourage a close review in the study the Commission intends to undertake within three years of the adoption of the amendments."). *See* note 106.

[92] Milken Letter; NASAA Letter.

[93] Ely Letter; MacDougall Letter; Pearl Letter; Terdal Letter; Wolff Letter.

[94] Ely Letter; MacDougall Letter; Pearl Letter; Terdal Letter.

[95] Wolff Letter.

[96] Ely Letter; MacDougall Letter; Pearl Letter; Terdal Letter.

[97] Ely Letter; MacDougall Letter; Pearl Letter (recommending that an issuer be required to satisfy "at least three" of these five criteria or from an alternative "reasonable list"). *Cf.* Terdal Letter ("A more appropriate test of a "local company" would be one that has at least 80% of the employees' wages paid in state, or perhaps 80% of the work (i.e. manufacturing, producing, brewing, etc.) be done in state.").

thresholds.[98] Other commenters recommended a more flexible standard that would move away from the strict 80% thresholds in favor of majority requirements that would harmonize the current "doing business" tests with the proposed test for number of employees.[99] Finally, another commenter suggested a periodic review by the Commission to evaluate the 80% thresholds to determine whether the exemption succeeds in facilitating the goal of small business capital formation while protecting investors.[100]

c. Final Rules

After considering the comments, we are adopting, as proposed, updated and modernized "doing business" requirements in Rule 147 and new Rule 147A to comport with contemporary small business practices.[101] We believe these updated requirements will expand the universe of issuers that may rely on Section 3(a)(11) and the amended Rule 147 safe harbor, as well as new Rule 147A, to conduct exempt intrastate offerings, while continuing to require issuers to have an in-state presence sufficient to justify reliance on these provisions. Given the increasing "interstate" nature of small business activities, we believe it has become increasingly difficult for companies, even smaller companies that are physically located within a single state or territory, to satisfy the issuer "doing business" requirements of current Rule 147(c)(2).[102] Accordingly, we believe these issuer "doing business" requirements, identical for both amended Rule 147 and

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98 Wolff Letter (recommending 75% thresholds for use of funds, work done in-state, and number of employees residing in-state but that the rules require only a majority of the owners' primary residences be located in-state).

99 Milken Letter (stating that the requirement for a precise 80% threshold "can be confusing and difficult for issuers to assess. Additionally, the high and precise threshold can exclude issuers that rationally should qualify."); Pearl Letter.

100 NASAA Letter.

101 *See* Rules 147(c)(2) and 147A(c)(2).

102 *See* discussion in Section II.A.2 above.

new Rule 147A, will provide issuers with greater flexibility in conducting intrastate offerings and expand the availability of these two intrastate offering provisions.[103]

As proposed, we are adopting amendments to Rule 147(c)(2) and including provisions in new Rule 147A(c)(2) that will provide issuers with greater flexibility to satisfy the current "doing business" requirements by adding an alternative test based on the location of a majority of the issuer's employees while retaining the three 80% threshold tests in current Rule 147(c)(2).[104] Furthermore, while the substance of the three 80% threshold requirements of current Rule 147(c)(2) is being retained in the final rules, compliance with any one of the 80% threshold requirements (or the additional test based on the majority of employees) will be sufficient to demonstrate the in-state nature of the issuer's business, as proposed. This is a change from current Rule 147(c)(2), which requires issuers to satisfy all three 80% threshold requirements.

We recognize that commenters had various alternative views on these requirements. While some commenters sought to require issuers to meet additional criteria, other commenters sought to lower the percentage thresholds in the criteria to ease the issuer requirements. We believe that the approach we are adopting in the final rules will provide issuers with additional flexibility to satisfy the requirements, while continuing to function as meaningful indicia of the in-state nature of the issuer's business. In light of the fact that issuers will need to meet only one of the threshold tests, we are not changing the current 80% threshold tests to a majority requirement as one commenter suggested.[105] We believe it is appropriate to first observe how

103 *See, e.g.*, Transcript of Record 82-91, SEC Advisory Committee on Small and Emerging Companies (June 3, 2015).

104 *See* Rules 147(c)(2) and 147A(c)(2).

105 *See* Milken Letter.

the updated doing business in-state requirements are used by issuers in practice before making any further changes.[106] Except as discussed below, we also are not adopting alternative criteria for the doing business in-state requirements, as suggested by several commenters.[107] We believe the existing criteria have generally served states, issuers and investors well by being easy to understand and apply, and when updated as discussed above, will appropriately reflect characteristics in keeping with a local business presence.[108]

We are also making certain technical revisions to the three current 80% thresholds, as proposed, that we believe will simplify the structure and application of the rules.[109] In light of our amendments to require issuers to satisfy only one of the threshold tests, we are eliminating 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.[110] 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 is necessary under the new disjunctive approach that we are adopting in these rules.

Consistent with the proposal, and as supported by commenters, we are adding an alternative requirement to the three modified 80% threshold requirements. This requirement, which relates to the location of a majority of the issuer's employees, will provide an additional

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106 As we indicated in the Proposing Release, we expect the staff to undertake to study and submit a report to the Commission no later than three years following the effective date of the final rules on whether this new framework appropriately provides assurances that an issuer is doing business in the state in which the offering takes place.

107 *See* Ely Letter; MacDougall Letter; Pearl Letter; Terdal Letter.

108 *See* CFA Letter.

109 For example, in order to streamline the presentation of Rule 147(c)(2), we are re-designating 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 Instruction to Paragraph (c)(2)(i) of Rule 147. Similarly, Rule 147A will also include an instruction on how to calculate revenue under Rule 147A(c)(2)(i).

method by which an issuer may demonstrate that it conducts in-state business sufficient to justify reliance on either Rule 147 or new Rule 147A. For these purposes, we are permitting an issuer to satisfy the "doing business" requirements by having a majority of its employees based in such state or territory.[111] An employee would be based in the same state or territory of the issuer for purposes of this test if such employee is based out of offices located within such state or territory.[112] For example, if an employee provides services in the Maryland, Virginia and Washington, DC metro area out of the offices of a company in Maryland, the employee would be based in Maryland for purposes of this test. While some commenters suggested different thresholds for the employee test (ranging from 75% to 80%), we believe that using a majority of the employees test provides a standard that more accurately captures the increasingly flexible ways that companies structure and conduct their business operations, while still requiring that more employees be located in-state than elsewhere. Current workforce trends, such as telecommuting, whereby employees often work in a different geographical location from their employer, suggest that flexibility is particularly needed in this area. We believe adding this criterion to expand upon the current doing business requirements in Rule 147(c)(2) will provide additional flexibility to issuers by making these requirements more consistent with modern business practices, especially in light of the different roles employees play within smaller companies and the different locations in which employees carry out such roles, while still providing important indicia of the in-state nature of an issuer's business.

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110 17 CFR 230.147(c)(2)(i)(B).

111 *See* Rules 147(c)(2)(iv) and 147A(c)(2)(iv).

112 The state or territory in which an employee is based may, or may not, be the same state or territory in which the employee resides.

2. Reasonable Belief as to Purchaser Residency Status

a. Proposed Amendments

Consistent with the requirements in Regulation D,[113] we proposed 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.[114] 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.[115] We also proposed to eliminate the requirement in current Rule 147 that issuers obtain a written representation from each purchaser as to his or her residence, as we believed this requirement may be unnecessary in light of the proposed reasonable belief standard.[116]

b. Comments on the Proposed Amendments

Several commenters supported the proposal to include a reasonable belief standard.[117] One of these commenters stated that a reasonable belief standard will provide more certainty for issuers about the availability of the exemption and increase its utility without sacrificing investor protection.[118]

Commenters were divided on whether to eliminate the requirement to obtain a written

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113 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).

114 *See* proposed Rule 147(d).

115 *Id.*

116 17 CFR 230.147(f)(1)(iii).

117 ABA Letter; City of Adrian Letter; CFA Letter; NASAA Letter.

118 NASAA Letter.

representation from the purchaser as to his or her residence, with two commenters supporting the proposed elimination of the requirement[119] and two commenters opposing it.[120] Commenters opposing elimination of the requirement stated that the written representation should not be the sole indication of residency under a facts and circumstances exercise, but asserted that it is a useful indication of residency.[121]

Several commenters requested that the Commission provide a safe harbor for determining an individual purchaser's residence, based upon certain objective criteria.[122] Two of those commenters supported the creation of a non-exclusive safe harbor setting out the means by which a reasonable belief may be established, including the circumstances in which an issuer may rely on the steps taken by a third-party, such as a service provider or intermediary.[123] Another of those commenters stated that Commission staff should work with the states to standardize requirements for determining state of residency for purposes of investor participation in an offering to help ensure compliance with the residency requirement.[124] In addition, the 2015 Small Business Forum recommended that the Commission create a safe harbor for determining the "place of business" of a non-natural person investor in Rule 147 offerings, which could be as simple as a self-certification as to its place of business.[125]

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[119] CFIRA Letter; CrowdCheck Letter.

[120] CFA Letter; NASAA Letter.

[121] NASAA Letter ("this requirement should remain in place but may be construed as evidence of, but not be dispositive of, a reasonable belief of purchaser residency.").

[122] CFIRA Letter; CrowdCheck Letter; Letter from Brandon Smith, Managing Principal, Localstake Marketplace LLC, November 17, 2015 ("Localstake Letter"); Letter from Rose Oswald-Poels, President/CEO, Wisconsin Bankers Association, January 8, 2016 ("WBA Letter").

[123] CFIRA Letter; CrowdCheck Letter.

[124] Localstake Letter.

[125] *See* 2015 Small Business Forum Recommendations.

c. Final Rules

Consistent with the proposal, and with the determination of accredited investor status under Regulation D,[126] we are adopting amendments to Rule 147 and a provision in new Rule 147A that will include a reasonable belief standard for the issuer's determination as to the residence of the purchaser at the time of the sale of the securities.[127] Under the final rules, an issuer will satisfy the requirement that the purchaser in the offering be a resident of the same state or territory in which the issuer is resident 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.[128] Under current Rule 147(d), regardless of the efforts an issuer takes to determine that potential investors are residents of the state in which the issuer is resident, the exemption is lost for the entire offering if securities are offered or sold to just one investor that was not in fact a resident of such state. We continue to 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 amended Rule 147 and new Rule 147A by providing issuers with additional certainty about the availability of the exemption under Section 3(a)(11) or new Rule 147A while still providing appropriate investor protections.[129]

In a change from the proposal, both amended Rule 147 and new Rule 147A will include a requirement that issuers obtain a written representation from each purchaser as to his or her

126 *See* note 113 above.

127 *See* Rules 147(d) and 147A(d).

128 *Id.*

129 The burden will continue to be on the issuer to establish that the purchaser is an in-state resident or that the issuer had a reasonable belief as to residency. Otherwise, the sale to a non-resident purchaser would preclude reliance on amended Rule 147 or new Rule 147A.

residence.[130] We are persuaded by those commenters who stated that this requirement should be retained and considered as evidence of, but not be dispositive of, the purchaser's residency. In the context of Section 3(a)(11), 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."[131] Whether an issuer has formed a reasonable belief that the prospective purchaser is an in-state resident will be determined on the basis of all facts and circumstances. Obtaining a written representation from purchasers of in-state residency status will not, without more, be sufficient to establish a reasonable belief that such purchasers are in-state residents.[132]

In addition to the written representation, other facts and circumstances could include, but will not be limited to, for example, a pre-existing relationship between the issuer and the prospective purchaser that provides the issuer with sufficient knowledge about the prospective purchaser's principal residence or principal place of business so as to enable the issuer to have a reasonable basis to believe that the prospective purchaser is an in-state resident. An issuer may also consider other facts and circumstances when 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, any documentation issued by a federal, state, or local government authority, such as a driver's license or identification card, or a public or private database that the issuer has determined is reasonably reliable, including credit bureau databases, directory listings, and public records.

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130 *See* Rules 147(f)(1)(iii) and 147A(f)(1)(iii).

131 *See* 1961 Release at 3.

132 *See* Instruction to Paragraph (d) of Rule 147 and Instruction to Paragraph (d) of Rule 147A.

While a few commenters[133] and the 2015 Small Business Forum recommended that the Commission provide a safe harbor for determining a purchaser's residence, including the circumstances in which a reasonable belief may be established, we are not doing so in the final rules. Our rules do not provide a safe harbor for the reasonable belief determination made under Rule 501(a) of Regulation D for exempt offerings, and we do not believe that the determinations required for amended Rule 147 and new Rule 147A present a more compelling case for having such a provision. In addition, we are concerned that a safe harbor could be viewed as an exclusive or minimum standard. We believe that requiring issuers to consider the facts and circumstances in order to establish a reasonable basis to believe that the purchaser is a resident of the same state or territory in which the issuer is resident is appropriate and will provide sufficient certainty for issuers seeking to satisfy the requirements of the exemption. Commission staff will consider available information on issuer compliance with the "reasonable belief" standards in connection with the study of amended Rule 147 and new Rule 147A.[134]

3. Residence of Entity Purchasers

a. Proposed Amendments

We proposed 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.[135] For these purposes, we also proposed to define a purchaser's "principal place of business," consistent with the proposed

[133] CFIRA Letter; CrowdCheck Letter; Localstake Letter; WBA Letter.

[134] *See* Section I above.

[135] *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." Current Rule 147 does not define "principal office." 17 CFR 230.147(c)(2)(iv).

definition for issuer eligibility purposes, as the location in which the officers, partners, or managers of the entity primarily direct, control and coordinate its activities.[136]

b. Comments on the Proposed Amendments

Two commenters supported the proposed amendments to replace the "principal office" requirement for entity purchasers with the "principal place of business" standard, consistent with the standard for issuers.[137] One commenter suggested that the Commission clarify how the residency of non-business trusts should be determined.[138]

c. Final Rules

Consistent with the proposal, we are adopting amendments to Rule 147 and a provision in new Rule 147A that will 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.[139] The final rules define a purchaser's "principal place of business," consistent with the definition for determining issuer residency contained in paragraph (c)(1) of Rules 147 and 147A, as the location in which the officers, partners, or managers of the entity primarily direct, control and coordinate its activities.[140] In addition, as suggested by one commenter,[141] we are adding an instruction to the requirement as to the residency of the purchaser stating that a trust that is not deemed by the law

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

[137] NASAA Letter; NextSeed Letter.

[138] Bishop Letter (recommending that Rule 147(d)(1) be amended to add: "A trust that is not deemed by the law of the state or territory of its creation to be a separate legal entity is deemed to be a resident of each state or territory in which its trustee is, or trustees are, resident.").

[139] *See* Rules 147(d) and 147A(d).

[140] *See* Rules 147(c)(1), 147(d)(1), 147A(c)(1) and 147A(d)(1).

[141] Bishop Letter.

of the state or territory of its creation to be a separate legal entity should be deemed to be a resident of each state or territory in which its trustee is, or trustees are, resident.[142]

4. Limitation on Resales

a. Proposed Amendments

We proposed 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 by a purchaser would need to be made only to residents within the purchaser's state or territory of residence.[143] In contrast, Rule 147(e) currently requires that during the period in which securities are offered and sold in reliance on the intrastate offering exemption, and for a period of nine months from the date of the last sale by the issuer of such securities, all resales of any securities sold in the offering shall only be made to persons resident within the state or territory of which the issuer is a resident. In the Proposing Release, we explained 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 has taken the securities "without a view to further distribution or resale to non-residents."[144] In this regard, we believed that a time-based limitation on potential resales to non-residents that relates back to the date of the purchase by a resident investor from the issuer would more precisely address the concern regarding out-of-state resales.

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142 *See* Instruction 1 to Paragraph (d)(1) of Rule 147 and Instruction 1 to Paragraph (d)(1) of Rule 147A.

143 Proposed Rule 147(e).

144 *See* Proposing Release, at text accompanying note 87.

We also proposed 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).[145] We believed 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. As proposed, issuers would remain subject to requirements relating to, for example, in-state sales limitations, legends, 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. Lastly, although we did not propose to amend our rules to provide that securities issued under amended Rule 147 be considered "restricted securities" under Rule 144(a)(3),[146] we requested comments on this question.

b. Comments on the Proposed Amendments

Several commenters supported the proposed change to the 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.[147] Commenters, however, had differing views on the length of the holding period from the date of sale. Two commenters supported a nine-month holding period from the date of sale.[148] One of these commenters reasoned that this period sufficiently demonstrates the purchase was for investment without an

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

146 17 CFR 230.144(a)(3).

147 CFA Letter; CFIRA Letter; CrowdCheck Letter; NASAA Letter.

148 CFA Letter; NASAA Letter.

intent to distribute out-of-state or avoid registration.[149] Two other commenters stated that a period of six months is adequate to establish that securities have "come to rest" in a state.[150] Those commenters noted that a nine-month period does not exist in any other securities law requirements, so the potential exists for confusion. One commenter recommended that the Commission clarify that bona fide gifts are not subject to the limitation on resales out-of-state, and that a donee is deemed to have acquired the securities when they were acquired by the donor.[151]

Commenters were divided on whether securities issued under amended Rule 147 should be considered "restricted securities" under Rule 144(a)(3). One commenter stated that securities issued under amended Rule 147 should be considered "restricted securities" under Rule 144(a)(3).[152] Two other commenters stated that the securities should not be treated as "restricted securities" under Rule 144(a)(3), noting that the "coming to rest" in-state purpose of the nine-month restriction is sufficiently distinct from the policy considerations underlying Rule 144.[153]

In addition, several commenters supported no longer conditioning the availability of the exemption on purchaser compliance with Rule 147(e).[154] One of those commenters reasoned that if an issuer takes reasonable steps to comply with the limitations on resale, the issuer should

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[149] NASAA Letter.

[150] CrowdCheck Letter; CFIRA Letter. These commenters stated that allowing a six-month period, by analogy to parts of Rule 144, is more appropriate.

[151] Bishop Letter.

[152] NASAA Letter.

[153] CFIRA Letter; CrowdCheck Letter.

[154] CFIRA Letter; CrowdCheck Letter; NASAA Letter.

not lose the original exemption if a purchaser does not comply with the resale restrictions at a later date.[155]

c. Final Rules

After considering the comments, we are adopting a requirement in amended Rule 147 and new Rule 147A providing that for a period of six months from the date of the sale of the security by the issuer any resale of the security shall be made only to persons resident within the state or territory in which the issuer was resident at the time of the sale of the security by the issuer.[156] We are persuaded by those commenters that indicated that a period of six months is adequate to establish that securities sold in an intrastate offering have "come to rest" in a state by analogizing to provisions of Rule 144, in which a six-month holding period is deemed sufficient to establish a requisite investment intent.[157] In this regard, given the use of a six-month resale restriction in the Rule 144 context, we believe that a similar resale restriction in the intrastate offering context should provide adequate assurance that the securities will come to rest in-state.[158]

We note that bona fide gifts are not subject to the limitation on resales in amended Rule 147 or new Rule 147A.[159] Since bona fide gifts are not transactions for value, they require no investment decision by the donee and thus do not involve the sale of a security subject to

155 NASAA Letter.

156 Rules 147(e) and 147A(e).

157 *See* CFIRA Letter and CrowdCheck Letter. Rule 144 provides a safe-harbor from being deemed a "statutory underwriter" under Section 2(a)(11) of the Securities Act. Specifically, Rule 144(d)(1)(i) requires a six-month holding period for restricted securities sold by issuers reporting under the Exchange Act in order for a purchaser to resell such securities and not be deemed an underwriter.

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

159 *See* Bishop Letter.

regulation under the Securities Act.[160] However, we note that subsequent resales of donated securities are subject to the resale restrictions regardless of the state in which the holder of the donated securities resides. To address bona fide gifts of securities to out-of-state donees, as well as the resales of securities that were wrongfully sold to out-of-state purchasers, within the six month re-sale limitation period, we are revising our proposed resale limitation to focus on the state or territory in which the issuer was resident, as opposed to where the last purchaser of the securities may have resided. Accordingly, the resale limitation in the final rules limits resales to "persons resident within the state or territory in which the issuer was resident…at the time of the sale of the security by the issuer" as opposed to limiting resales to "persons resident within the purchaser's state or territory of residence," as proposed. We believe this revision will address situations in which purchasers in the offering subsequently gift or wrongfully sell their securities to out-of-state residents who then wish to resell their securities within the six month limitation of paragraph (e). This change to the rules makes clear that the six-month limitation on resales applies to all holders of the securities, including holders subsequent to the original purchaser, whether they received the shares as a gift, donation, or by purchase.[161]

As proposed, the resale limitation period for both amended Rule 147(e) and new Rule 147A(e) will relate back to the date of purchase by a resident investor from the issuer, in contrast to current Rule 147(e) that does not start the resale limitation period until the offering has

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160 Section 2(a)(3) of the Securities Act defines "sale" or "sell" to "include every contract of sale or disposition of a security or interest in a security, for value." A lack of monetary consideration, however, does not always mean that there was not a sale or offer for sale for purposes of Section 5. *See, e.g.,* Capital General Corporation, 54 SEC Docket 1714, 1728-29 (July 23, 1993) (Capital General's "gifting" of securities constituted a sale because it was a disposition for value, the "value" arising "by virtue of the creation of a public market for the issuer's securities."). *See also* SEC v. Harwyn Industries Corp., 326 F. Supp. 943 (S.D.N.Y. 1971).

161 *See* Rules 147(e) and 147A(e).

terminated (i.e., until all offers and sales have ceased).[162] We continue to 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 purchase by a resident investor from the issuer would more precisely address the concern regarding out-of-state resales.

In light of our revision to the resale limitation to focus on the state where the issuer is a resident, we are including additional language in amended Rule 147(e) and new Rule 147A(e) to specify that all re-sales during this six month resale limitation period will be restricted to the state or territory in which the issuer was a resident at the time of the sale of the security by the issuer to a purchaser. Accordingly, if an issuer were to change its state or territory of residence during the six month resale limitation period, all resales would, nevertheless, continue to be limited to the state or territory in which the issuer resided at the time of the original sale of securities in reliance upon either Rule 147 or Rule 147A. We believe this additional language will preserve the intent of the proposed resale restriction—to help ensure that the securities offered pursuant to an intrastate offering exemption have come to rest within the state of the offering before being resold.

As proposed, an issuer's ability to rely on the respective rules will not be conditioned on a purchaser's compliance with Rule 147(e) and Rule 147A(e).[163] As discussed in the Proposing Release, the application of current Rule 147(e) in the overall scheme of the safe harbor can cause uncertainty for issuers. We continue to believe that removing the condition on purchaser compliance with Rule 147(e) will increase the utility of the exemption by eliminating the uncertainty created in the offering process for issuers under the current rules. As one commenter

[162] The resale limitation period may end on different dates for different purchasers if the issuer sold shares on multiple dates.

[163] *See* Rules 147(b) and 147A(b). Current Rule 147(a) would be re-designated as Rule 147(b).

noted, if an issuer takes reasonable steps to comply with the limitations on resale, it should not lose the availability of the exemption due to a purchaser not complying with the resale limitations.[164] We continue to believe that eliminating this uncertainty should not result in an increased risk of issuer non-compliance with the rules, because issuers will remain subject to requirements relating to, for example, in-state sales limitations, legends, stop transfer instructions for transfer agents, and offeree and purchaser disclosures, in order to satisfy the exemption at the federal level.[165] In addition, issuers will continue to be subject to the antifraud and civil liability provisions of the federal securities laws, as well as state securities law requirements.

Lastly, while one commenter believed that securities issued under amended Rule 147 should be considered "restricted securities" under Rule 144(a)(3),[166] we believe that limiting the resale of these securities only to persons resident within the same state or territory in which the issuer is a resident for a period of six months from the date of the sale of the security by the issuer to the purchaser is sufficient to assure that the offering has come to rest in the state or territory in which the issuer resides and thereby preserve the local character of the offering. We note that states are free to impose any additional requirements they believe are necessary to protect the residents of their states, including imposing further transfer restrictions on securities issued under amended Rule 147 or new Rule 147A similar to that required under Rule 144(a)(3). In addition, persons reselling securities will need to consider whether they could be an "underwriter" if they acquired the securities with a view to "distribution" or if they are

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164 NASAA Letter.

165 Commission staff will seek to review information gathered by state regulators on issuer compliance with the legend requirements in amended Rule 147(f) and new Rule 147A(f) as part of the study of amended Rule 147 and new Rule 147A. *See* Section I.

166 *Id*.

participating in a "distribution."[167] A seller that complies with the conditions of the Rule 144 safe harbor will not be deemed to be an underwriter.[168]

5. Integration

a. Proposed Amendments

The proposed Rule 147 integration 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 proposed paragraph (h) of Rule 147;
    - 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);
    - Exempt from registration under Section 4(a)(6) of the Act (15 U.S.C. 77d(a)(6)); or

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167 *See* Section 4(a)(1) of the Securities Act (exempting from registration "transactions by any person other than an issuer, underwriter, or dealer") and Section 2(a)(11) of the Securities Act (defining the term "underwriter"). 15 U.S.C. 77d(a)(1) and 15 U.S.C. 77b(a)(11).

168 17 CFR 230.144.

- Made more than six months after the completion of an offering conducted pursuant to this rule.[169]

b. Comments on the Proposed Amendments

One commenter supported including registered offers and sales and certain other exempt offerings occurring within six months after completion of the offering in the integration safe harbor, as proposed.[170] The same commenter did not support providing a safe harbor for any and all prior offers or sales of securities by the issuer, as proposed in paragraph (g)(1) of the amended rule, and instead recommended restricting the safe harbor to cover only offers and sales of securities that take place before the six-month period immediately preceding the Rule 147 offering.[171] While acknowledging that the proposed integration safe harbor is consistent with the integration safe harbor in Rule 251(c) of Regulation A, the commenter distinguished Regulation A from Rule 147 by noting that "Regulation A is a quasi-registration subject to regulatory oversight by the Commission and the states while a Rule 147 offering may be exempt at both the federal and state level." In determining an integration safe harbor model to follow, the commenter indicated it would be better to look to Rule 502(a) of Regulation D, which limits the safe harbor for private offerings to offers and sales occurring either six months before, or six months after, a Regulation D offering.[172]

On the other hand, two commenters believed that Rule 147 offerings should not be

169 *See* proposed Rule 147(g).

170 NASAA Letter.

171 *Id*.

172 *Id*. Rule 502(a) provides that "Offers and sales that are made more than six months before the start of a Regulation D offering or are made more than six months after completion of a Regulation D offering will not be considered part of that Regulation D offering, so long as during those six month periods there are no offers or sales of securities by or for the issuer that are of the same or a similar class as those offered or sold under Regulation D, other than those offers or sales of securities under an employee benefit plan as defined in Rule 405 under the Act." 17 CFR 230.502(a).

integrated with any other exempt offerings.[173] One of these commenters recommended that Rule 147 contain language expressly stating that an offering made in reliance on Rule 147 will not be integrated with another exempt offering made concurrently, provided that each offering meets the requirements of the claimed exemption.[174]

c. Final Rules

After considering the comments, we are adopting amendments to the integration safe harbor under Rule 147 and providing an identical integration safe harbor provision in new Rule 147A, substantially as proposed. The integration safe harbor will cover any prior offers or sales of securities by the issuer, as well as certain subsequent offers or sales of securities by the issuer occurring after the completion of an offering pursuant to Rule 147 or Rule 147A, as applicable. Accordingly, offers and sales made pursuant to Rules 147 and 147A will not be integrated with:

- Offers or sales of securities made prior to the commencement of offers and sales of securities pursuant to Rules 147 or 147A; or
- Offers or sales of securities made after completion of offers and sales pursuant to Rules 147 or 147A that are:
    - Registered under the Securities Act, except as provided in Rule 147(h) or Rule 147A(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;

[173] NextSeed Letter; Localstake Letter.

[174] NextSeed Letter.

- Exempt from registration under Regulation S (17 CFR §§ 230.901 through 230.905);
- 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 Rules 147 or 147A.[175]

As discussed in the Proposing Release, integration safe harbors provide issuers, particularly smaller issuers whose capital needs often change, with greater certainty about their eligibility to comply with an exemption from Securities Act registration.[176] Consistent with the proposal and the approach taken in Rule 251(c) of Regulation A, the safe harbor from integration provided by Rule 147(g) and Rule 147A(g) will expressly provide that any offer or sale made in reliance on the respective rules will 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 respective intrastate offerings under either Rule 147 or Rule 147A. For transactions that fall within the scope of the safe harbor, issuers will not have to conduct an integration analysis of the terms of any offering being conducted under the other specified provisions in order to determine whether the two offerings would be treated as one for purposes of qualifying for either exemption.[177] While one commenter recommended that the Commission adopt a safe harbor more closely aligned with the

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175 *See* Rules 147(g) and 147A(g).

176 *See* Proposing Release at Section II.B.4.d. (Integration); *see also* 2015 Regulation A Release at Section II.B.5. (Integration).

177 The issuer will, however, need to comply with the requirements of each exemption that it is relying upon. For example, an offering made pursuant to Rule 506(b) will not be integrated with a subsequent offering pursuant to Rule 147A, but the issuer will need to comply with the requirements of each rule, including the limitation on general solicitation for offers made pursuant to Rule 506(b).

provisions of Rule 502(a) of Regulation D,[178] we believe the integration safe harbor in Rule 251(c) of Regulation A is more consistent with the Commission's post-JOBS Act approach to integration that has evolved since the adoption of Regulation D in 1982 to better articulate the principles underlying the integration doctrine in light of current offering practices and developments in information and communication technology.[179] As we explained in the Proposing Release, we believe that our approach to integration will provide issuers with greater certainty as to the availability of an exemption for a given offering and increase consistency in the application of the integration doctrine among the exemptive rules available to smaller issuers, while preserving important investor protections provided in each exemption.[180]

The bright-line integration safe harbor we are adopting in amended Rule 147(g) and new Rule 147A(g) will assist issuers, particularly smaller issuers, in analyzing certain transactions, but will not address the issue of potential offers or sales that occur concurrently with, or close in time after, a Rule 147 or 147A offering. There is no presumption that offerings outside the integration safe harbors should be integrated. Rather, whether concurrent or subsequent offers and sales of securities will be integrated with any securities offered or sold pursuant to amended Rule 147 or new Rule 147A will depend on the particular facts and circumstances, including whether each offering complies with the requirements of the exemption that is being relied upon for the particular offering.[181] For example, an issuer conducting a concurrent exempt offering

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[178] NASAA Letter.

[179] *See also,* Regulation Crowdfunding Adopting Release.

[180] *See* Proposing Release at text accompanying note 103. *See also* Rule 251(c) of Regulation A [17 CFR 230.251(c)]; Rule 701 [17 CFR 230.701]. Each exemption is designed based on a particular type of offer and investor, with corresponding requirements that must be satisfied.

[181] The integration concept was first articulated by the Commission in 1933 and was further developed in two interpretive releases issued in the 1960s. *See* SEC Rel. No. 33-97 (Dec. 28, 1933); SEC Rel. No. 33-4434 (Dec. 6, 1961); SEC Rel. No. 33-4552 (Nov. 6, 1962). The interpretive releases stated that determining whether a particular securities offering should be integrated with another offering requires an analysis of

for which general solicitation is not permitted will need to be satisfied that purchasers in that offering were not solicited by means of the offering made in reliance on Rule 147 or new Rule 147A.[182] If an offer fails to comply with the requirements of the exemption, and the offer is not registered and no other exemption is available, that offer would be in violation of Section 5 of the Securities Act.

Amended Rule 147, as a safe harbor under Section 3(a)(11), will continue to prohibit out-of-state offers to any person not residing in the same state or territory in which the issuer is resident. Accordingly, an issuer conducting a concurrent exempt offering for which general solicitation is permitted across state lines would be unlikely to comply with the in-state offer restriction in Rule 147(b).[183] For example, issuers relying on amended Rule 147 will not be able to conduct a concurrent Regulation Crowdfunding offering, since by its nature a Regulation

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the specific facts and circumstances of the offerings. The Commission identified five factors to consider in making the determination of whether the offerings should be integrated. *See* SEC Rel. No. 33-4552 (Nov. 6, 1962). *See also* Rule 502(a) of Regulation D. More recently, the Commission has provided additional guidance to help issuers evaluate whether two offerings should be integrated. In 2007, the Commission provided a framework for analyzing how an issuer can conduct simultaneous registered and private offerings. *See* SEC Release No. 33-8828 (Aug. 3, 2007) [72 FR 45116 (Aug. 10, 2007)]. In 2015, when implementing provisions of the JOBS Act, the Commission applied this framework to concurrent exempt offerings, including situations where one offering permits general solicitation and the other does not. *See* 2015 Regulation A Release at Section II.B.5 and Regulation Crowdfunding Adopting Release at Section II.A.1.c. In those releases, the Commission noted that an offering made pursuant to Regulation A or Regulation Crowdfunding should not be integrated with another exempt offering made by the issuer, provided that each offering complies with the requirements of the exemption that is being relied upon for the particular offering. *Id*.

182 For a concurrent offering under Rule 506(b), purchasers in the Rule 506(b) offering could not be solicited by means of a general solicitation under Rule 147 or new Rule 147A. The issuer would need an alternative means of establishing how purchasers in the Rule 506(b) offering were solicited. For example, the issuer may have had a preexisting substantive relationship with such purchasers. Otherwise, the solicitation conducted in connection with the Rule 147 or Rule 147A offering would very likely preclude reliance on Rule 506(b). *See also* SEC Rel. No. 33-8828 (Aug. 3, 2007) [72 FR 45116 (Aug. 10, 2007)].

183 *See* Rule 147(b).

Crowdfunding offering would involve a multistate offer due to the offering terms being made publicly available from an intermediary's online platform.[184]

An issuer relying on the new Rule 147A exemption, which permits multi-state offers, may conduct a concurrent exempt offering for which general solicitation is permitted, so long as the issuer complies with the legend and disclosure requirements of Rule 147A(f), as well as any additional restrictions on the general solicitation required by the other exemption concurrently being relied upon by the issuer. For example, the limitations imposed on advertising the terms of the offering pursuant to Rule 204 of Regulation Crowdfunding would limit the issuer's general solicitation in a concurrent offering made pursuant to Rule 147A. Similarly, 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 147A offering, unless that advertisement also included the disclosure required by, and otherwise complied with, paragraph (f) of Rule 147A.[185]

As discussed in the Proposing Release, we are mindful of the risk that offers made pursuant to an exemption shortly before a registration statement is filed could be viewed as conditioning the market for that registered offering. Accordingly, final Rules 147 and 147A will exclude 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.[186] Commission staff expects to review issuer

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[184] For the same reasons, issuers will not be able to rely on amended Rule 147 and conduct concurrent Regulation A offerings or registered public offerings.

[185] *See* Rule 147A(f); *see also* discussion in Section II.A.**1**.

[186] *See* Rules 147(h) and 147A(h). In such circumstances, whether an offer made within the thirty-day period before the filing of a registration statement constitutes an impermissible offer for purpose of Securities Act Section 5(c) will be based on the facts and circumstances of such offer.

compliance with the expanded integration safe harbor as part of the study of amended Rule 147 and new Rule 147A.[187]

6. Disclosures to Investors

a. Proposed Amendments

We proposed to retain the substance of the disclosure requirements of current Rule 147(f)(3), in modified form. 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 to include the legend set forth in proposed Rule 147(f)(1)(i) on the certificate or other document evidencing the offered security. Although the disclosure should be prominently disclosed to each offeree and purchaser at the time any offer or sale is made by the issuer to such person, the proposed amendments would no longer require that such disclosure be made in writing in all instances. Instead, the proposed amendments would require issuers to provide the required disclosure to offerees in the same manner in which an offer is communicated, while continuing to require written disclosure to all purchasers. In addition, the proposed amendments would no longer require issuers to disclose to offerees and purchasers the stop transfer instructions provided by an issuer to its transfer agent[188] or the provisions of Rule 147(f)(2) regarding the issuance of new certificates during the Rule 147(e) resale period.[189]

b. Comments on the Proposed Amendments

Two commenters supported the proposal to include in the text of the amended rule the specific language of the required disclosure.[190] These commenters also stated that all offerees

[187] *See* Section I above.

[188] *See* 17 CFR 230.147(f)(1)(ii).

[189] *See* 17 CFR 230.147(f)(2).

[190] CFA Letter; NASAA Letter.

and purchasers should continue to receive written disclosures, rather than, as proposed, permitting offerees to receive oral disclosures if the offer is communicated orally.[191]

c. Final Rules

After considering the comments, we are adopting amendments to Rule 147 and a provision in new Rule 147A that will require issuers to make specified disclosures to offerees and purchasers about the limitations on resale contained in Rules 147(e) and 147A(e), respectively. Issuers will also be required to meet the legend requirement of Rules 147(f)(1)(i) and 147A(f)(1)(i), respectively. Although the disclosure should be prominently disclosed to each offeree and purchaser at the time any offer or sale is made by the issuer to such person, consistent with the proposal, the amendment and new rule will not require that such disclosure be made in writing in all instances.

While two commenters recommended that we require issuers to provide all offerees written disclosures, rather than permitting offerees to receive oral disclosures if the offer is communicated orally,[192] we are not adopting that requirement in our rules. We believe the approach we are adopting—requiring issuers to provide the disclosure to offerees in the same manner in which an offer is communicated—will provide appropriate flexibility to issuers in the conduct of their offerings and avoid potential confusion as to when, for example, an oral offer must be followed up with a written disclosure.[193] Requiring the disclosure to be made orally if the offer is made orally also will help ensure that the investor receives the required disclosure when most relevant (i.e., immediately upon learning about the offer). Furthermore, we believe

191 *Id.*

192 *Id.*

our amendments to Rule 147(f)(3) and the provision in new Rule 147A(f)(3) will maintain appropriate investor protections, especially in light of the new provision requiring issuers to provide written disclosure to all purchasers within a reasonable period of time before the date of sale. We note that this requirement to provide written disclosure a reasonable period of time before the date of sale is consistent with the disclosure delivery requirements of Regulation D and Rule 701.[194] Finally, while we are not adopting commenters' suggestions to require that written disclosure be provided to all offerees, nothing in our rules prevents state regulators, that deem it necessary and appropriate, from requiring such written disclosures for offers to residents within their states. State regulators are in a position to tailor any such rules to their local capital markets in a manner that addresses capital market practices and investor protection measures they deem appropriate for offers and sales to residents of their state.

Consistent with the proposal, issuers will also be required to satisfy the legend requirement in Rules 147(f)(1)(i) and 147A(f)(1)(i), respectively. However, issuers will not be required to disclose to offerees and purchasers the stop transfer instructions provided by an issuer to its transfer agent[195] or the provisions of Rules 147(f)(2) and 147A(f)(2), respectively, regarding the issuance of new certificates during the resale period.[196] Although issuers will have to comply with these transfer agent instruction requirements,[197] we continue to believe that

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[193] In addition, it may not be possible for an issuer to provide written disclosures to all offerees. For example, an issuer conducting an offer over the radio would not be able to provide the written disclosures to everyone listening to the offer on the radio as it would not know the identity of each of the offerees.

[194] *See e.g.*, Rules 501(i)(4) and 502(b)(1) of Regulation D and Rule 701(e).

[195] *See* 17 CFR 230.147(f)(1)(ii).

[196] *See* 17 CFR 230.147(f)(2). Additionally, as discussed in Section II.B.1 above, we are requiring issuers in offerings conducted pursuant to Rule 147 or Rule 147A 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* Rules 147(f)(3) and 147A(f)(3).

[197] *See* Rules 147(f)(1)(ii), 147(f)(2), 147A(f)(1)(ii) and 147A(f)(2).

requiring issuers to disclose information regarding such requirements to offerees and purchasers at the time of the offer and/or sale will not enhance the disclosure requirements under Rules 147(e), 147A(e), 147(f)(1) or 147A(f)(1), and we therefore are eliminating the disclosure requirements related to stop transfer instructions and the issuance of new certificates from Rule 147 and not including them in new Rule 147A.[198]

Finally, in order for the required disclosure to offerees and purchasers under amended Rule 147(f) and new Rule 147A(f) to be as clear as possible, and consistent with our revisions to make the issuer's state of residency the focus of the relevant resale restrictions, we are adding a requirement that the issuer identify in this disclosure the particular state or territory in which the issuer was resident at the time of the original sale of the security. Since a small business may change the location of its residence and principal activities within the six-month resale limitation period provided for in amended Rule 147(e) and new Rule 147A(e), we believe this information, which should be readily available to the issuer, will assist purchasers in understanding the implications of the applicable resale restrictions.

7. State Law Requirements

a. Proposed Amendments

We proposed to limit the availability of Rule 147 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 more than $5 million in a twelve-month period and that limits the amount of securities an investor can purchase in any such

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198 *See* Rules 147(f)(3) and 147A(f)(3).

offering.[199] In the Proposing Release, we expressed our preliminary view that, in light of the other proposed changes to Rule 147, including a maximum offering amount limitation and investment limitations in the rule would provide investors with additional protection and would be consistent with existing state law crowdfunding provisions.[200]

b. Comments on the Proposed Amendments

All commenters that addressed the issue opposed any limits at the federal level on offering size or investment size.[201] In general, these commenters preferred that any limits be imposed through the state legislative and/or rulemaking process, which they stated may be better situated to making a determination about specific limits.[202] Commenters also stated that the requirements are unnecessary at the federal level since these are local offerings where only the individual state's residents are involved.[203] One of these commenters noted the potential disparate impact on larger versus smaller states with different resident populations and gross domestic products.[204] Another of these commenters noted that, in addition to the regulation of these offerings at the state level, to the extent federal regulatory oversight is deemed necessary, these offerings are also subject to the Commission's powers to enforce the antifraud provisions

199 *See* proposed Rule 147(a).

200 *See* Proposing Release.

201 *See* ABA Letter; Letter from Rutheford B. Campbell, Jr., Spears-Gilbert Professor of Law, University of Kentucky College of Law, March 30, 2016 ("Campbell Letter"); CFIRA Letter; Congressional Letter ("the states are better positioned to determine offering and investment caps that best meet their local population and business needs"); CrowdCheck Letter; Guzik Letter; Milken Letter; NASAA Letter; NextSeed Letter; WBA Letter.

202 *See, e.g.*, ABA Letter; Campbell Letter; CFIRA Letter; Congressional Letter; CrowdCheck Letter; Guzik Letter; NASAA Letter; WBA Letter.

203 ABA Letter; Campbell Letter; CFIRA Letter; CrowdCheck Letter; Guzik Letter; Milken Letter; NASAA Letter; NextSeed Letter; WBA Letter.

204 NASAA Letter.

of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.[205] Another of these commenters stated that the baseline cost of the proposed federal requirements may prevent state policy makers from adding investor protection provisions that the states consider to be more effective due to the cumulative compliance burden.[206] In addition, the 2015 Small Business Forum recommended that the Commission remove the $5 million limit in the proposal, permitting the states to set their own limits as appropriate.[207]

A few commenters stated that, if the proposed limits were retained, any limit on the amount a company can raise under Rule 147 should be indexed for inflation,[208] with one of these commenters suggesting an automatic, periodic review of any such limits.[209] One commenter strongly encouraged the Commission to raise the offering limit significantly.[210] Two commenters believed that, if the proposed limits were retained, Rule 147 should be amended to require that the offering, not the state exemption, be limited to no more than $5 million in order to allow issuers to rely upon existing state law exemptions.[211] One of these commenters also suggested that, if the proposed investment limits were retained, the Commission should establish them as direct requirements of amended Rule 147 and should only apply them to non-accredited investors.[212]

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205 Guzik Letter.

206 Milken Letter.

207 *See* 2015 Small Business Forum Recommendations.

208 ABA Letter; NASAA Letter; Milken Letter.

209 NASAA Letter.

210 WBA Letter.

211 Bishop Letter; WBA Letter.

212 WBA Letter.

c. Final Rules

Given the comments received, the recommendations of the 2015 Small Business Forum and the intrastate nature of the offerings, we are not limiting amended Rule 147 and new Rule 147A to offerings that either are registered in the state where all of the purchasers are resident or that are conducted pursuant to an exemption from state law registration in a 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. Consistent with the policy underlying Section 3(a)(11), we believe it appropriate that the resident investor protections in intrastate offerings primarily flow from the requirements of state securities law. 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 noted in the Proposing Release, of the states that have adopted and/or enacted crowdfunding 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 crowdfunding provision with an aggregate offering amount that exceeds $5 million.[213] Additionally, almost all of these states have adopted provisions that impose investment limitations on investors.

In light of these existing limitations in state exemptions and the fact that all commenters opposed our proposed limits at the federal level on offering size and investment size, we are not

[213] *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 $5 million in a twelve-month period. All other states that have adopted some form of a state-based crowdfunding provision limit the aggregate offering

adopting the proposed federal limits on state exemptions. As commenters noted, states can decide whether to adopt requirements not specifically contemplated by the federal requirements that are consistent with their respective interests in facilitating capital formation and protecting their resident investors in intrastate securities offerings within their jurisdiction.[214] If any states determine to amend their statutes and/or rules to require compliance with new Rule 147A, those states can consider whether any additional requirements should be adopted at the state level given their interest in regulating local offerings within their jurisdiction. Moreover, in addition to state securities law requirements, issuers will continue to be subject to the antifraud and civil liability provisions of the federal securities laws.

C. Additional Considerations

In addition to soliciting specific comments on the proposals, we also solicited general comments, including additional or different revisions to the rules and other matters that may impact the proposals.

1. Notice Filings

Commenters were divided on whether to require issuers utilizing the exemption to make a notice filing with the Commission. While one commenter specifically stated that additional federal administrative obligations, such as new minimum disclosure or delivery requirements, registration and/or additional filings with the Commission, should not be imposed on issuers for conducting intrastate crowdfunding,[215] another commenter recommended that the Commission

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*.

214 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).

215 NextSeed Letter.

require issuers utilizing Rule 147 to file a notice with the Commission, but (similar to Regulation D) the exemption should not be conditioned on the filing.[216] Given the local intrastate nature of the exemptions, we continue to believe that the limited benefits of a notice filing with the Commission would not justify the costs and burdens on issuers to add such a requirement. We note, however, that states could make a notice filing (at the state level) a condition to any state law exemption.[217] In this regard, we note that a vast majority of intrastate crowdfunding provisions require a notice filing with a state regulator.[218] Commission staff will seek to collaborate with state regulators to consider filing data in connection with the study of amended Rule 147 and new Rule 147A.[219]

2. Intrastate Broker Dealer Exemption

Exchange Act Section 15(a)(1) exempts from broker-dealer registration requirements under Section 15(b) a broker-dealer whose business is exclusively intrastate and who does not use any facility of a national securities exchange ("intrastate broker-dealer exemption").[220] Several commenters supported interpreting the intrastate broker-dealer exemption under the Exchange Act to include intermediaries whose activities are limited to facilitating intrastate

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216 Campbell Letter.

217 *See* NASAA Letter.

218 *E.g.*, Alabama, Arizona, Colorado, Delaware, Florida, Georgia, Idaho, Illinois, Iowa, Indiana, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Montana, Nebraska, New Mexico, North Carolina, Oregon, South Carolina, Tennessee, Texas, Vermont, Washington, West Virginia, Wisconsin, Wyoming and the District of Columbia. Other states have pending legislation that would require notice filings for intrastate crowdfunded offerings, *e.g.*, California, Hawaii, Missouri, Nevada, and New Hampshire.

219 *See* Section I above.

220 Under Section 15(a)(1) of the Exchange Act, it is generally unlawful for any broker or dealer to use any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempt security) unless the broker or dealer is registered with the Commission. Section 15(a)(1) provides an exemption from registration for "a broker or dealer whose business is exclusively intrastate and who does not make use of any facility of a national securities exchange."

offerings using the Internet.[221] One commenter was concerned that intrastate intermediaries operating exclusively online may not qualify for the intrastate exemption from registration if they post information on the Internet and it is accessed by out-of-state residents.[222] The commenter, therefore, suggested that the Commission clarify that an entity will not relinquish its ability to rely on the intrastate broker-dealer exemption solely because it has a web presence, as long as it continues to operate and conduct sales intrastate.[223] Two commenters similarly suggested that intrastate intermediaries should be able to rely on the intrastate broker-dealer exemption from broker-dealer registration if they use the Internet to facilitate offerings being conducted in reliance on Rule 147.[224]

We agree with the commenters that it would be helpful to provide guidance regarding the use of the Internet by a person that seeks to rely on the intrastate broker-dealer exemption.[225] In providing this guidance, we are seeking to take into account the contemporary business practices

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221 *See* NASAA Letter; NextSeed Letter; WBA Letter. The commenters were focused, in particular, on intermediaries that facilitate intrastate crowdfunding offerings using the Internet.

222 NASAA Letter. This commenter noted that an SEC staff Guide to Broker-Dealer Registration indicates that information posted on the Internet that is accessible by persons in another state would be considered an interstate offer of securities and would require federal broker-dealer registration. *See id. See also* Guide to Broker-Dealer Registration, Division of Trading and Markets, U.S. Securities and Exchange Commission (Apr. 2008), *available at https://www.sec.gov/divisions/marketreg/bdguide.htm*. The Commission has not previously spoken to this issue, and the guidance in this release is intended to take into account modern business practices of broker-dealers and clarify the permissibility of the use of the Internet by broker-dealers relying on the intrastate broker-dealer exemption. To the extent the staff guidance is inconsistent, it is superseded.

223 *See* NASAA Letter. The commenter also suggested that intrastate broker-dealers be permitted to advertise and use the Internet without having to register with the Commission so long as they used certain disclaimers. *Id.*

224 NextSeed Letter ("[S]tate crowdfunding intermediaries should be permitted to use the internet to facilitate intrastate crowdfunding offerings pursuant to Rule 147 and still be able to rely on the intrastate broker-dealer exemption."); WBA Letter ("If crowdfunding offerings conducted in accordance with amended Rule 147 are intrastate in nature, then state crowdfunding portals which exclusively host such offerings should be deemed to conduct 'exclusively intrastate' business under [Section] 15(a)(1).").

225 Although commenters focused on broker-dealers who facilitate intrastate crowdfunding offerings, we are providing more general guidance not limited to offerings relying upon intrastate crowdfunding provisions under state law.

of broker-dealers, which have evolved over the years to include as a routine matter the use of the Internet as an essential tool in conducting business. As noted elsewhere, the actions we are taking today are intended to facilitate capital formation, while maintaining appropriate investor protections. We believe that a broker-dealer whose business otherwise meets the requirements of the intrastate broker-dealer exemption should not cease to qualify for the intrastate broker-dealer exemption solely because it has a website that may be viewed by out-of-state persons, so long as the broker-dealer takes measures reasonably designed to ensure that its business remains exclusively intrastate.[226] The use of disclaimers clearly indicating that the broker-dealer's business is exclusively intrastate and that the broker-dealer can only act for or with, and provide broker-dealer services to, a person in its state could be one means reasonably designed to ensure that the broker-dealer's business remains exclusively intrastate so long as the broker-dealer does not provide brokerage services to a person that indicates that it is, or that the broker-dealer has reason to believe is, not within the broker-dealer's state of residence.[227] These measures are not

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226 As noted, Section 15(a)(1) of the Exchange Act provides an exemption from registration for "a broker or dealer whose business is exclusively intrastate." Our guidance today is intended to provide clarity regarding when a broker-dealer's business will be "exclusively intrastate" in connection with its use of the Internet. As discussed in this section of this release, a broker-dealer with a website that may be viewed by an out-of-state person may still be able to rely on the intrastate exemption if the broker-dealer implements measures reasonably designed to ensure that its business remains exclusively intrastate. This guidance is separate and apart from the question of whether a security may be offered and sold on the broker-dealer's website in reliance on an exemption from registration under Section 5 of the Securities Act. In this regard, we note that an offer in the context of the Securities Act has generally been defined broadly, and the considerations involved in determining whether an offer includes an impermissible general solicitation are necessarily distinct from the considerations as to whether a broker-dealer's activities occur exclusively within a single state. Therefore, a broker-dealer facilitating an offering pursuant to an exemption from registration under the Securities Act should be careful not to engage in activity that would compromise the issuer's ability to rely on the applicable exemption to Securities Act Section 5. *See, e.g.*, Rules 147 and 147A, including paragraphs (d) and (f) and the Instruction to paragraph (d).

227 This guidance is consistent with the concepts articulated in prior Commission guidance for foreign broker-dealers. *See* Interpretation: Re: Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions, or Advertise Investment Services Offshore, SEC Rel. No. 33-7516 (Mar. 23, 1998) ("Offshore Interpretation"). In the Offshore Interpretation, the Commission stated that it would not consider a foreign broker-dealer's advertising on an Internet website to constitute an attempt to induce a securities transaction with U.S. persons if the foreign broker-dealer takes measures reasonably designed to ensure that it does not effect securities transactions with U.S. persons as a result of its Internet activities.

intended to be exclusive. A broker-dealer could adopt other measures reasonably designed to ensure that it does not provide brokerage services to persons that are not within the same state as the broker-dealer. We do not believe, however, that an intermediary's business would be "exclusively intrastate" if it sold securities or provided any other brokerage services to a person that indicates that it is, or that the broker-dealer has reason to believe is, not within the broker-dealer's state of residence.[228] We believe that this guidance will facilitate capital formation by smaller companies while maintaining appropriate protections for investors.[229] This guidance also is consistent with, and will further, the goal of modernizing our rules to comport with contemporary business practices.

3. Section 12(g) Registration

Several commenters recommended exempting securities issued in reliance upon Rule 147 from the reporting requirements of Section 12(g) of the Exchange Act.[230] Most of these commenters asserted that the Rule 147 exemption would be of limited utility if the securities were not exempted from Section 12(g).[231] In addition, the 2015 Small Business Forum

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The Commission further stated that, as applied in the broker-dealer context, a foreign broker-dealer generally would be considered to have taken measures reasonably designed to ensure it does not effect securities transactions with U.S. persons as a result of its Internet activities if it: (i) posts a prominent disclaimer on the website either affirmatively delineating the countries in which the broker-dealer's services are available, or stating that the services are not available to U.S. persons; and (ii) refuses to provide brokerage services to any potential customer that the broker-dealer has reason to believe is, or that indicates that it is, a U.S. person, based on residence, mailing address, payment method, or other grounds.

228 *See, e.g.*, *In the Matter of Professional Investors, Inc.*, 37 S.E.C. 173, 175-176 (1956) (indicating that a broker-dealer that effected transactions on national securities exchanges for its customers and its own account and, as an underwriter, sold stock on behalf of an out-of-state issuer no longer had an exclusively intrastate business and the intrastate exemption from registration as a broker-dealer was therefore not available); *Peoples Securities Company*, 39 S.E.C. 641, 652-653 (1960) (stating that a broker-dealer's business was not exclusively intrastate based on its interstate activities, which included sales of securities to out-of-state residents), aff'd sub nom. *Peoples Securities Co. v. S.E.C.,* 289 F.2d 268 (C.A. 5, 1961).

229 Commission staff expects to consider the role of intrastate broker-dealers and other intermediaries in offerings under amended Rule 147 or new Rule 147A in connection with its study. *See* Section I above.

230 CFIRA Letter; CrowdCheck Letter; Guzik Letter; Milken Letter; City of Adrian Letter.

231 CFIRA Letter; CrowdCheck Letter; Guzik Letter; City of Adrian Letter.

recommended that the Commission provide a permanent exemption from Section 12(g) registration under the Exchange Act for securities sold in a Rule 147 offering.[232] As amended by the JOBS Act, Section 12(g) requires, among other things, that an issuer with total assets exceeding $10,000,000 and a class of securities held of record by either 2,000 persons or 500 persons who are not accredited investors to register such class of securities with the Commission.[233]

Section 12(g) was originally enacted by Congress as a way to ensure that purchasers of over-the-counter securities about which there was little or no information, but which had a significant shareholder base, were provided with ongoing information about their investment.[234] Unlike Tier 2 offerings under Regulation A[235] or Regulation Crowdfunding,[236] where the Commission provided conditional exemptions from registration under Section 12(g), issuers that utilize the exemptions under amended Rule 147 or new Rule 147A will not be required to comply with ongoing reporting requirements. Given the lack of ongoing reporting requirements, we believe that the Section 12(g) record holder and asset thresholds continue to provide an important baseline above which issuers should generally be subject to the disclosure obligations of the Exchange Act. As the shareholder base of these issuers and their total assets grow, we

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232 *See* 2015 Small Business Forum Recommendations.

233 *See* Section 501 of the JOBS Act. *See also* 17 CFR 240.12g-1. In the case of an issuer that is a bank, a savings and loan holding company or a bank holding company, Exchange Act Section 12(g)(1)(B) (15 U.S.C. 78*l*(g)(1)(B)) requires, among other things, that the issuer, if it has total assets exceeding $10,000,000 and a class of securities held of record by 2,000 persons, register such class of securities with the Commission. *See* Section 601 of the JOBS Act and Section 85001 of the FAST Act. *See also* 17 CFR 240.12g-1.

234 *See generally Report of the Special Study of Securities Markets of the Securities and Exchange Commission*, House Document No. 95, House Committee on Interstate and Foreign Commerce, 88th Cong., 1st Sess. (1963), at 60-62.

235 *See* 2015 Regulation A Release at Section II.B.6.

236 *See* Regulation Crowdfunding Adopting Release at Section II.E.4.

believe that the additional protections that will be provided by registration under Section 12(g) are necessary and appropriate.

4. Exclusion of Investment Companies

In the proposing release, we asked whether we should leave existing Rule 147 in place and unchanged as a safe harbor under Section 3(a)(11) while adopting the proposed revisions to Rule 147 as a new rule, and if so, whether we should make any additional changes to the proposed rule. One commenter that recommended retaining the existing Rule 147 safe harbor and adopting a new exemption also recommended that the new exemption exclude investment companies subject to the Investment Company Act of 1940 (the "Investment Company Act"),[237] including private equity funds, from relying upon Rule 147.[238] Under Section 24(d) of the Investment Company Act,[239] the Section 3(a)(11) exemption is not available for an investment company registered or required to be registered under the Investment Company Act.[240] Since we are retaining Rule 147 as a safe harbor under Section 3(a)(11), Rule 147 will continue to be unavailable for an investment company registered or required to be registered under the Investment Company Act. To provide a consistent treatment between Rule 147 and new Rule 147A, we are specifically excluding an issuer that is an investment company registered or required to be registered under the Investment Company Act from relying on Rule 147A.[241] As

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[237] 15 U.S.C. 80a-1 *et seq.*

[238] NASAA Letter.

[239] 15 U.S.C. 80a-24(d).

[240] *See* 1961 Release at note 1.

[241] *See* Rule 147A(a). Investment companies are companies that are registered or required to be registered under the Investment Company Act. 15 U.S.C. 80a-1 *et seq*. Private funds (including private equity funds and other pooled investment vehicles) generally rely on the exclusions from the definition of "investment company" in Sections 3(c)(1) or 3(c)(7) of the Investment Company Act. *See* 15 U.S.C. 80a-3(c). Private funds are precluded from relying on either of these exclusions if they make a public offering of their securities. *Id.* Accordingly, if such a private fund engaged in a public offering of its securities, that private fund would no longer be able to rely on the applicable exclusion under Section 3(c)(1) or (7) and thus

described above, the final rules maintain a consistent approach across the two intrastate offering exemptions, where possible, including with respect to issuer eligibility. In addition, this same commenter also recommended excluding other types of issuers from Rule 147.[242] Since these other types of issuers are not excluded from existing Rule 147 and because we believe that, absent specific Congressional direction or evidence of abuse, the states should have the discretion to determine whether any additional restrictions are appropriate for offerings conducted exclusively within their jurisdiction, we are not amending Rule 147 or including a provision in Rule 147A to exclude other types of issuers from these provisions.

5. Trust Indenture Act

Two commenters supported exempting securities issued in reliance upon Rule 147, as proposed to be amended, from the Trust Indenture Act of 1939.[243] Rule 147 offerings are exempt from the Trust Indenture Act pursuant to Section 304(a)(4) which exempts any security issued in reliance on Section 3(a)(11) of the Securities Act.[244] Since the Trust Indenture Act applies to any debt security sold through the use of the mails or interstate commerce, including debt securities sold in transactions that are exempt from Securities Act registration, the issuance of a debt security under new Rule 147A, as a new exemption not under Section 3(a)(11), raises questions about the applicability of the Trust Indenture Act. We note, however, that Trust

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would be required to be registered under the Investment Company Act, unless another exclusion or exemption is available. As a result, the private fund would be an "investment company" for purposes of Section 24(d) and would be excluded from the Section 3(a)(11) exemption and safe harbor of existing Rule 147.

[242] Specifically, NASAA also recommended excluding the following types of issuers from the exemption: holding companies (i.e., companies whose principal purpose is owning stock in, or supervising the management of, other companies); blind pools; commodity pools; public companies reporting under the Exchange Act; and blank check companies (i.e., 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 or other entity or person).

[243] NextSeed Letter; WBA Letter.

Indenture Act Section 304(a)(8)[245] and Rule 4a-1[246] provide an exemption for the issuance of up to $50 million of debt securities without an indenture in any 12-month period. Given the existing exemption for up to $50 million of debt securities, we do not believe that a specific exemption from the requirements of the Trust Indenture Act for offerings of debt securities under Rule 147A is necessary at this time.

6. Other Requirements

Two commenters recommended that the Commission work with the states to encourage, or amend Rule 147 in a way that encourages, issuers to use any U.S. escrow agent, as opposed to using only escrow agents registered in the state of the offering, which is often a requirement of state law.[247] Another commenter recommended amending Rule 147 to include bad actor disqualification provisions similar to those set forth under Rule 506(d).[248]

As noted elsewhere, the amendments we are adopting today are intended to facilitate capital formation, while maintaining appropriate investor protections and providing state securities regulators with the flexibility to add additional investor protections they deem appropriate for offerings within their state. Moreover, a broad consensus of commenters opposed additional requirements for exempt intrastate offerings beyond those currently contemplated by our rules.[249] State legislatures and/or securities regulators have a significant interest in intrastate offerings made to their residents and therefore may wish to impose, and are uniquely positioned to determine, additional requirements they deem necessary or appropriate for

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244 15 U.S.C. 77ddd(a)(4).

245 15 U.S.C. 77ddd(a)(8).

246 17 CFR 260.4a-1.

247 City of Adrian Letter; Localstake Letter.

248 NASAA Letter.

the protection of their residents. Consistent with our approach to other aspects of the final rules, we believe it is appropriate in these circumstances to defer to the states regarding which, if any, of the additional provisions recommended by commenters should supplement the federal rules. In this regard, we note that bad actor disqualification provisions are a feature of most state crowdfunding exemptions.[250] In addition, a majority of states have adopted the Uniform Limited Offering Exemption ("ULOE"), or a variant of that uniform exemption.[251] The ULOE includes a bad actor disqualification provision.[252] Other state exemptions include bad actor disqualification provisions,[253] and the small corporate offering registration ("SCOR") program[254] also contemplates disqualification of an issuer or any of its officers, directors, principal stockholders or promoters because of prior violations of the securities laws. We believe that state and federal

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249 *See* Section II.B.7 above.

250 *See* NASAA Letter. *See*, *e.g.*, Alabama, Arizona, Colorado, Florida, Georgia, Idaho, Illinois, Iowa, Indiana, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Mississippi, Montana, Nebraska, New Jersey, New Mexico, North Carolina, Oregon, South Carolina, Tennessee, Texas, Vermont, Washington, Wisconsin and the District of Columbia.

251 *See*, *e.g.*, Alabama, Arizona, Colorado, Georgia, Illinois, Iowa, Kansas, Louisiana, Massachusetts, Maryland, Mississippi, Nebraska, New Hampshire, New Mexico, North Carolina, North Dakota, Oklahoma, Pennsylvania, South Carolina, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, Wyoming and the District of Columbia. The Uniform Limited Offering Exemption was adopted by NASAA in 1983 and again in 1989 (available from the NASAA website at http://www.nasaa.org/wp-content/uploads/2011/07/UNIFORM-LIMITED-OFFERING-EXEMPTION.pdf).

252 *See* Section 1.B of the ULOE.

253 *See*, *e.g.*, the Model Accredited Investor Exemption (available from the NASAA website at http://www.nasaa.org/wp-content/uploads/2011/07/24-Model_Accredited_Investor_Exemption.pdf), as well as other state exemptions such as the Small Issuer Exemption in Pennsylvania, 10 Pa. Code § 203.187, and the Small Offering Exemption in Washington, WAC 460-44A-504.

254 Forty-three states, the District of Columbia and the Commonwealth of Puerto Rico have adopted some form of the SCOR program or recognize the filing of Form U-7 (also referred to as uniform limited offering registration ("ULOR")). *See* CCH Blue Sky Law Reporter, Blue Sky Findings Lists, Small Corporate Offering Registration Program and Form U-7, ¶ 6461 (2016). SCOR and Form U-7 were developed by NASAA as a registration format for companies registering securities under state securities laws when relying upon an exemption from Securities Act registration, including Rule 504. A company may not use the SCOR Form to offer and sell its securities if the company or any of its officers, directors, principal stockholders or promoters are disqualified because of prior violations of the securities laws. A company also may not use salespersons who are disqualified because of prior violations of the securities laws. *See* SCOR Overview, available from the NASAA website at http://www.nasaa.org/industry-resources/corporation-finance/scor-overview/.

regulators share an interest in collaborative efforts that facilitate capital formation and investor protection. Accordingly, Commission staff will seek to collaborate with state regulators to review data on the application of state bad actor disqualification provisions in offerings conducted pursuant to amended Rule 147 or new Rule 147A to inform whether the Commission should consider including bad actor disqualification provisions in Rules 147 and 147A.[255]

III. AMENDMENTS TO RULES 504 AND 505 OF REGULATION D

A. Overview of Rules 504 and 505

Rule 504[256] 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:

- subject to reporting pursuant to Section 13 or 15(d) of the Exchange Act;[257]
- an investment company;[258] 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”).[259]

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 for offers and sales made:

[255] *See* Section I above.

[256] 17 CFR 230.504.

[257] 17 CFR 230.504(a)(1).

[258] 17 CFR 230.504(a)(2).

[259] 17 CFR 230.504(a)(3).

- 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, and 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.[260]

Rule 504, together with Rules 505 and 506, comprise the Securities Act exemptions and safe harbor in Regulation D.[261] 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

[260] 17 CFR 230.504(b)(1). State exemptions of this nature include those based upon the "Model Accredited Investor Exemption," which was adopted by NASAA in 1997. CCH NASAA Reporter Para. 361. Generally, the model rule exempts offers and sales of securities from state registration requirements, if among other matters, the securities are sold only to persons who are, or are reasonably believed to be, "accredited investors" as defined in Rule 501(a) of Regulation D, 17 CFR 230.501(a). The model rule restricts transfer of the securities for 12 months after issuance except to other accredited investors or if registered. General solicitations by any means under that provision are generally limited to a type of "tombstone" ad. *See* Model Accredited Investor Exemption, available from the NASAA website at http://www.nasaa.org/wp-content/uploads/2011/07/24-Model_Accredited_Investor_Exemption.pdf.

[261] 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 with the non-public offering exemption in Section 4(a)(2) of the Securities Act. Rule 507 disqualifies issuers from relying on

to state registration is available under state securities laws.[262] The vast majority of states have adopted a uniform registration form for offerings relying upon Rule 504.[263] One state, however, recently adopted a form of state-based crowdfunding that permits the use of general solicitation but has provided for an abbreviated state registration procedure where, in addition to following various state-specific requirements for registration, an issuer also complies with Rule 504 of Regulation D.[264] 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.[265]

B. Amendments to Rule 504

1. Proposed Amendments to Rule 504

In an effort to facilitate capital formation, including facilitating the development of comprehensive regional coordinated review programs at the state level, and enhance investor protection, we proposed 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 further proposed a technical amendment to Rules 504 and 505 to account for the re-designation of Securities Act

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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.

262 Section 18(b)(4)(D) of the Securities Act provides "covered security" status to all securities sold in transactions exempt from registration 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.

263 *See* note 254 above.

264 Of the 34 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 where the issuer is required to file with the Maine securities regulator in an abbreviated registration procedure. *See* ME. REV. STAT. tit. 32, § 16304(6-A)(D) (2013).

Section 3(b) as Section 3(b)(1) that occurred as a result of the enactment of the JOBS Act in 2012.[266] Additionally, to account for the proposed increase in the Rule 504 aggregate offering amount limitation, we proposed 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.[267]

2. Comments on the Proposed Amendments to Rule 504

Many commenters supported, and no commenters opposed, increasing the Rule 504 offering amount limit from $1 million to $5 million.[268] These commenters stated that increasing the offering amount limit will allow more small businesses to use this capital raising tool, better satisfying the needs of these businesses for capital formation and helping to facilitate multi-state offerings.[269] Several commenters stated that Rule 504 is currently being underutilized, in part, due to the low offering amount limit of $1 million and the erosion of the dollar’s value due to inflation since the offering amount limit was last raised in 1988 from $500,000 to $1 million.[270] As Rule 504 allows issuers to conduct an offering in multiple states and provides an opportunity for states to coordinate a regional review of the offering, commenters stated that an increase in the Rule 504 offering amount limit will encourage new interstate, regional approaches to crowdfunding and other small business offerings and will provide greater utility to a regional

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265 *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.

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

267 *See* proposed Notes 1 and 2 to Rule 504(b)(2). *See also* 17 CFR 230.504(b)(2).

268 ABA Letter; CFA Letter; CFIRA Letter; CrowdCheck Letter; Milken Letter; NASAA Letter.

269 *Id.*

270 ABA Letter; Milken Letter; NASAA Letter.

review of those offerings.[271] Two commenters stated that the offering amount limit should be increased to $10 million in order to offset the significant compliance costs involved in state registration and review.[272] In addition, the 2015 Small Business Forum recommended that the Commission increase the proposed limit on Rule 504 to $10 million, permitting the states to set their own limit as appropriate.[273] Another commenter stated that Rule 504 should be automatically indexed for inflation in order to preserve the utility of the rule from the erosion of the dollar's value in real terms.[274] Two commenters stated the Commission should use its general exemptive authority under Section 28 for future increases in the Rule 504 offering limitation.[275] Several commenters also supported, and no commenters opposed, amending Rule 504 to include bad actor disqualification provisions to provide a more uniform set of bad actor triggering events across Regulation D.[276]

In response to our solicitation for comment on whether to repeal Rule 504(b)(1)(iii) or amend the rule to place limitations on resale, one commenter recommended that the Commission not repeal or amend Rule 504(b)(1)(iii), but retain this provision to provide an environment that

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[271] NASAA Letter ("Maine currently permits interstate crowdfunding under the federal exemption in Rule 504 and Mississippi and Vermont dually offer intrastate crowdfunding under Section 3(a)(11) and interstate crowdfunding under Rule 504. Many other states are presently exploring a dual option for crowdfunding, including additional regional review programs under Rule 504."). *See also* CFA Letter.

[272] CrowdCheck Letter ("Having recently gone through the coordinated review process in the context of a Regulation A offering, we believe that the compliance cost involved in state registration and review is significant, and Rule 504 will only be of interest to issuers if they can raise enough capital to offset this burden."); CFIRA Letter.

[273] *See* 2015 Small Business Forum Recommendations.

[274] Milken Letter ("Rule 504's current obsolescence is largely a result of the erosion of the dollar's value in real terms…Indexing would place Rule 504 in a similar position to Regulation Crowdfunding offerings where, under Section 4A(h)(1) of the 1933 Act the annual dollar amount is to be adjusted for inflation at least every five years.").

[275] ABA Letter; Milken Letter.

[276] ABA Letter; CFA Letter ("It not only clarifies the applicability to new Rule 504 offering limits, but also provides consistency across Regulation D."); CFIRA Letter; CrowdCheck Letter; NASAA Letter ("We also

"allow[s] the states to experiment" and innovate in a manner that may prove useful for state and federal policy makers.[277] Rule 504(b)(1)(iii) provides an exemption from registration for offers and sales of securities that are conducted "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)." Securities sold without registration in reliance on this provision are not subject to the limitations on resale established in Rule 502(d) and, as such, are not "restricted securities" for purposes of Rule 144(a)(3)(ii). Another commenter indicated that "the Commission should consider amending Rule 504 to permit resales of securities issued in Rule 504 'public offerings' in states where the offering complies with exemptions that permit general solicitation or advertising and that require dissemination of a state law compliant disclosure document."[278]

One commenter recommended that the Commission exempt securities sold under Rule 147 and 504 from the requirements of Section 12(g) of the Securities Exchange Act of 1934.[279] In addition, the 2015 Small Business Forum recommended that the Commission provide a permanent exemption from Section 12(g) registration under the Exchange Act for securities sold in a Rule 504 offering.[280]

3. Final Amendments to Rule 504

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strongly support a more uniform set of bad actor triggering events across Regulation D…as this would align with bad actor disqualification provisions already included in state crowdfunding exemptions.").

277 Milken Letter (noting that this approach "will allow for innovation in a tightly controlled environment that may prove useful for other state and federal policy makers.").

278 ABA Letter.

279 Milken Letter ("Given the expected local nature of Rule 147 offerings and the likelihood that they will be made to the general public for relatively small amounts, it is very possible that small companies making even modest offerings would accrue sufficient numbers of non-accredited investors to be forced to register with the Commission.").

280 *See* 2015 Small Business Forum Recommendations.

The amendments that we are adopting to Rule 504 will 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).[281] The Commission has not raised the 12-month aggregate offering amount limit in Rule 504 since 1988, when the Commission increased the original Rule 504 offering amount limit of $500,000 to $1 million.[282] Adjusted for inflation, the $1 million limit in 1988 would equate to approximately $2 million today.[283] We believe the $5 million limit will facilitate issuers' ability to raise capital. We also believe that our amendments to increase the aggregate offering amount limit in Rule 504 to $5 million 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. Increasing the aggregate offering amount limit from $1 million to $5 million will also increase the flexibility of state securities regulators to set their own limits and to consider whether any additional requirements should be implemented at the state level.

Although two commenters and the 2015 Small Business Forum recommended that the Commission increase the Rule 504 offering amount limit to $10 million, we are not exceeding the maximum offering amount permitted under Section 3(b)(1). Although, as several commenters noted, we could use our exemptive authority under Section 28 of the Securities Act

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281 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.

282 *See* SEC Rel. No. 33-6758 (Mar. 3, 1988) [53 FR 7870 (Mar. 10, 1988)].

283 Annual inflation rates (1988-2015) based on consumer price index data, for all urban consumers, obtained from the Bureau of Labor Statistics.

to raise the maximum offering amount above $5 million,[284] in accord with the suggestion of one of those commenters,[285] we believe it appropriate to first observe market activity under a new maximum offering amount of $5 million before raising the Rule 504 offering limit higher.

In conjunction with our increase to the Rule 504 aggregate offering amount limit, we are also adopting provisions that will disqualify certain bad actors from participation in offerings conducted pursuant to the exemption.[286] We believe that the disqualification provisions that we are adopting, which are substantially similar to related provisions in Rule 506 of Regulation D,[287] will create a more consistent regulatory regime across Regulation D and provide additional protections to investors in Rule 504 offerings.

The Rule 504 disqualification provisions will be implemented by reference to the disqualification provisions of Rule 506 of Regulation D.[288] 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. In accordance with the views of several commenters,[289] the bad actor triggering events for Rule 504 will be substantially similar to existing provisions in Regulation D,[290] Regulation A,[291] and Regulation Crowdfunding[292] and will apply to the issuer

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[284] ABA Letter; Milken Letter.

[285] ABA Letter ("If the increase to $5 million is adopted, after there is experience with the use and operation of new Rule 504, the Commission may wish to consider using its exemption authority under Section 28 to increase the dollar limitation amount that may be offered under Rule 504.").

[286] *See* Rule 504(b)(3).

[287] *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).

[288] *See* Rule 504(b)(3), referencing the disqualification provisions of Rule 506(d), 17 CFR 230.506(d), and Instruction to Paragraph (b)(3) of Rule 504, referencing the disclosure provisions of Rule 506(e), 17 CFR 230.506(e).

[289] CFA Letter; NASAA Letter.

[290] *See* Rules 505(b)(2)(iii) and 506(d) of Regulation D, 17 CFR 230.505(b)(2)(iii), 230.506(d).

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),[293] disqualification will only occur for triggering events that occur after effectiveness of any amendments, but disclosure will be required for triggering events that pre-date effectiveness of any amendments.[294]

We also sought public comment on whether additional changes to Rule 504 should be adopted in the final amendments. In particular, in conjunction with the increase in the Rule 504 offering amount limit, we contemplated amending the calculation of the aggregate offering limit in Rule 504(b)(2). 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 amount under Rule 504.[295] This rule also includes illustrations of how the aggregate offering limit is calculated in the event that an issuer sells securities pursuant to Rule 504 and Rule 505 within the same twelve-month period.[296]

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

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

292 *See* Rule 503 of Regulation Crowdfunding, 17 CFR 227.503.

293 *See* 17 CFR 230.506(e).

294 *See* Rule 504(b)(3).

295 17 CFR 230.504(b)(2); *see also* 17 CFR 230.505(b)(2).

296 *See* 17 CFR 230.504(b)(2).

through multiple offerings pursuant to Section 3(b)."[297] In the intervening years, however, in implementing Congressional mandates,[298] the Commission has increased the number of exemptive provisions available to issuers, particularly smaller issuers, to raise large sums of capital in a more cost-effective manner in offerings that are exempt from registration, while continuing to provide appropriate safeguards for investors.[299] Therefore, we sought 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)(1), should be retained in the amendments.[300]

Although no commenters responded to our request for comment on this issue, in light of our repeal today of Rule 505, which is the only other existing exemption in Regulation D promulgated under Section 3(b)(1), we are amending Rule 504(b)(2) to omit any reference to the aggregation of offering proceeds across all offerings that are conducted pursuant to Section 3(b) of the Securities Act. Correspondingly, we are also deleting the related note under Rule 504(b)(2) illustrating 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.

We are also adopting a further technical amendment to the second note to Rule 504(b)(2), as proposed. Specifically, we are updating the illustration of how the aggregate offering amount

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

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

299 *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.

300 We are referring to Section 3(b)(1) instead of Section 3(b), due to the changes that occurred as a result of the Securities Act amendments in Title IV of the JOBS Act.

limitation is calculated to account for the increase to the Rule 504 aggregate offering amount limitation from $1 million to $5 million.[301]

One commenter[302] and the 2015 Small Business Forum recommended that the Commission provide an exemption from Section 12(g) registration under the Exchange Act for securities sold in a Rule 504 offering.[303] As discussed above, Section 12(g) requires, among other things, that an issuer with total assets exceeding $10,000,000 and a class of securities held of record by either 2,000 persons, or 500 persons who are not accredited investors, register such class of securities with the Commission.[304] Unlike Tier 2 offerings under Regulation A[305] or Regulation Crowdfunding,[306] where the Commission provided conditional exemptions from registration under Section 12(g), issuers that utilize the exemptions under amended Rule 504 will not be required to comply with ongoing reporting requirements. Given the lack of ongoing reporting requirements under Rule 504, we believe that the Section 12(g) record holder and asset thresholds continue to provide an important baseline above which issuers should generally be subject to the disclosure obligations of the Exchange Act. As the shareholder base of these companies and their total assets grow, we believe that the additional protections that will be provided by registration under Section 12(g) are necessary and appropriate.

Another commenter recommended that the Commission amend Rule 504 to permit the resale of securities issued in Rule 504 "public offerings" in states where the offering complies with exemptions that permit general solicitation or advertising and that require a public filing and

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301 *See* Instruction to Paragraph (b)(2) to Rule 504.

302 Milken Letter.

303 *See* 2015 Small Business Forum Recommendations.

304 *See* note 233 above.

305 *See* 17 CFR 251. *See also* 2015 Regulation A Release at Section II.B.6.

delivery of a state law compliant disclosure document before any sales to purchasers.[307] As discussed above, Rule 504 currently permits the resale of securities issued in Rule 504 offerings that involve general solicitation or advertising where either the offering is registered in one or more states and one or more states require the dissemination of a state-approved disclosure document or the offering is exempt but sales are only made to accredited investors.[308] Consistent with the limitations on resales in other Securities Act exemptions that permit general solicitation or advertising, such as Rule 506(c) and Regulation Crowdfunding, we have concerns with expanding the ability to issue freely tradable securities under Rule 504 to offerings that permit general solicitation or advertising to non-accredited investors without state registration. Further, we believe that the additional protections that will be provided by the limitations on resale for securities offered and sold in these transactions, which are directed primarily to non-accredited investors,[309] are necessary and appropriate given that these offerings are not registered at either the state or federal level.

C. Repeal of Rule 505

In light of the proposed amendments to Rule 504, we solicited comments on whether we should repeal Rule 505 as an exemption from registration. Rule 505 is used far less frequently than Rule 506,[310] and in the Proposing Release, we noted that an increase in the Rule 504 offering amount limit from \$1 million to \$5 million could further diminish its utility.[311]

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306 *See* 17 CFR 17 CFR 227.100. *See also* Regulation Crowdfunding Adopting Release at Section II.E.4.

307 ABA Letter.

308 *See* 17 CFR 230.504(b).

309 In contrast, general solicitation or advertising is permitted under Rule 506(c), so long as the issuer limits all sales exclusively to accredited investors and the issuer takes reasonable steps to verify that the investor is an accredited investor.

310 *See* note 22 above. *See also* Table 5 in Section V.A.2.a below.

311 *See* Proposing Release at Section III.C.

1. Comments on Repealing Rule 505

Three commenters responded to our request for comment on Rule 505. One commenter recommended that the Commission review the Rule 505 exemption "to consider whether modifications may and/or should be made to modernize the exemption; for example, reviewing the aggregate offering amount or information requirements."[312] This commenter strongly opposed, however, replacing Rule 505 with a new Securities Act exemption providing "covered security status" under Section 18 of the Securities Act to securities issued in reliance on the new exemption.[313] This commenter cautioned "against considering a new framework for Rule 505 that is contrary to the rule's original intent and purpose—to be a coordinated federal-state exemption and 'to achieve a uniform system of federal-state limited offering exemptions that facilitates capital formation consistent with the protection of investors.'"[314]

Another commenter stated that changes to Rule 505 aimed at facilitating very small offerings by early stage companies merit further consideration.[315] This commenter also recommended that the Commission consider "whether an exempt, simple debt-only offering is feasible and could be made cost-efficient for smaller issuers."[316] According to this commenter, the Commission should explore whether an exemption focused on simple debt securities could serve the needs of small businesses and investors, especially since the unique nature of simple debt securities may warrant more modest and easier compliance requirements, while not

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[312] NASAA Letter.

[313] *Id.* (opposing extension of covered security status "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 purchaser,' pursuant to Securities Act Section 18(b)(3).")

[314] *Id.* ("In 1983, NASAA adopted a model exemption, the Uniform Limited Offering Exemption ("ULOE"), designed to provide an exemption at the state level for offerings that are exempt at the federal level under Rules 505 and 506 of Regulation D.").

[315] Milken Letter.

sacrificing investor protections, as compared to an exemption that permits both debt and equity offerings.[317]

Finally, another commenter stated that, if the proposed changes to Rule 504 are adopted, Rule 505 would be substantially similar to Rule 504, making Rule 505 unnecessary, unless the Commission increases the aggregate offering amount that may be raised under Rule 505 in any twelve-month period.[318] This commenter recommended, for example, that the ceiling could be raised from $5 million to $10 million or some larger amount, thereby preserving Rule 505 as a viable alternative exemption. Despite its infrequent use, the commenter noted that Rule 505 serves the purpose of permitting issuers to sell to up to 35 non-accredited investors without having to be satisfied that these investors meet a financial sophistication test.[319]

2. Repeal of Rule 505

After considering these comments, we are repealing Rule 505. After the effective date of the repeal of Rule 505, issuers will no longer be able to make offers and sales of securities in reliance on Rule 505. We believe that amending Rule 504 to increase the aggregate offering amount from $1 million to $5 million will further reduce the incentives to use Rule 505 by issuers contemplating an exempt offering. We also believe that, even if we were to raise the Rule 505 aggregate offering amount limit from $5 million to $10 million, or some higher

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316 *Id.*

317 *Id.* In commenting on the proposed amendments to Rule 147, one commenter noted that small businesses are likely to seek debt financing more frequently than equity offerings. *See* Nextseed Letter (“equity offerings are more likely to be attractive to technology-based, high growth companies that cannot financially support debt obligations,” as compared to “Main Street” businesses (e.g., local restaurants operated by friends and families) that are inherently local in nature seeking to raise not millions of dollars, but much smaller amounts of capital that traditional lenders are increasingly reluctant to fund).

318 ABA Letter.

319 *Id.* In contrast, issuers relying upon Rule 506(b) may sell to up to 35 non-accredited investors, but each non-accredited investor must satisfy a financial sophistication test set forth in Rule 506(b)(2)(ii).

amount, such a higher limit would not increase the utility of the Rule 505 exemption as compared to Rule 506, which has no limit, given the historical use of Rule 505 as compared to Rule 506. Further, although Rule 505 provides issuers the ability to sell securities to up to 35 non-accredited investors without having to make a finding, as in Rule 506(b)(2)(ii), that such persons have the knowledge and experience in financial matters that they are capable of evaluating the merits and risks of the prospective investment,[320] this provision does not appear to have historically resulted in the Rule 505 exemption being widely utilized.[321]

We believe the flexibility of the requirements of Rule 504, as amended today, as well as the availability of Rule 506(b) and Rule 506(c) will continue to fulfill the original objectives of Regulation D to achieve uniformity between state and federal exemptions in order to facilitate capital formation consistent with the protection of investors.[322] Amended Rule 504 will be available only to non-reporting issuers[323] that are not investment companies[324] or development stage companies[325] for offerings of up to $5 million in a twelve-month period and will permit general solicitation and the issuance of unrestricted securities in certain limited situations.[326] Rule 506(b) and 506(c) are available to all issuers without any aggregate offering amount

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320 *Cf.*, 17 CFR 506(b)(2)(ii).

321 For the period 2009-2015, there were a total of 1,542 Rule 505 offerings. During this same time period, there were a total of 70,793 Rule 506(b) offerings of $5 million or less. *See* Table 5 in Section V.A.2.b below. *See also* 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*.

322 *See* SEC Rel. No. 33-7644 (Feb. 25, 1999) [64 FR 11090 (Mar. 8, 1999)] ("Seed Capital Release") at text accompanying note 4. *See also* Release No. 33-6389 (Mar. 8, 1982) [47 FR 11251] (Regulation D adopting release).

323 *See* Rule 504(a)(1).

324 *See* Rule 504(a)(2).

325 *See* Rule 504(a)(3).

326 *See* Rule 504(b)(1).

limitations. Rule 506(b) prohibits general solicitation and limits sales to no more than 35 non-accredited investors.[327] Rule 506(c) permits general solicitation where all purchasers of the securities are accredited investors and the issuer takes reasonable steps to verify that the purchasers are accredited investors.[328] Securities issued pursuant to Rules 506(b) and 506(c) are deemed restricted securities.[329] Reporting issuers also can register the offer and sale of securities on Form S-1, for which the Commission recently promulgated rules permitting forward incorporation by reference.[330]

IV. OTHER MATTERS

If any of the provisions of these rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

V. ECONOMIC ANALYSIS

This section analyzes the expected economic effects of the final rules relative to the current baseline, which is the regulatory framework and state of the market[331] in existence today,

[327] *See* 17 CFR 230.506(b)(2).

[328] *See* 17 CFR 230.506(c).

[329] *See* 17 CFR 230.506(b)(2) and 17 CFR 230.502(d).

[330] *See* SEC Release No. 33-10003 [81 FR 2743] (Jan. 19, 2016) (revising Form S-1 to permit a smaller reporting company to incorporate by reference into its registration statement any documents filed by the issuer subsequent to the effective date of the registration statement). The information delivery requirements under Rule 505 for an Exchange Act reporting issuer that sells securities to a non-accredited investor are similar to the disclosure requirements for a registered offering under the Securities Act. *See* Rule 502(b)(2)(ii).

[331] 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 safe harbor and Rule 504 exemption 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

including current provisions available to potential issuers to raise capital up to $5 million. We are mindful of the costs imposed by, and the benefits obtained from, the final rules. Relative to this baseline, our analysis considers the anticipated benefits and costs for market participants affected by the final rules as well as the impact of the final rules on efficiency, competition and capital formation.[332] We also analyze the potential benefits and costs stemming from alternatives to the final rules that we considered. Many of the benefits and costs discussed below are difficult to quantify, especially when analyzing the likely effects of the final rules on efficiency, competition and capital formation. For example, it is difficult to precisely estimate the extent to which amended Rule 147 and new Rule 147A will promote future reliance by issuers on these provisions, or the extent to which future use of amended Rule 147 and new Rule 147A will affect the use of other offering methods. Similarly, it is difficult to quantify the effect of the final rules 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 final rules.

A. Baseline

The final rules will modernize Rule 147, a safe harbor under Section 3(a)(11), and establish new Rule 147A in order to facilitate intrastate offerings, including intrastate crowdfunded offerings under state securities laws. We also are amending Rule 504 of Regulation D to raise the aggregate amount that can be raised during a twelve-month period from $1 million

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exemption. Participants face different trade-offs when choosing between the markets created by each of the exemptions and safe harbors.

332 Securities Act Section 2(b) and Exchange Act Section 3(f) direct 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) and 15 U.S.C. 78c(f). In addition, Exchange Act Section 23(a)(2) requires us, when adopting rules, to consider the impact that any new rule would have on

as established in 1988, to $5 million and to disqualify certain bad actors from participating in Rule 504 offerings. In light of the amendments to Rule 504, we are also repealing Rule 505, an alternate exemption available under Regulation D for offerings of up to $5 million during a twelve-month period.

The final rules will primarily impact the financing market for startups and small businesses.[333] The baseline for our economic analysis—including the baseline for our consideration of the effects of the final rules on efficiency, competition and capital formation—is the regulatory framework and market structure in existence today in which startups and small businesses 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 Rules 147, 504 and 505, our analysis includes a description of the types of investors who purchase or may consider purchasing such securities and a discussion of the role of intermediaries in such offerings. Table 1 summarizes the main characteristics of Rules 147, 504 and 505.

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competition. *See* 15 U.S.C. 78w(a)(2)

333 According to the Longitudinal Business Database of the U.S. Census Bureau, there were more than 6.7 million active establishments in the U.S., of which approximately 5.5 million had fewer than 500 paid employees and approximately 5.2 million had less than 100 paid employees. *See* U.S. Department of Commerce, United States Census Bureau, *Business Dynamics Statistics, Data: Firm Characteristics* (2013), *available at* http://www.census.gov/ces/dataproducts/bds/data_firm.html.

Table 1: Main Characteristics of Existing Rules 147, 504 and 505

Type of Offering	Offering Limit[334]	Solicitation	Issuer and Investor Requirements	Filing Requirement	Restriction on Resale	Blue Sky Law Preemption and Bad Actor Disqualification Provisions
Rule 147	None	Only intrastate solicitation	All issuers must be incorporated and "doing business" in state. Statutory exemption excludes investment companies. 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[335]	State Law Preemption: No Bad Actor Provisions: Required by the majority of states at the state level[336]
Rule 504 Regulation D	$1 million	General solicitation permitted in specified circumstances[337]	Excludes investment companies, blank-check companies, and Exchange Act reporting companies.	File Form D	Restricted, unless offering is within specified circumstances[338]	State Law Preemption: No Bad Actor Provisions: Required by the majority of states at the state level[339]
Rule 505 Regulation D	$5 million	No general solicitation	Excludes investment companies. Unlimited accredited investors and up to 35 non-accredited investors.	File Form D	Restricted securities	State Law Preemption: No Bad Actor Provisions: Yes

1. Current Market Participants

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

335 *See* 17 CFR 230.147(e). Additional resale restrictions may apply under state securities laws.

336 *See* text accompanying notes 250, 251, 252, 253 and 254 above.

337 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 that permits general solicitation or advertising so long as sales are made only to accredited investors. *See* Rule 504(b).

338 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. *See* Rule 504(b).

The final rules that amend existing Rules 147 and 504, establish new Rule 147A, and repeal Rule 505 will primarily affect securities issuers, particularly startups and small businesses, that rely on unregistered offerings under these and other provisions or safe harbors to raise capital, as well as accredited and non-accredited investors who participate in unregistered offerings.

a. Issuers

i. Rule 147 Issuers

Under current Rule 147, there is no limit on the amount of capital that can be raised. Since the Section 3(a)(11) exemption is not available for an investment company registered or required to be registered under the Investment Company Act,[340] the existing Rule 147 safe harbor is also not available to these issuers. Current Rule 147 has no other restrictions on the type of issuers that may rely on the safe harbor. 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% threshold requirements concerning their revenues, assets and use of net proceeds.

While we lack data on the number and size of Rule 147 offerings[341] 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 used by U.S. incorporated entities that are

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339 *See* text accompanying notes 250, 251, 252, 253 and 254 above.

340 *See* 15 U.S.C. 80a-24(d) and 1961 Release at note 1.

341 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. Commission staff will seek to collaborate with state regulators in gathering information for the study of amended Rule 147 and new Rule 147A. *See* Section I above.

likely small businesses seeking to raise small amounts of capital locally without incurring the costs of registering with the Commission.

Currently, most of the states that have enacted crowdfunding provisions require issuers that intend to conduct intrastate crowdfunding offerings to use Rule 147.[342] Based on information from NASAA,[343] as of May 20, 2016, 34 states and the District of Columbia have enacted 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, 179 state crowdfunding offerings have been reported to be filed with the respective state regulator.[344] Of these offerings, 166 were reported to be approved or cleared, as of July 2016.[345]

Given that investment companies are statutorily restricted from relying on Section 3(a)(11)[346] and that almost all the enacted state crowdfunding provisions currently exclude reporting companies, we expect that issuers that rely on Rule 147 are likely operating companies ("non-fund issuers") that are not reporting under the Exchange Act. As stated above, information on the size of these issuers is not available. Data from NASAA shows that most

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

343 *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/.

344 *See* Slide Presentation on "NASAA Intrastate Crowdfunding Update," NASAA July 18, 2016 *available at* http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2014/12/Intrastate-Crowdfunding-Slides-7-18-16.pdf.

345 *Id.* Most of the early approved or cleared offerings were in Georgia, Michigan, Oregon, Kansas and Indiana. *See* Slide Presentation on "Intrastate Equity Crowdfunding" by Anya Coverman, Deputy Director of Policy, NASAA at the SEC Government Business Forum on Small Business Capital Formation, November 19, 2015 available at http://www.sec.gov/info/smallbus/sbforum119015-coverman-presentation.pdf.

346 *See also* note 241 above.

issuers are from various industries including agriculture, manufacturing, business services, retail, entertainment, and technology.

We anticipate that many potential issuers of securities under amended Rule 147 and new Rule 147A, particularly those utilizing the exemptions for intrastate crowdfunding, will continue to be small businesses, early stage firms and "idea" stage business ventures that have not yet commenced operations. 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.[347]

ii. Rule 504 and Rule 505 Issuers

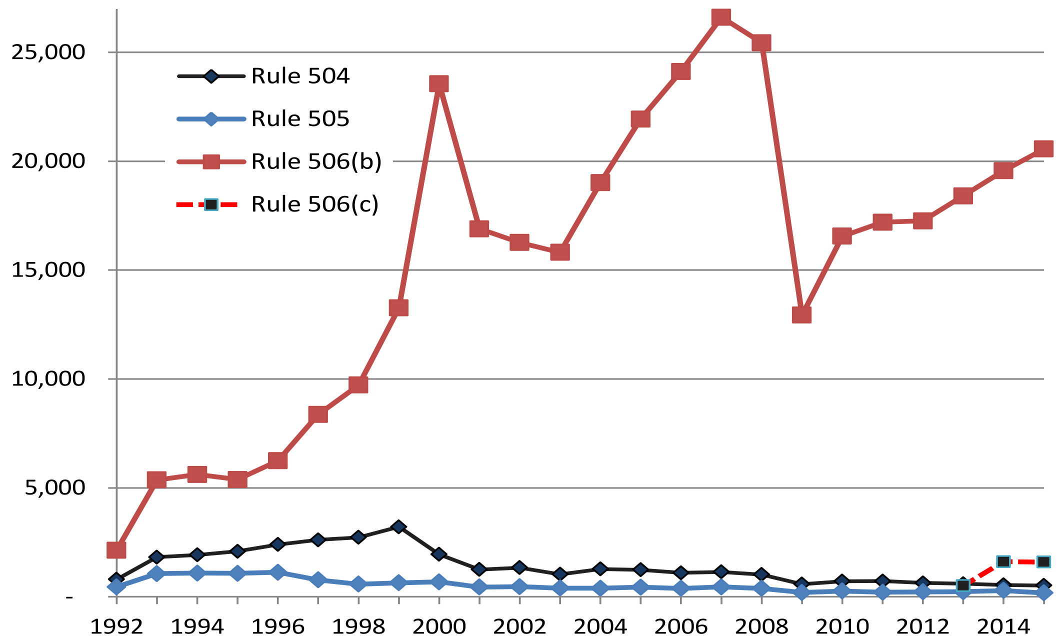
Rules 504 and 505 of Regulation D provide exemptions from registration under Section 3(b)(1) of the Securities Act for small offerings where the Commission believes registration under the Securities Act is not necessary by reason of the small amount involved or the limited character of the public offering. An analysis of Form D filings indicates that reliance on these two exemptions has been declining over time. As shown in Figure 1, while offerings under Rule 506(b) of Regulation D grew significantly from 1993 to 2015, offerings under Rule 504 and Rule 505 in 2015 were approximately a 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.[348] Compared to the early 1990s when Rule 504 offerings constituted

[347] 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*, J. BUS. VENT., January 2014 (1-16).

[348] While there is a strong, positive correlation of the incidence of new Regulation D offerings with the economic conditions of the public market (*see* Section 4.2 of Unregistered Offerings White Paper), some of the decline in Rule 504 offerings during the early 2000s could also be attributed to the 1999 Commission decision to reinstate the ban on general solicitation in Rule 504 offerings. *See* Seed Capital Release and

approximately 28% of all new Regulation D offerings, the proportion of Rule 504 offerings between 2009 and 2015 ranged between 3% and 4% of all new Regulation D offerings. The number of new Rule 505 offerings peaked in 1996 at 1,124 (12% of all new Regulation D offerings), and during 2015, less than 1% of all new Regulation D offerings claimed the Rule 505 exemption.

Figure 1: Number of New Offerings under Regulation D Exemptions[349]



The current limited use of the Rule 504 and Rule 505 exemptions and the predominance of Rule 506, especially Rule 506(b), are also evident when we consider the total amount raised in offerings under each of these exemptions. Overall, capital formation in the Rule 504 and Rule

Release No. 34-69959 (July 10, 2013). Though the incidence of new Rule 506 offerings recovered in 2003 with improved conditions in the public markets, the number of new Rule 504 offerings remained well below the pre-2000 levels.

349 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.

505 markets individually constituted approximately 0.1% of the capital raised in all Regulation D offerings initiated during 2009-2015.[350] 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 approximately 7%. Similarly, considering only Regulation D offerings by non-fund issuers of up to $5 million (the maximum amount that an existing Rule 505 offering or amended Rule 504 offering can raise in a year), the share of the total amount raised for Rule 505 offerings was less than 2%.

Table 2 presents data on the number of new Rule 504 and 505 offerings and amounts reported to be raised in these offerings during the period 2009-2015.[351] Since investment companies are excluded from using the two exemptions, issuers relying on Rules 504 and 505 are predominantly non-fund issuers.[352] Form D data also indicates that the mean and median Rule 504 offering sizes during 2009-2015 were approximately $0.5 million and $0.36 million, respectively, while the average and median Rule 505 offering sizes were approximately $1.90 million and $1.54 million, respectively.

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[350] Based on staff analysis of Form D filings. *See also* Unregistered Offerings White Paper.

[351] *Id*. This analysis uses the same assumptions and methodologies described in the Unregistered Offerings White Paper.

[352] Non-fund issuers constituted 98% and 93% of all Rule 504 and Rule 505 offerings, respectively. In terms of amounts reported to be raised, non-fund issuers raised 96% and 76% of all amounts reported to be raised in Rule 504 offerings and Rule 505 offerings, respectively. Based on information in Form D filings, funds using the Rule 504 or Rule 505 exemption were not registered under the Investment Company Act.

Table 2: Rule 504 and Rule 505 Capital Raising Activity, 2009-2015

	Number of Offerings[353]		**Total Amount Raised ($ million)**	
	Rule 504	**Rule 505**	**Rule 504**	**Rule 505**
2009	579	195	$91	$185
2010	714	262	$131	$257
2011	721	207	$113	$205
2012	632	227	$109	$193
2013	599	229	$97	$203
2014	544	289	$94	$238
2015	519	179	$84	$134
2009-2015	**4,308**	**1,588**	**$719**	**$1,415**

Companies that file reports with the Commission under Section 12(b), Section 12(g) or Section 15(d) of the Exchange Act can use the Rule 505 exemption but not the Rule 504 exemption. Data from Form D filings indicates that approximately 10 of 278 unique Rule 505 issuers during 2014 and 8 of 163 unique Rule 505 issuers during 2015 were reporting companies.[354] These reporting companies initiated 12 Rule 505 offerings during 2014 and 11 such offerings during 2015. The mean size of Rule 505 offerings by reporting companies was approximately $824,000 and the median size was approximately $200,000.

Figure 2 shows the financial size of Rule 504 and Rule 505 issuers based on revenues or net asset value during the period 2009-2015.[355] Of all the issuers that disclosed these metrics in

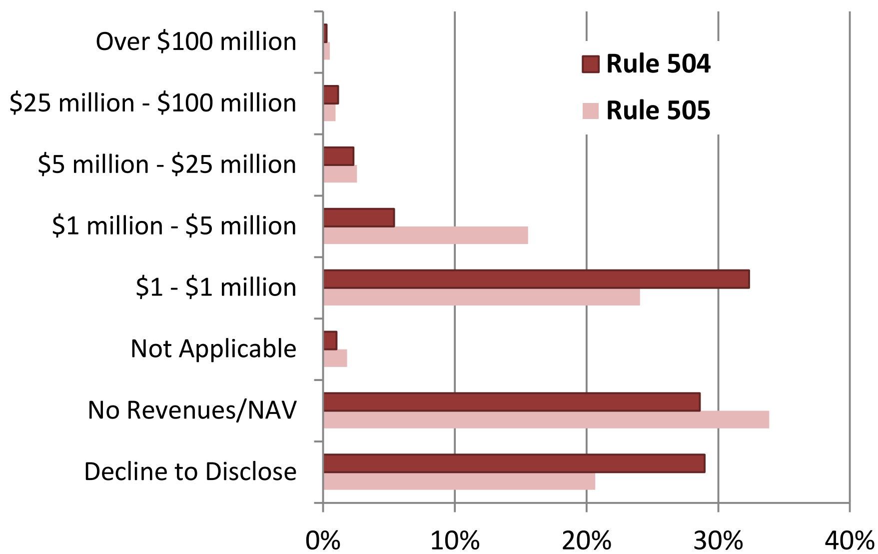
353 Based on staff analysis of Form D filings. This analysis uses the same assumptions and methodologies described in the Unregistered Offerings White Paper. As noted in the Unregistered Offerings White Paper, some issuers in Regulation D offerings check multiple exemptions in their Form D filing. Under those circumstances, staff assigns the highest checked numerical exemption to the offering. While issuers in 4,308 offerings checked only the Rule 504 exemption and reported to raise $719 million during the period 2009-2015, issuers in an additional 1,224 offerings checked the Rule 504 exemption along with the Rule 505 and/or the Rule 506 exemption and safe harbor. Similarly, issuers in 1,520 offerings checked only the Rule 505 exemption and reported to raise $1,399 million during 2009-2015; issuers in an additional 68 new offerings checked the Rule 504 and 505 exemptions; and issuers in 2,170 new offerings checked the Rule 505 exemption along with the Rule 506 exemption.

354 Based on staff analysis of Form D filings and Form 10-K filings made during 2014 and 2015.

355 Based on staff analysis of Form D filings.

their Form D filings (approximately 70% of all Rule 504 issuers and 80% of all Rule 505 issuers), more than three quarters of those 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 and Rule 505 issuers likely consist of startups and small businesses. These issuers' small size is also consistent with their younger age, as measured by years since incorporation. Based on Form D filings, 51% of Rule 504 issuers and 62% of Rule 505 issuers initiated their offerings during the year of their incorporation or in the subsequent year. Another 14% of Rule 504 and Rule 505 issuers initiated their offerings between two and three years since incorporation.[356]

Figure 2: Financial Size (Revenues/Net Asset Value) of Rule 504 and Rule 505 Issuers, 2009-2015



Most Rule 504 and Rule 505 issuers that initiated offerings in the past seven years operate in the technology, real estate or other industry (Figure 3).[357]

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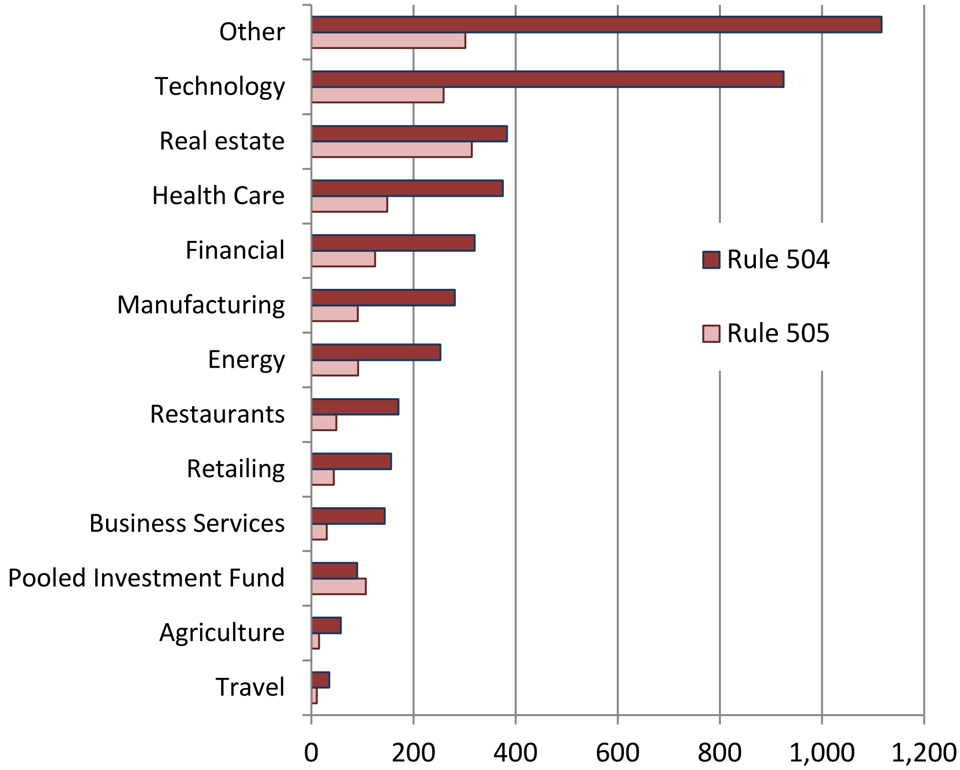
[356] *Id.*

Figure 3: Number of Rule 504 and Rule 505 Offerings by Industry, 2009-2015



With regard to the geographical location of issuers, Form D filings indicate that during the period 2009-2015, most Rule 504 and Rule 505 issuers had their principal place of business in California (22% and 21%), followed by Texas, New York, Florida, Colorado and Illinois; most were incorporated in Delaware (19%, 23%), California (13%, 12%), Nevada and Texas. In addition, approximately 37% of Rule 504 offerings and 39% of Rule 505 offerings reported having different states of incorporation and principal places of business. While only approximately 2% of Rule 504 and Rule 505 offerings were initiated by foreign-incorporated issuers, a larger number of issuers (4-5%) reported their principal place of business to be outside the United States. In addition, approximately 89% of issuers in the Rule 504 market and 93% of

357 *Id.*

issuers in the Rule 505 market initiated only one offering. Approximately 83% of Rule 504 offerings and 79% of Rule 505 offerings during the period 2009-2015 were equity offerings.[358]

b. Investors

Currently, Rule 147 limits offers and sales to residents of the same state or territory as the issuer. While there are generally no limitations on who can invest in Rule 504 offerings, only accredited investors and up to 35 non-accredited investors can participate in Rule 505 offerings. Although the Commission does not require a form to be filed in connection with Rule 147 offerings, and thus does not receive information concerning investors participating in these offerings, data from Form D filings provide some insights into the number and characteristics of investors in Rule 504 and Rule 505 offerings.

Data in Table 3 below shows that more than 34,000 investors participated in new Rule 504 offerings initiated during the period 2009-2015, while almost 14,400 investors participated in new Rule 505 offerings initiated during the same period.[359] An analysis of the same Form D filings indicates that, for new Rule 504 offerings that reported sales, the mean number of investors was approximately 11 and the median number of investors was approximately four. The mean and median number of investors in new Rule 505 offerings that reported sales was 12 and seven, respectively.

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358 *Id.*

359 *Id*. *See also* Unregistered Offerings White Paper.

Table 3: Number and Type of Investors in Rule 504 Offerings, 2009‒2015[360]

	Rule 504 Offerings			Rule 505 Offerings		
	Total Investors	Mean Number of Investors	% Offerings with Non-Accredited Investors	Total Investors	Mean Number of Investors	% Offerings with Non-Accredited Investors
2009	4,004	9	53%	1,818	12	38%
2010	5,427	10	54%	2,234	11	41%
2011	5,512	11	57%	1,676	12	43%
2012	6,295	13	58%	2,027	13	44%
2013	5,573	13	61%	2,167	13	41%
2014	3,996	10	60%	2,943	13	36%
2015	3,398	9	61%	1,520	11	43%
2009-2015	**34,205**	**11**	**57%**	**14,385**	**12**	**41%**

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. Data in Table 3 above shows that issuers in approximately 57% of Rule 504 offerings and 41% of Rule 505 offerings during 2009-2015 reported having sold or intending to sell to non-accredited investors.[361]

Given existing investment limitations under state crowdfunding provisions, we believe that many investors affected by amended Rule 147 and new Rule 147A will 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

360 *Id.* The data shown in the table represents offerings that reported sales to investors.

361 Form D data shows that Rule 504 offerings that involved non-accredited investors were, on average, smaller and had a fewer mean number of investors (8) than those offerings that involved only accredited investors (9). In contrast, Rule 505 offerings that indicated potential sales to non-accredited investors were, on average, larger and had a greater mean number of investors (11) than Rule 505 offerings that sold only to accredited investors (8). We note that since issuers do not file Form D at the close of the offering, the number of investors reported in initial Form D filings may be an underestimate (offerings reporting zero

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[362] may make these offerings less attractive for such investors, which include VCs and angel investors.[363] While an intrastate crowdfunding offering can result in increased visibility for an issuer, it is likely that such investors will elect to invest in offerings relying on Rule 506, which are not subject to the investment limitations applicable to crowdfunding.

c. Intermediaries

Issuers that undertake 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 that exists for most private offerings. Private offerings can also involve finders and investment advisers who connect issuers with potential investors for a fee.[364] We do not have information on the extent of intermediary use in Rule 147 offerings; however, an analysis of

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investors are included).

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

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

364 Depending on the nature and scope of their activities, these persons may need to be registered as broker-dealers or finders under state law.

Form D filings indicates that intermediaries are used less frequently in Rule 504 offerings than in registered offerings. Approximately 20% of Rule 504 offerings and 29% of Rule 505 offerings reported using an intermediary during the period 2009-2015.[365] The average commissions and fees paid by issuers that reported using an intermediary was approximately 6% of the offering amount for Rule 504 and 5.6% for Rule 505.[366]

Although we are unable to predict the potential use of broker-dealers, transfer agents,[367] investment advisers and finders in private offerings as a result of the adoption of the final rules, data on the use of broker-dealers and finders in the Rule 506 market suggests that they do not currently play a large role in private offerings. Form D filings indicate that approximately 17% of Rule 506 offerings with an offering size up to $5 million, including 18% of such Rule 506 offerings initiated by non-fund issuers, used an intermediary during 2009-2015.[368] The use of a broker-dealer or a finder increased with offering size, while the average percentage of the total fee declined with offering size.[369] We base these estimates, however, only on available data from the Regulation D market. It is possible that issuers engaging in other types of unregistered

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365 Based on staff analysis of Form D filings.

366 *Id.*

367 Aside from their standard role in maintaining records of ownership of securities, transfer agents play an important role in private offerings that involve restricted securities, in which there may be limitations on resale of such securities for a certain period or to certain types of investors. In addition to ensuring compliance with such provisions, only a transfer agent can remove a restrictive legend from the security, which is done with the consent of the issuer.

368 Based on staff analysis of Form D filings.

369 Based on analysis of Form D filings for 2009-2015, approximately 20% of all Rule 506 offerings reported using an intermediary. Further, intermediaries participated in approximately 16% of Rule 506 offerings of up to $1 million and 31% of offerings of more than $50 million during the period 2009-2015. The average total fee (commission plus finder fee) paid by issuers conducting offerings of up to $1 million was 6.2%, while the average total fee paid by issuers conducting offerings of more than $50 million was 1.9%. *See also* Section 5.3 in the Unregistered Offerings White Paper.

offerings, for which data is not available to us, may use broker-dealers and finders more frequently or less frequently.[370]

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

The potential economic impact of the final rules, including their effects on efficiency, competition and capital formation, will depend primarily on the extent of use of amended Rules 147 and 504 and new Rule 147A and how these methods compare to alternative sources of capital that startups and small businesses can utilize.

As the amendments to Rule 504 would permit offerings up to $5 million by all types of issuers (other than investment companies, Exchange Act reporting companies and development stage companies), 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 of up to $4 million and most restrict private funds from utilizing the crowdfunding provisions. In addition, final Rules 147, 147A and 504 all exclude investment companies. Thus, our analysis below also includes a discussion of alternative sources for non-fund issuers to raise capital up to $5 million.[371]

Startups and small businesses can potentially access a variety of external financing

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[370] 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 with the state or as a broker-dealer. Based on FOCUS Reports filed with the Commission, as of December 2015, there were 4,122 registered broker-dealers, with average total assets of approximately $0.98 billion per broker-dealer. The aggregate assets of these registered broker-dealers totaled approximately $4.1 trillion. *See* Regulation Crowdfunding Adopting Release for a more detailed discussion of intermediaries in crowdfunding offerings.

[371] 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 or new Rule 147A, we believe that the impact of the final rules on larger offerings is not likely to be significant, given the local nature of offerings under these exemptions and current state regulations applicable for larger offerings. *See* Section V.B (discussing the

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 incur a variety of fees and expenses related to registration and reporting requirements. 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 public companies of $1.5 million per year.[372] 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.[373] Hence,

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impact of the final rules in detail).

372 *See* IPO Task Force, *Rebuilding the IPO On-Ramp* (Oct. 20, 2011), at 9, *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 companies 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 smaller issuers .

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, 2015). 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, "*The JOBS Act and the Costs of Going Public*," working paper, October 4, 2015, *available at* http://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2492241, ("Chaplinsky Study").

373 *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).

Recent studies that analyze IPOs by EGCs and non-EGCs find that the costs of raising capital through an IPO are similar pre- and post-JOBS Act. *See, e.g.*, Michael Dambra, Laura Fields and Matthew Gustafson, for a small issuer seeking to raise less than $5 million, a registered offering typically may not be economically feasible relative to options available under exempt offerings.

a. Exempt Offerings

For startups and small businesses that can potentially access capital under Rules 147, 504 and 505, offerings under other existing exemptions or safe harbors from registration 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),[374] Regulation A,[375] Section 4(a)(6),[376] and Rule 506 of Regulation D.[377]

Each of these provisions, 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 provisions.

"*The JOBS Act and IPO Volume: Evidence that Disclosure Costs Affect the IPO Decision*", 116 J. FIN. ECON.121-143 (2015); *see also* Chaplinsky Study.

374 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."

375 Regulation A provides an exemption from registration for certain small issuances. The Commission recently adopted amendments to Regulation A that became effective on June 19, 2015. *See* 2015 Regulation A Release.

376 Regulation Crowdfunding provides an exemption from registration for small offerings up to $1 million sold within a twelve month period. The rules became effective on May 16, 2016. *See* Regulation Crowdfunding Adopting Release.

377 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 an exemption from registration that the Commission adopted to implement Section 201(a) of the JOBS Act.

Table 4: Other Provisions Currently Available for Capital Raising

Type of Offering	Offering Limit[378]	Solicitation	Issuer and Investor Requirements	Filing Requirement	Restriction on Resale	Blue Sky Law Preemption and Bad Actor Disqualification Provisions
Section 3(a)(11)	None	All offerees must be resident in state	All issuers and investors must be resident in state, and an issuer, if a corporation, must be incorporated in state; investment companies are excluded.	None	No[379]	State Law Preemption – No Bad Actor Provisions: Required by the majority of states at the state level[380]
Section 4(a)(2)	None	No general solicitation	Transactions by an issuer not involving any public offering[381]	None	Restricted securities	State Law Preemption: No Bad Actor Provisions: No
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	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	File testing the waters materials, Form 1-A for Tier 1 and Tier 2 offerings; file annual, semi-annual, and current reports for Tier 2 offerings; file exit report for Tier 1	No	State Law Preemption: Tier 1: No Tier 2: Yes Bad Actor Provisions: Yes

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

379 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 also may have specific resale restrictions. Rule 147 limits resales to persons residing in-state for a period of nine months after the last sale by the issuer.

380 *See* text accompanying notes 250, 251, 252, 253 and 254 above.

381 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[378]	Solicitation	Issuer and Investor Requirements	Filing Requirement	Restriction on Resale	Blue Sky Law Preemption and Bad Actor Disqualification Provisions
	sales by affiliates of the issuer		similar interests in other mineral rights[382]	offerings; and file exit report to suspend or terminate reporting for Tier 2 offerings.		
Section 4(a)(6) Regulation Crowdfunding[383]	$1 million	Allowed after Form C is filed and with limitations on advertising	Excludes foreign private issuers; investment limitations based on annual income and net worth	File Form C; reviewed financial statements required for offerings greater than $100,000; audited financial statements required for offerings greater than $500,000 (unless it is the first offering made pursuant to the exemption); file annual reports.	12-month resale limitation; resale within one year to issuer and certain investors	State Law Preemption : Yes Bad Actor Provisions: Yes
Rule 506(b) Regulation D	None	No general solicitation	No issuer exclusion; unlimited accredited investors and up to 35 non-accredited investors	File Form D	Restricted securities	State Law Preemption :Yes Bad Actor Provisions: Yes

382 The Regulation A exemption is also 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.

383 See Table 6 below for a more detailed comparison between Regulation Crowdfunding and intrastate crowdfunding provisions.

Type of Offering	Offering Limit[378]	Solicitation	Issuer and Investor Requirements	Filing Requirement	Restriction on Resale	Blue Sky Law Preemption and Bad Actor Disqualification Provisions
Rule 506(c) Regulation D	None	General solicitation is permitted, subject to certain conditions[384]	No issuer exclusion; unlimited accredited investors; no non-accredited investors	File Form D	Restricted securities	State Law Preemption :Yes Bad Actor Provisions: Yes

While we do not have data on offerings relying on an exemption under Section 3(a)(11) or Section 4(a)(2), data available from Regulation D and Regulation A filings allow us to gauge how frequently issuers seeking to raise up to $5 million rely on these provisions. Based on Form D filings from 2009 to 2015, a substantial number of issuers chose to raise capital by relying on Rule 506(b), even though their offering size would qualify under Rule 504 or Rule 505.[385] As shown in the upper part of Table 5, most Regulation D issuers made offers for amounts of up to $1 million from 2009 to 2015. A large majority of offerings up to $5 million relied 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.

The overwhelming majority of non-fund issuers (approximately 73%) conducting offerings less than $5 million were five years or younger, and 64% 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 of $5 million or less during this period were organized

384 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.

385 *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* report from U.S. Government Accountability Office, *Factors That May Affect Trends in Regulation A Offerings*, GAO-12-839 (Jul. 3, 2012), *available at* http://www.gao.gov/products/GAO-12-839.

as either a corporation or a limited liability company. Almost 21% reported having no revenues, while approximately 20% had revenues of less than $5 million.[386]

Table 5: Number of Regulation D and Regulation A Offerings By Size, 2009-2015

	Offering size				
	<=$1 million	**$1-$2.5 million**	**$2.5-5 million**	**$5-50 million**	**>$50 million**
All offerings					
Rule 504	4,224				
Rule 505	592	518	432		
Rule 506(b)	35,688	18,998	16,107	31,978	14,726
Rule 506(c)	1,233	529	512	975	268
Total	41,737	20,045	17,051	32,953	14,994
Regulation A	10	6	33	6	
Non-fund offerings					
Rule 504	4,143				
Rule 505	568	496	378		
Rule 506(b)	32,095	16,975	13,866	22,291	3,375
Rule 506(c)	1,007	447	472	763	153
Total	37,813	17,918	14,716	23,054	3,528

Note: Data based on Form D filings for Regulation D offerings and Form 1-A filings for qualified Regulation A offerings from 2009 to 2015. We consider only new offerings and exclude offerings that do not report offering size and report amount sold as $0 on Form D. Data on Rule 506(c) offerings covers the period from September 23, 2013 (the date the rule became effective) to December 31, 2015. We also use the maximum amount indicated in Form 1-A to determine offering size for Regulation A offerings.

Table 5 also includes the number of Regulation A offerings by size. From 2009 to 2015, 49 issuers relied on Regulation A for offerings of up to $5 million.[387] This data includes 17 offerings, of which 11 have offering sizes of up to $5 million, initiated subsequent to the effectiveness of amendments to Regulation A in June 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

386 These percentages could be higher because almost 55% of the issuers that conduct Regulation D offerings of $5 million or less declined to disclose the size of the offering.

387 We only consider offerings with offering statements that have been qualified by the Commission. For purposes of counting offerings, 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

recently, more time is needed to assess how the changes in Regulation A will affect capital raising by small issuers.[388]

b. Regulation Crowdfunding

The analysis above does not include data regarding securities-based crowdfunding transactions under the recently adopted Regulation Crowdfunding exemption. The new rules, which became effective on May 16, 2016, supplement the existing regulatory scheme of exemptions and safe harbors that are described above and provide start-ups and small businesses with an alternate source for raising capital through offerings exempt from registration under the Securities Act. As of September 30, 2016, approximately 114 offerings relying on the federal crowdfunding exemption filed a Form C with the Commission.[389]

Offerings pursuant to these rules 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 specified investment limits), are freely tradable after one year, and can be offered and sold without state qualification or registration. Unlike intrastate crowdfunding provisions enacted at the state level, the new federal crowdfunding exemption allows interstate offerings, whereby an issuer can make offers and sell to investors in multiple states. Table 6 presents a comparison of the provisions of Regulation Crowdfunding and current intrastate crowdfunding provisions that rely on current Rule 147 for federal exemption.

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permitted offering amount.

388 *See* 2015 Regulation A Adopting Release.

389 Based on Form C filings, as of September 30, 2016. Analysis of data reported in Form C and Form C-U filings indicates that the mean maximum offer size was approximately $643,150 and the mean amount reported to be raised per offering was $440,480 . Based on filings of Form C-U as of September 30, 2016, 12 offerings were reported to be completed.

Table 6: Intrastate Crowdfunding and Regulation Crowdfunding Provisions

	Current Rule 147 + State Level Crowdfunding Provisions[390]	Regulation Crowdfunding
Investor Base	Rule 147 requires that all investors reside in the state of the issuer	All investors, all states
State Registration	Exemption provided by state	Preemption of state registration
Issuer Incorporation/ Residency Limitations	Rule 147 requires issuer to be incorporated and "doing-business" in state	Excludes foreign private issuers
Excluded Issuers	Investment companies are excluded under the federal exemption. Although not excluded under Rule 147, most state crowdfunding provisions also exclude Exchange Act reporting companies and blank check companies	Exchange Act reporting companies, investment companies, pooled investment funds, and blank check companies
Offering Size Limits	Although not limited under Rule 147, state provisions limit between \$250,000 and \$4 million, depending on state. Mean (median) limit: \$1.6 (\$2) million	Up to \$1 million
Security Type	Although not limited under Rule 147, equity and debt permitted in some states; equity only in other states; any security in some other states	Any security
Audited Financials Requirement	Although no requirements under Rule 147, most states require, 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	Rule 147 and states allow, but only to investors residing in state	Allowed after filing of Form C and subject to limitations on advertising
Investment Limits	No limits under Rule 147 \$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 investment cap of \$100,000

390 Information in this column is based on the provisions that are 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/.

	Current Rule 147 + State Level Crowdfunding Provisions[390]	Regulation Crowdfunding
Restrictions on Resale	Rule 147 restricts interstate resales for nine months[391]	12-month resale limitation; resale within one year to issuer and certain investors
Exemption from Section 12(g) Registration Requirements	None	Conditional exemption, 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.[392]

For example, a 2014 study reports that startups frequently resort to bank financing early in their lifecycle.[393] 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 bank loans, business credit cards, and credit lines.[394] Another report shows a decline in

391 *See* 17 CFR 230.147(e). States may impose additional resale restrictions.

392 Using data from the 1993 Survey of Small Business Finance, one study indicates that financial institutions account for approximately 27% of small companies' 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.

393 *See* Alicia M. Robb, and David T. Robinson, 2014, *The Capital Structure Decisions of New Firms*, Review of Financial Studies 27(1), pp. 153–179 ("Robb Study").

394 *See also* NextSeed Letter.

cumulative bank lending to small businesses, which fell by $100 billion from 2008 to 2011.[395] 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 December 2015, small business lending, specifically business loans of up to $1 million, by FDIC-insured depository institutions amounted to approximately $606 billion, which is 15% lower than the June 2008 level but 2% above December 31, 2014 level.[396]

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.[397] These loans were borrowed from two types of financial institutions: depository and non-depository institutions (*e.g.*, finance companies, factoring or leasing companies).[398] Lines of credit were the most widely used type of credit.[399] Other types included mortgage loans, equipment loans, and motor vehicle loans.[400]

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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395 *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.

396 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/

397 *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 FRB Survey").

398 *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/epdf.

399 *See* 2003 FRB Survey, note 397 (estimating that 34% of small businesses use lines of credit).

would not be willing to provide, absent a guarantee.[401] SBA loan programs include 7(a) loans,[402] microloans[403] and Certified Development Company loans (CDC loans).[404] For example, in fiscal year 2015, the SBA supported approximately $33.2 billion in 7(a) and CDC loans, microloans and surety bonds distributed to approximately 61,000 small businesses.[405] In addition, investments in high-growth small businesses through its Small Business Investment Company program increased from $5.5 billion in 2014 to $6.3 billion in 2015.[406] SBA guaranteed loans, however, currently account for a relatively small share (20%) of the balances of small business loans outstanding.[407]

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,

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400 *Id.*

401 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.

402 15 U.S.C. 631 *et seq*. 7(a) loans provide small businesses with financing guarantees (up to $5 million) for a variety of general business purposes through participating lending institutions.

403 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 approximately $13,000. *See* Microloan Program, U.S. Small Business Administration, *available at* http://www.sba.gov/content/microloan-program.

404 15 U.S.C. 695 *et seq*. The CDC loans (up to $5.5 million) 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.

405 *See* U.S. Small Business Administration, *Agency Financial Report: Fiscal Year 2015*, *available at* https://www.sba.gov/sites/default/files/aboutsbaarticle/Agency_Financial_Report_FY_2015.pdf.

406 *Id.*

407 As of the end of fiscal year 2015, the SBA guaranteed business loans outstanding (including 7(a) and CDC loans) equaled $118.8 billion. *See SBA Agency Financial Report: Fiscal Year 2015.* This comprises approximately 20% of the approximately $606 billion in outstanding small business loans for commercial real estate and commercial and industrial loans discussed above. In addition to loan guarantees, the SBA program portfolio also includes direct business loans, which are mainly microloans and disaster loans.

insufficient assets to offer as collateral, and high external monitoring costs.[408] 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 institutions generally require a borrower to provide collateral and/or a guarantee,[409] 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,[410] microfinance,[411] and other alternative online lending channels.[412] According to some industry estimates, the global volume of "lending-based crowdfunding,"

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408 *See* Robb Study.

409 Approximately 92% of all small business debt to financial institutions is secured, and owners of the company guarantee about 52% of that debt. *See* Allen N. Berger and Gregory F. 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, informationally opaque companies as a result of strategic use of soft information by local lenders. S*ee* Sumit Agarwal and Robert Hauswald, 2010, *Distance and Private Information in Lending*, Review of Financial Studies 13(7), pp. 2757–2788.

410 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.

411 *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, with an estimated $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.

412 Several models of online small business lending have emerged: online lenders raising capital from institutional investors and lending on their own account (e.g., 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 traditional and alternative lenders, including term loans, lines of credit, merchant cash advances and factoring products,. *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 Study").

which includes peer-to-peer lending to consumers and businesses, had risen to approximately $11.08 billion in 2014.[413] Technology has facilitated the growth of alternative models of small business lending. According to one academic study,[414] 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 2015 Small Business Credit survey,[415] 20% of all small businesses surveyed applied for credit with an online lender.[416]

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 with arm's-length, more formal funding channels.[417] 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.[418] Family and friends, however, may be able to provide only a limited

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413 *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 Report") at 56. The Massolution 2015 Report refers to peer-to-peer lending to consumers and 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.

414 *See* Mills Study.

415 The survey was conducted by the Federal Reserve Banks of New York, Atlanta, Boston, Cleveland, Philadelphia, Richmond and St. Louis during 2015. It focused on credit access among businesses with fewer than 500 employees in 26 states. 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 2015 Small Business Credit Survey: Report on Employer Firms*, *available at* https://www.clevelandfed.org/community-development/small-business/about-the-joint-small-business-credit-survey/2015-joint-small-business-credit-survey.aspx.

416 *Id.* The survey also showed differences in the use of online lenders by type of borrower: 26% and 21% of small businesses that have been in business for less than 2 years and 3-5 years, respectively, applied for credit with online lenders. By comparison, 11% of small businesses with revenue between $1million-$10 million and 6% of small businesses with revenue greater than $10 million applied for credit to an online lender. Mature (older, higher revenue, greater number of employees) categories of small businesses were much more likely to apply for credit with bank lenders than with online lenders.

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

418 *See* Robb Study, at 1219.

amount of capital compared to more formal sources. We do not have data available on these financing sources that could allow us to quantify their magnitude or compare them to other current sources of capital.

B. Analysis of Final Rules

1. Broad Economic Considerations

The final rules are intended to streamline and modernize 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 that provides startups and small businesses an alternative mechanism of raising funds by selling small amounts of securities to a large number of investors using the Internet. 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 intrastate crowdfunding provisions require issuers to comply with the requirements of Section 3(a)(11) and Rule 147, while three states currently provide issuers with the option of utilizing Rule 504 or another Regulation D exemption.[419]

By establishing new Rule 147A and modernizing the existing requirements under Rule 147, the final rules could facilitate capital formation through intrastate crowdfunded offerings as well as through other state registered or state exempt offerings. Raising the offering amount

[419] Maine's provisions currently permit interstate crowdfunding utilizing the Rule 504 exemption and Mississippi and Vermont dually offer intrastate crowdfunding under Section 3(a)(11) and interstate crowdfunding under Rule 504. *See* NASAA Letter.

limit under amended Rule 504 from $1 million to $5 million may facilitate smaller offerings, including those registered or exempt from registration in a particular state, or regional offerings made pursuant to regional state coordinated review programs.[420] Such programs, when implemented, may enable issuers relying on Rule 504 to register an offering in any one rather than in each of the several states where they conduct offers and sales, thereby saving them time and money. In light of the current infrequent use of the Rule 505 exemption and the increase in the maximum offering size under Rule 504 to $5 million, repealing Rule 505 will simplify the existing Securities Act exemptive framework without significantly diminishing issuers' capital raising options.

The amendments to Rule 147 and Rule 504 and the establishment of Rule 147A will remove or reduce certain impediments to capital raising identified by market participants and commenters.[421] As discussed below, the effects of the final rules on capital formation will depend, first, on whether issuers that currently raise or plan to raise capital will choose to rely on the safe harbor and exemptions provided by amended Rules 147 and 504 and new Rule 147A 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 final rules on capital formation, we consider the features of amended Rules 147 and 504 and new Rule 147A that potentially could increase securities offerings by new issuers and by issuers that already rely on other private offering methods.

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

421 *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. *See also* 2015 Small Business Forum Recommendations; ABA Letter; CFIRA Letter; CrowdCheck Letter; Milken Letter.

Second, to the extent that securities offerings relying on the final rules provide capital raising options for issuers that currently do not have access to capital, the final rules 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 methods that could arise from issuers changing such methods.

Third, to the extent that states currently have residency and eligibility requirements that correspond to existing Rule 147, the impact of amended Rule 147 and new Rule 147A on capital formation will significantly depend on whether state law is amended to align with the final rules. Any changes to intrastate and regional securities offering provisions that may be enacted by states would, in turn, affect the expected use of amended Rules 147 and 504 and new Rule 147A. Currently, most intrastate crowdfunding provisions require issuers to rely on Rule 147 and Section 3(a)(11) for exemption from Securities Act registration. To the extent state law provisions are amended to allow these offerings to comply with amended Rule 147, new Rule 147A or amended Rule 504, the choice between these three exemptions could depend on issuers' preferences with respect to general solicitation, target investor base, issuer incorporation and investor location. For example, while issuers relying on the amended Rule 147 safe harbor must be incorporated in the state where they seek to conduct an intrastate offering, there is no such restriction for issuers relying on the Rule 147A exemption. While both Rule 147 and Rule 147A offerings will be restricted to in-state investors, Rule 504 offerings will be available to investors in more than one state, thus facilitating regional offerings. At the same time, there is no limit on the maximum offering amount under amended Rule 147 or new Rule 147A, while amended Rule 504 limits the maximum amount that can be sold over a twelve-month period to $5 million.

Finally, the impact of the final rules on aggregate capital formation also will depend on whether new investors are attracted to the Rule 147, Rule 147A and Rule 504 markets or whether investors reallocate existing capital among various types of offering methods. If the final rules allow issuers to reach a category of potential investors significantly different from those that they can reach through other offering methods, or attract existing investors to invest a greater share of their wealth in primary offerings, then capital formation, in aggregate, could increase. On the other hand, if the final rules are viewed as substantially similar to alternate offering methods, investors with limited investment capital may simply reallocate their capital from other markets to the Rule 147, Rule 147A or Rule 504 markets. Investor demand for securities offered under the final rules could, in particular, depend on the extent to which expected risk, return and liquidity of the offered securities compare to what investors can obtain from securities in other exempt offerings and in registered offerings.

Investor demand also will depend on whether state disclosure requirements are sufficient to enable investors to evaluate the aforementioned characteristics of offerings made pursuant to Rules 147, 147A or 504. For example, investors may be less willing to participate in offerings that are made in reliance on exemptions both from state and federal registration and that are subject to fewer disclosure requirements. For some investors, these concerns may be mitigated by other state and federal provisions, such as the amendment being adopted to disqualify certain bad actors from participation in Rule 504 offerings or the disclosure requirements for larger intrastate crowdfunding offerings under state law provisions.[422]

In sum, we believe that the potential use of Rules 147, 147A and 504 will depend largely on how issuers perceive the trade-off between the costs of compliance under federal provisions

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422 *See* NASAA's Intrastate Crowdfunding Resource Center, *available at* http://www.nasaa.org/industry-resources/corporation-finance/instrastate-crowdfunding-resource-center/.

as well as state regulation, if any, and the benefits of access to non-accredited investors. For instance, relative to Regulation Crowdfunding, the extent to which issuers rely on Rules 147, 147A or 504 for intrastate crowdfunding offerings will depend on whether the benefits of a larger offering amount and fewer reporting requirements outweigh the costs of a more geographically limited investor base, compliance with issuer residency requirements and the potential for registration under Section 12(g) of the Exchange Act. In this regard, we believe a small, local business that serves local customers (e.g., a hair salon or a pizza shop), rather than a scalable business like a technology start-up, is more likely to use intrastate crowdfunding than interstate crowdfunding.[423] Compared to Rules 147, 147A and 504, other exemptions and safe harbors already being utilized could remain attractive to issuers. For example, offerings conducted pursuant to the exemption from registration under Rule 506(b) of Regulation D, which accounts for a significant amount of exempt offerings,[424] are subject to limits on participation by non-accredited investors. In contrast, issuers relying on Rules 147, 147A or 504 could generally sell securities to an unlimited number of non-accredited investors, 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.[425] In addition, offerings under Rule 506(b) that are limited to

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[423] *See* Nextseed Letter.

[424] *See* discussion in Section V.2 above.

[425] *See e.g.*, NASDAQ Private Market overview, *available at* https://www.nasdaqprivatemarket.com/market/overview (explaining that "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.").

accredited investors require only a notice filing with the Commission and have no specified disclosure requirements. Finally, relative to Regulation A, Rules 147, 147A and 504 will have fewer disclosure and other regulatory requirements at the federal level. However, unlike securities issued in reliance on Regulation A, which are freely tradable, securities issued under Rules 147, 147A and 504 could be less liquid due to their resale restrictions.

Overall, the amendments to Rules 147, 147A and 504 could increase the aggregate amount of capital raised if used by issuers that have not previously conducted securities offerings. The net effect also will depend on whether investors find the rules' investor protections to be sufficient to evaluate the expected return and risk of such offerings. As noted above, the final rules may have a limited impact on capital formation if they simply cause issuers to conduct, and investors to reallocate their participation across, different types of offerings. However, even redistribution among capital raising methods will have a net positive effect on capital formation and allocative efficiency if it allows issuers to access capital at a lower cost.

As the final rules are not currently in effect, data does not exist to estimate the effect of the final rules on the potential rate of substitution between alternative methods of raising capital and the overall expansion or decline in capital raising by potential issuers affected by the rules. However, we anticipate that the final rules, by lowering investor search costs and easing issuer eligibility requirements, will result in an increased use of the federal intrastate offering provisions, including for intrastate crowdfunding, as more states enact provisions facilitating such offerings. Similarly, we expect the final rules will increase the use of the Rule 504 exemption, especially by facilitating efforts among state securities regulators to implement regional coordinated review programs that will enable regional offerings. Although it is not possible to predict the extent of such increase or the type and size of issuers that will conduct intrastate and small regional offerings, the current number of businesses pursuing similar levels of financing through alternative capital raising methods, as discussed in the baseline analysis above, provide an upper bound for Rule 147, Rule 147A and Rule 504 usage.[426] Nevertheless, the baseline data show that the potential number of issuers that might seek to offer and sell securities in reliance on Rules 147, 147A and 504 is large, particularly when compared to the current number of approximately 9,000 reporting companies.[427]

We recognize that the amendments to Rules 147 and 504 and new Rule 147A could raise investor protection concerns. For instance, as discussed in detail further in this section, allowing issuers with more geographically dispersed assets and revenues than currently permitted to rely on Rules 147 and 147A may raise concerns about reduced oversight by state securities regulators. We believe however, that the amended "doing business" tests along with the principal place of business requirement are sufficient to provide assurance of the local nature of an issuer's business operations.[428] We also believe such concerns are mitigated by the continuing applicability of state regulatory requirements, which may impose additional eligibility conditions for issuers in these offerings, as well as the residency requirements for investors that remain under the final rules.

Similarly, there could be concerns about not having an offering size limit at the federal level or not requiring a limit under state law if the issuer relies on a state exemption for an

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426 We believe the numbers in the baseline analysis 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 law preemption and permits unlimited offering amounts, which appears to make Rule 506 offerings more attractive for issuers.

427 *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.

428 See also NASAA Letter and CFA Letter.

intrastate offering. In adopting existing Rules 147, 504 and 505, the Commission relied substantially upon state securities laws and regulations on the rationale that the size and/or local nature of smaller offerings conducted pursuant to these provisions does not warrant imposing extensive regulation at the federal level.[429] The final rules preserve this approach by permitting state legislators and securities regulators to determine the specific additional rule requirements, if any, that should be mandated to regulate local offerings and provide additional investor protections. In this regard, the final rules provide greater flexibility to states in designing regulations that would work best for issuers and investors in their respective jurisdictions. We believe that such latitude could improve the efficiency of local capital markets and lead to competition between states in attracting issuers to locate to their jurisdictions.

In addition to state regulations, the amendments to Rule 504 to disqualify certain bad actors from participation in Rule 504 offerings could help to address such investor protection concerns. We also note that the Commission will retain authority under the antifraud provisions of the federal securities laws to pursue enforcement action against issuers and other persons involved in such offerings.[430] 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 final rules will affect the incidence of fraud in intrastate and Rule 504 offerings.

The impact of the repeal of Rule 505 will depend on the trade-offs that Rule 505 issuers and investors face when switching to alternate offering methods, predominantly other

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[429] *See* Seed Capital Release and Rule 147 Adopting Release. *See also*, ABA Letter and NASAA Letter.

[430] *See, e.g.*, Seed Capital Release at note 20 and accompanying text (Rule 504 offerings are subject to Section 17 of the Securities Act [15 U.S.C. 77q(a), Section 10(b) of the Exchange Act [15 U.S.C. 78j(b) and Rule 10b-5 thereunder [17 CFR 240.10b-5]).

unregistered offerings. This will be contingent on whether issuers can raise the desired amount of capital at the same or lesser cost as under Rule 505 in a timely manner.

For example, if issuers switch to offerings under Rule 506(b), they may only offer and sell to investors that are accredited or that, unlike in a Rule 505 offering, either alone or with a purchaser representative,[431] are sophisticated (i.e., have sufficient knowledge and experience in financial and business matters to make them capable of evaluating the merits and risks of the prospective investment). However, the possibility of raising unlimited amounts of capital and preemption from state blue sky laws may offset some of these concerns for potential issuers that subsequent to the repeal of Rule 505, would switch to a Rule 506 offering. In contrast, if issuers switch to offerings under amended Rule 504, they could replicate most characteristics of an offering under existing Rule 505 and receive some additional benefits, such as access to an unlimited number of non-accredited investors and the ability to engage in general solicitation in certain situations. However, reporting companies, albeit a small proportion of all Rule 505 issuers,[432] are not permitted to utilize the Rule 504 exemption.

As an alternative to Rule 505, issuers may also opt for a registered offering to raise capital. As noted above, a registered offering may not be economically feasible for small issuers relative to an exempt offering,[433] but may provide a reasonable alternative for Rule 505 issuers that are reporting companies.. Registered offerings, unlike Rule 505 or Rule 506(b) offerings, have benefits like providing investors with unrestricted securities, and providing issuers access to

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431 A purchaser representative is someone who is not an affiliate of the issuer but has such knowledge and experience in financial and business matters that he is capable of evaluating, alone, or together with other purchaser representatives of the purchaser, or together with the purchaser, the merits and risks of the prospective investment. *See also* Rule 501, Regulation D of Securities Act.

432 As discussed in Section IV(A)(1)(ii), the number of reporting companies that conducted a Rule 505 offering during 2014 and 2015 was 10 and 8, respectively.

433 *See* discussion in Section V(A(1)(c)(2) above.

an unlimited number of non-accredited investors and investors who prefer offerings that have the protections of the registration process. On the other hand, the costs of registering an offering compared with costs of raising capital through an exempt offering, including Rule 505 or Rule 506(b) offerings, may also affect an issuer's willingness to switch to a registered offering. Such costs include the costs of disclosure required for a registered offering relative to the disclosure required under Rule 505 or 506(b) when non-accredited investors are solicited,[434] including any costs associated with Commission staff review of the registration statement. Recent regulatory changes to Form S-1[435] that permit forward incorporation by reference of certain information required under Exchange Act reporting requirements may have lowered the costs of registered offerings for eligible smaller reporting companies by eliminating the need to update information in the Form S-1 that has become stale or is incomplete through a post-effective amendment. Whether Rule 505 issuers, in particular those that are reporting companies, switch to a registered offering or another form of unregistered offering such as Rule 506 offering will depend on how they assess such costs of registration relative to the benefits like broader access to non-accredited investors.[436]

The effect of the repeal of Rule 505 will also depend on investors' willingness and ability to participate in an alternate unregistered offering, such as a Rule 504 or Rule 506 offering, or a

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[434] The disclosure requirements under Rule 505 and Rule 506(b) for an Exchange Act reporting issuer that sells securities to a non-accredited investor are similar to the disclosure requirements for a registered offering under the Securities Act. *See* Rule 502(b)(2)(ii) of Regulation D. Note that if the Rule 505 or 506(b) offering is soliciting only accredited investors, there is no equivalent requirement for information being furnished.

[435] *See* note 330 above.

[436] *See, e.g.*, Armando Gomes and Gordon Phillips, "Why Do Public Firms Issue Private and Public Securities?", J. FINAN. INTERMEDIATION, March 21, 2012 which find that choice of public versus private financing depends on asymmetric information, risk and market timing. *See also* Hsuan-Chi Chen, Na Dai, John Schatzberg, "The Choice of Equity Selling Mechanisms: PIPEs versus SEOs", J. CORP. FIN., August 21, 2009.

registered offering. This willingness will rest on whether investors find disclosure requirements and investor protections in alternate markets to be sufficient, relative to the Rule 505 market, to evaluate the expected return and risk of such offerings. For example, it is possible that investor protection levels will be perceived to be lower in a Rule 506 offering as these offerings are preempted from state or Commission registration. In addition, "unsophisticated" non-accredited investors that may have been able to participate in a Rule 505 investment opportunity may not be able to participate in a Rule 506(b) offering without a purchaser representative and hence may find their set of investment opportunities reduced. Similarly, while more than 35 non-accredited investors (the maximum eligible to invest in a Rule 505 offering) will be able to participate in an offering under amended Rule 504, Rule 504 has fewer disclosure requirements at the federal level relative to a Rule 505 or 506 offering, which may raise potential investor protection concerns. Such concerns, however, may be offset by disclosure requirements imposed at the state level. Thus, the net impact on the overall level of investor protection will likely depend on the capital markets that substitute for the repealed Rule 505 market.

Overall, the repeal of Rule 505 may not have a significant or any impact on capital formation if issuers can successfully find commensurate investor interest in an alternate unregistered or registered offering market. If issuers are not able to find an alternate exemption and raise sufficient amounts of capital, an outcome we believe is unlikely, overall capital formation in the economy and allocative efficiency of capital markets could slightly decline.

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

2. Analysis of Amendments to Existing Rule 147 and New Rule 147A

The amendments to Rule 147 and new Rule 147A will modernize and expand the options available under federal law for exempt intrastate offerings by local companies, including offerings relying upon crowdfunding provisions under state securities laws.

a. Retention of Existing Rule 147

The proposed amendments would have replaced the existing Rule 147 safe harbor with a new intrastate offering exemption. In contrast, the final rules amend Rule 147 and retain it as a safe harbor under Section 3(a)(11), while also establishing new Rule 147A pursuant to the Commission's general exemptive authority under Section 28. Because most state crowdfunding provisions require issuers to comply with Section 3(a)(11) and Rule 147, retention of Rule 147 within the statutory parameters of Section 3(a)(11) will enable issuers to continue to rely upon the existing safe harbor to conduct intrastate offerings until states update their laws or regulations to allow issuers to rely on new Rule 147A.[437] This will help to ensure that intrastate offering activity is not adversely affected during the interim period or in states that do not amend their laws, and will thus provide greater certainty to market participants, including issuers and investors who participate in such intrastate offerings.[438] Together, the amendments to Rule 147 and new Rule 147A seek to modernize federal regulation of intrastate offerings to comport with contemporary business practices and communications technology, while retaining the underlying intent of the rules to permit issuers to raise money from investors resident within the same state without registering the offering at the federal level.

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[437] Most states that have enacted state crowdfunding provisions require issuers to comply with the provisions of Section 3(a)(11) and Rule 147. See note 30 above.

[438] *See, e.g.*, ABA Letter, NASAA Letter, CrowdCheck Letter, Guzik Letter, NextSeed Letter and the 2015 Small Business Forum Recommendations.

Amended Rule 147 will differ from new Rule 147A with respect to two provisions that are statutorily mandated by Section 3(a)(11). Under Section 3(a)(11), and by extension the safe harbor under Rule 147, offers can be made only to in-state residents and issuers are required to be incorporated in the state where they conduct the intrastate offering. The provisions of new Rule 147A will not include these two limitations; however, both Rule 147 and 147A will require an issuer to have its principal place of business within the state or territory of the offering. In the following sections, we first discuss the economic effects of not including the two statutory limitations contained in Rule 147 within new Rule 147A and then discuss the amendments that are substantially identical under Rules 147 and 147A.

b. Distinguishing Provisions under New Rule 147A

i. Elimination of Restrictions on Manner of Offering

Offers pursuant to current and amended Rule 147 must be limited to in-state residents.[439] However, the provisions under new Rule 147A will 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.[440] Both amended Rule 147 and new Rule 147A require issuers to include prominent disclosures 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 are being sold in an unregistered offering and have resale restrictions for a six-month period.[441] In addition, under both rules, states retain the flexibility to impose additional disclosure or other requirements related to offers and sales made in the intrastate offering. As Internet-based advertising is easily accessible across state lines,

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[439] *See* Rule 147(b).

[440] *See* Rule 147A(b).

[441] *See* Rules 147(f) and 147A(f).

issuers relying on existing Rule 147 that choose to disseminate offering materials using online media could have a higher risk of being non-compliant unless they take additional and potentially costly precautions to restrict any advertising that can be viewed outside their state of incorporation. Eliminating manner of offering restrictions in Rule 147A will allow issuers to engage in broad-based solicitations, including on publicly accessible websites, in order to successfully locate potential in-state investors. For example, an issuer resident in New Jersey will be permitted under Rule 147A to advertise and disseminate offering information through online media to reach New Jersey residents, including those who may work and access the online solicitation while in New York. Thus, Rule 147A will provide issuers with the flexibility to utilize a wider array of options to advertise their offerings, allowing them to take advantage of modern communication technologies such as the Internet and other social media platforms to reach investors.[442] In this regard, we expect Rule 147A to be particularly effective at facilitating state-based crowdfunding offerings that rely heavily on online platforms to bring issuers and investors together.[443] Online advertising provides a lower cost and more efficient means of communicating with a more diffused base of prospective investors. Consequently, eliminating manner of offering restrictions in Rule 147A should result in lower search costs for Rule 147A issuers. The provisions may facilitate compliance with the rules' requirements as issuers will not need to limit advertising or take additional precautions to ensure that only in-state residents view the offering.

Under the final rules, issuers will be able to choose between utilizing Rule 147 and Rule 147A for intrastate offerings based on their preferences for communicating with investors. This

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[442] *See also* ABA Letter, CFA Letter, Nextseed Letter.

[443] *See* Massolution 2015 Report.

could enable a larger number of issuers to utilize intrastate offerings to meet their capital raising needs. To the extent issuers shift from another unregistered capital market to the Rule 147A market, capital formation may not increase but the allocative efficiency of capital markets could improve, if issuers are able to meet their capital raising needs more effectively and investors are better able to find investment opportunities that satisfy their financial objectives. We believe that eliminating the manner of offering restrictions in Rule 147A will attract a number of new issuers that previously could not avail themselves of lower-cost capital raising opportunities, such as intrastate crowdfunding, that primarily rely on online media to advertise the offering to large numbers of investors. Such improved access to cheaper capital raising methods may result in higher levels of capital formation in the economy.

In addition, eliminating manner of offering restrictions in Rule 147A may result in a greater number of investors becoming aware of a larger and more diverse set of investment opportunities in private offerings, enabling them to diversify their investment portfolios and allocate their capital more efficiently. Further, broadly advertised offerings under Rule 147A may compete for potential investors more effectively with offerings where general solicitation is also permitted, such as Rule 504, Rule 506(c), and Regulation A offerings. The final rules could thus intensify competition among unregistered capital markets for attracting issuers that want to raise capital and investors that are looking for suitable investment opportunities. An increase in competition could change the number and type of market participants across various markets, which would impact the relative demand for and supply of capital in each of these markets.

However, as issuers utilizing Rule 147A advertise more widely and freely, the likelihood of out-of-state investors purchasing into an intrastate offering could increase. The inclusion of legends and other mandatory disclosures may mitigate this concern and may provide a certain measure of investor protection, although out-of-state investors in their desire to participate in an attractive investment opportunity may overlook the legends or disclosures or may simply disregard them. While issuers are required to have a reasonable belief that all their purchasers are resident within the state and obtain a written representation from each purchaser as to his or her residence, the probability of circumventing the out-of-state sale restrictions by investors who misrepresent their residency status could increase as out-of-state residents may view Internet-based advertising and become aware of Rule 147A offerings in another state. Likewise, there may be an increased probability that out-of-state purchasers will attempt to purchase in resale transactions that occur within the restricted period. However, due to inclusion of rule provisions such as the requirement of written representation by investors as to their residency status as well as requirements related to legends, transfer agent instructions and prominent disclosure about limitations on resales, we believe that such concerns may not be significantly higher than under amended Rule 147, which retains the restrictions related to manner of offerings. Allowing Internet-based advertising of Rule 147A offerings and the potential increased use of the intrastate offering exemptions could also impact the effectiveness of state oversight if regulators do not have adequate resources to monitor the manner in which these securities are marketed to the general public. Overall, we believe that the final rules will modernize existing regulations to reflect modern business practices and technological developments while maintaining appropriate investor protections.

ii. Incorporation and Principal Place of Business Requirements

New Rule 147A will eliminate the current requirements in Rule 147 for issuers to be incorporated and have their principal office in the state where an offering is being conducted. In order to establish sufficient in-state presence to be eligible to conduct an exempt intrastate offering, in lieu of such requirements, Rule 147A will require issuers to have their principal place of business in the state where an offering is conducted. The principal place of business will be defined as the location from which officers, partners or managers of the issuer primarily direct, control and coordinate the activities of the issuer.[444]

We believe that the elimination of the incorporation or organization in-state requirement in Rule 147A better comports with modern business practices and thereby will make it easier for a greater number of issuers to utilize the new exemption, relative to amended Rule 147. A significant number of public and private companies are incorporated in states other than the state in which their principal place of business is located, thereby precluding otherwise eligible issuers from utilizing Rule 147 to conduct an intrastate offering.[445]

Most of these companies have chosen to incorporate in jurisdictions where corporate laws are consistent with modern business practices or provide more flexibility.[446] For example, according to one academic study, corporate laws affect company value, even after controlling for

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444 *See* Rule 147A(c)(1). Corporations, limited partnerships and trusts relying on amended Rule 147 will continue to be required to be organized or incorporated in the state where the offering is being conducted in order to establish in-state residency. Rule 147(c), however, will be amended by replacing the principal office requirement with a principal place of business requirement. We believe principal place of business is conceptually similar to principal office location. *See* Section II(A)(2).

445 For example, based on analysis of EDGAR filing data, 76% of Exchange Act reporting companies indicated, in their 2015 Form 10-K filings, that they had a separate state of principal executive office and state of incorporation. Analyzing by size (assets), more than two-thirds of the smallest 10% of reporting companies reported different states of incorporation and principal office. The practice of incorporating in different states extends beyond public companies to private and smaller companies. During 2009-2015, 37% of Rule 504 offerings and 39% in Rule 505 offerings indicated in their Form D filings that they had different states of incorporation and principal place of business. See baseline analysis in Section IV(A)(1)(ii). Form D data also indicates that approximately 65% of all Rule 506 offerings initiated during 2009-2015 reported different states of incorporation and operations. While smaller companies may be less likely than larger companies to have separate states of incorporation and principal places of business, Form D data indicates that a considerable number of small businesses are currently unable to meet the state of incorporation requirement in existing Rule 147.

446 *See* ABA Letter, CFA Letter, CrowdCheck Letter, Milken Letter.

company size, diversification, profitability, investment opportunities and industry.[447] Thus, companies may have strong incentives to select perceived favorable regimes, such as that of Delaware.[448] These studies and industry practices indicate that companies' choice of state of incorporation depends on the economic benefits derived from the regulatory environment in which the company is organized and not necessarily where the company operates most efficiently.

Since the geographical location of investment and employment is aligned more closely with the principal place of business of a company than where it is incorporated, we believe replacing the current incorporation and residency requirements of current Rule 147 with a principal place of business requirement in Rule 147A will be sufficient to establish the in-state nature of the issuer's business. Such a change will also be consistent with the objectives of the current intrastate offering exemption, while making it easier for more issuers to utilize the new exemption relative to the amended Rule 147 safe harbor under Section 3(a)(11).

By not requiring issuers to be incorporated in-state, it may be possible for foreign incorporated issuers that have their principal place of business in a U.S. state to be able to access the Rule 147A capital market. This will create a uniform standard for companies that are operating locally, irrespective of their country or state of incorporation, to utilize the Rule 147A exemption. Form D filings for the period 2009-2015 reported that approximately 2.5% of Regulation D offerings (approximately 3,211 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.

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447 Robert Daines, "*Does Delaware Law Improve Firm Value?" J. FIN. ECON.*, Volume 62, Issue 3 (2001) at 525-558.

448 *See* Scott D. Dyreng, Bradley P. Lindsey, Jacob R. Thornock, "*Exploring the Role Delaware Plays as a Domestic Tax Haven*," *J. FIN. ECON.*, Volume 108, Issue 3, (2013) at 751-772 (explaining that Delaware's tax laws play an economically important role in U.S. companies' decision to locate in Delaware).

Allowing issuers to raise capital in the state in which it has its principal place of business, without regard to the jurisdiction of incorporation under new Rule 147A, could enable issuers to organize or incorporate in foreign jurisdictions with perceived advantages that may increase the financial viability of such issuers, especially for early stage companies. However, to the extent that it is more difficult to enforce securities and other relevant laws against such foreign organized or incorporated issuers, risks to investors in such issuers could increase. Overall, given the intrastate character of Rule 147A offerings, we do not think it likely that a significant number of foreign issuers will seek to utilize this exemption.

Under Rule 147 and Rule 147A, issuers will be able to have a "principal place of business" within only one state or territory, and therefore the issuer will be able to conduct an intrastate (Rule 147 or Rule 147A) offering in only one state or territory. To mitigate the risk of issuers switching their principal place of business to a different state in order to conduct Rule 147 or Rule 147A offerings in multiple states, the final rules 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 six months from the date of last sale of securities under the prior Rule 147 or Rule 147A offering. These provisions will 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. The duration of this limitation is consistent with the period for which resales to out-of-state investors will be prohibited.

To the extent a change in principal place of business to a new state is motivated by business or regulatory considerations, this amendment could affect the capital raising prospects of companies by requiring them to delay their subsequent intrastate offerings or seek to conduct an offering under another exemption. For example, certain start-ups and small businesses that could potentially relocate their principal place of business in pursuit of costs savings could be affected by the final rules.

c. Common Requirements of Amended Rule 147 and New Rule 147A

i. "Doing Business" In-State Tests

Similar to the proposed amendments, the final rules will modify the current "doing business" in-state requirements in Rule 147 by requiring issuers to satisfy one of four specified tests. A similar requirement will be included in Rule 147A. The specified tests will include a new test whereby issuers can satisfy the "doing business" requirement if a majority of their employees are located in the offering state. Specifically, under amended Rule 147 and new Rule 147A, in order to be deemed "doing business" in a state, issuers will have to 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 modifications to the existing "doing business" in-state tests will modernize the Rule 147 safe harbor and provide greater flexibility to potential issuers relying on Rules 147 and 147A to conduct intrastate offerings. This will ease issuer burden in complying with the provisions, while also better aligning the rules with modern business practices such that issuers will be able to use the test that best reflects the local nature of their business operations.[449]

Rule 147 currently requires issuers to satisfy all three "doing business" in-state tests, which can be burdensome even for small businesses that have a strong nexus to one state. For example, for some startups and early stage ventures that are unable to access alternate methods of raising capital and therefore seek to rely on the intrastate offering exemption, the existing "doing business" tests, by restricting these issuers' operations and capital investments substantially to one state may have adverse effects on their growth and viability. Moreover, in recent years new business models have emerged that may make satisfying all three tests ill-suited for issuers who would otherwise be able to rely on Rule 147 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.[450] 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.[451] Similarly, the growth of modern technologies has made it easier for companies, through *e*-commerce and shared logistical networks, to reach a larger and more diffused customer base, leading to more dispersed revenue streams.

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[449] *See also* CFA Letter.

[450] Consider the example of an *e*-commerce company that invests in distribution facilities outside its state to meet the needs of customers who are resident outside that state. Under current requirements, such an issuer may be able to invest only a small part (less than 20%) of the capital raised in a Rule 147 offering outside its principal state of business to remain eligible for the exemption. *See also* NASAA Letter.

[451] *See* Mohanbir Sawhney and Deval Parikh, "*Where Value Lives in A Networked World*," Harvard Business Review (2001).

Requiring an issuer to own a majority of its assets, invest most of the capital it raises, and obtain its revenue in one state could create inefficient constraints for startups and small businesses to operate and grow in the modern business environment. While the original intent of 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,[452] 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 changes, we believe that the modifications to the "doing business" requirements in the final rules will provide issuers with greater flexibility in conducting intrastate offerings and help to eliminate potential uncertainty about the availability of intrastate offering exemptions.

Compared to current Rule 147, the revised "doing business" requirements in the final rules will enable a greater number of companies to rely on Rule 147 or Rule 147A to raise capital through local offerings. Such new issuers could be those entities that are currently accessing capital through alternate means, or they could be issuers that could not previously raise sufficient amounts of capital in any market but would be able to use amended Rule 147 or new Rule 147A to meet their funding needs. In addition, to the extent raising capital in a Rule 147 or Rule 147A offering is less costly than raising capital using alternate means, issuers will benefit from such lower costs. Easier access to local capital may enable issuers to finance investment opportunities in a timely manner, thereby accelerating company growth and promoting state employment and economic growth.

As more companies become eligible or are willing to raise capital pursuant to amended Rule 147 or new Rule 147A, the set of investment opportunities for investors will also increase

[452] *See* Rule 147 Adopting Release.

in a corresponding manner, resulting in greater allocative efficiency and capital formation. These economic benefits generally depend on the extent to which increased use of the intrastate offering provisions, compared to current Rule 147, arises as a result of substitution out of other types of offerings. On one hand, if increased use of the intrastate offering provisions causes issuers and investors to migrate from other types of offerings as a result of marginally more attractive prospects for investment and capital raising, the aggregate increase in capital formation may not be significant but competition amongst types of private offerings will be higher.[453] On the other hand, if amended Rule 147 or new Rule 147A attracts new issuers, capital formation levels will increase in the economy. We believe that, by facilitating intrastate crowdfunding, the final rules could provide new company growth and consequently lead to an overall increase in capital formation. Further, the final rules could lead to increased capital formation by facilitating other state registered or exempt offerings, including those with amounts greater than what is allowed for intrastate crowdfunding 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 under amended Rule 147 or new Rule 147A.

At the same time, if issuers with assets and operations dispersed over more than one state make use of amended Rule 147 or new Rule 147A, there may be concerns that state oversight of such issuers could weaken, with a consequent reduction in investor protection. We believe, however, that qualifying under any one of the four "doing business" in-state tests and requiring an issuer to have its principal place of business in the state, such that the officers and managers of the issuer primarily direct, control and coordinate the activities of the issuer in the state, will

[453] We note that issuers that meet current requirements under existing Rule 147 will also be eligible to rely on amended Rule 147 or Rule 147A.

provide state regulators with a sufficient basis from which to monitor an issuer's activities and enforce state securities laws for the protection of their residents.[454] Further, state enforcement actions aimed at 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. Moreover, with the adoption of amendments to Rule 147 and new Rule 147A, state regulators may choose to amend their state regulations to comport with these provisions, which would allow them to consider any additional requirements, including qualification tests, for issuers to comply with state securities offerings regulations.

Finally, we note that the high threshold levels specified in the final rules' "doing business" tests may preclude certain issuers whose business models result in widely distributed operations (*e.g.*, some *e*-commerce companies) from qualifying under any of the four tests and thus from relying on these intrastate offering provisions. Such issuers could rely on alternate capital raising methods such as Regulation Crowdfunding. To the extent these issuers are unable to raise the required capital through alternate methods, these provisions could adversely impact capital formation and investment opportunities for such firms. We believe, however, that the vast majority of issuers will be able to satisfy the "doing business" test requirements in order to qualify for local capital-raising.

ii. Reasonable Belief and Written Representation As to Purchaser Residency Status

Amended Rule 147 and new Rule 147A include a reasonable belief standard for determining whether a purchaser is a state resident at the time of the sale of the securities. In a change from the proposed rules, the final rules will retain the requirement of current Rule 147

454 See also CFA Letter and NASAA letter.

that an issuer obtain investor representations as to his or her residency status. The reasonable belief standard is conceptually consistent with similar requirements in Regulation D offerings and will provide greater certainty to issuers as to their compliance with the conditions of the exemption, potentially encouraging greater reliance on the final rules.[455]

Retaining the written representation requirement could constrain issuer flexibility if the requirement predisposes them to rely on particular modes of residency verification over others.[456] It could also result in somewhat higher compliance costs for issuers. At the same time, the requirement could help to better ensure that issuers are selling to investors who are residents of the state in which the offering is being conducted. In this way, requiring a representation as to the purchaser's residency may mitigate some of the investor protection concerns raised by commenters.[457] While a formal representation of residency by itself is not sufficient to establish a reasonable belief that such purchasers are in-state residents, the representation requirement, together with the reasonable belief standard, may result in better compliance with the final rules, which would serve to increase investor protections. It is possible, however, that some issuers may consider a written representation to be dispositive of reasonable belief of investor's residency status, which would increase the risk of issuers' violating the final rules.

As an alternative, we considered providing a safe harbor for determining purchaser's residence, as requested by several commenters.[458] A safe harbor could provide greater certainty

455 *See* NASAA Letter.

456 For example, issuers may find it easier to obtain a proof of residency document directly from the purchaser along with a written representation, whereas they may have found it more efficient to rely on an alternate mode like third-party verification if a written representation was not required.

457 *See* CFA Letter, CrowdCheck Letter, NASAA Letter.

458 *See* CFIRA Letter; CrowdCheck Letter; Localstake Letter; WBA Letter.

for issuers as to their compliance with the rules' provisions, potentially encouraging greater use of the intrastate offering exemptions and enhancing capital formation. However, a safe harbor also could be viewed as an exclusive or a minimum standard that could restrict issuer choice of verification methods, and we believe that requiring issuers to consider the facts and circumstances of the offering and sale will best serve issuers' compliance with the final rules.

iii. Residence of Entity Purchasers

Amended Rule 147 and new Rule 147A 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 will 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.

iv. Limitations on Resales

Consistent with the proposal, amended Rule 147 and new Rule 147A will limit resales to in-state residents during a defined restricted period from the date of sale by the issuer. In a change from the proposed rules, this restricted period has been reduced from nine to six months. Current Rule 147 provides a restricted period of nine months, and the start date for the restricted period is from "date of *last* sale" rather than from the "date of sale" for the particular security in question. In addition, the issuers' ability to rely on Rules 147 and 147A will not be conditioned on a purchaser's compliance with the rules' resale restrictions.

Under the final rules, after expiration of the restricted period, investors will be able to sell their securities to out-of-state purchasers, even if the offering is not yet completed. While reducing the restricted period to six months may raise investor protection concerns, including concerns about increased probability that the securities will be purchased with an intention to distribute, we are persuaded by commenters that suggested a six-month period would be adequate to assure that the securities have come-to-rest in the state of issuance.[459] In addition, state regulators will have the flexibility to impose additional transfer restrictions under amended Rule 147 or new Rule 147A, if warranted within their jurisdiction. Additional language in amended Rule 147(e) and new Rule 147A(e) that specifies that all re-sales during this six-month restricted period will be limited to the state or territory in which the issuer is a resident at the time of the sale of the security by the issuer will help to maintain the intrastate nature of the offering even if the issuer relocates its principal place of business to a different state. The final rules, by shortening the restricted period, will provide greater liquidity for Rule 147 and Rule 147A securities, making them more attractive to investors, which could lead to greater investor participation and an increase in the supply of capital available in intrastate offerings. Further, it could improve price discovery and lead to lower capital raising costs for issuers.

Additionally, not conditioning the availability of amended Rule 147 or new Rule 147A on the issuer complying with the provisions relating to resale restrictions will provide greater certainty to issuers conducting an offering pursuant to these provisions. For example, issuers will not need to be concerned about potentially losing the exemption if the resale provisions are violated under circumstances that are beyond their control. At the same time, given that issuers will continue to be subject to other compliance requirements, 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 the final rules will not reduce investor protections.

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[459] *See* note 157. *See also* text accompanying notes 167 and 168.

Rule 147(f) and new Rule 147A(f) require disclosure of the resale restrictions to every offeree in the manner in which the offering is communicated. Compared to the requirements in current Rule 147, which require written disclosure of resale restrictions, these provisions will provide greater flexibility to issuers and ease compliance burdens in cases of oral offers, while potentially making it easier for investors to be made aware of the resale restrictions at the time an offer is made. This change will lower the regulatory burden for issuers, especially smaller issuers; however, where an offer is communicated other than in writing, it also may adversely impact the information provided to potential investors (offerees) because the investor may not receive such information in writing at the time an offering is initially made and being considered. To the extent that investors would be more likely to comprehend or heed written disclosures, these changes may adversely impact investor protection. This impact will be mitigated by the requirement to provide disclosure about resale restrictions, in writing, to every purchaser a reasonable period of time before the date of sale.[460]

Rule 147(f)(3) is also being amended 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 resale period, which also will ease compliance burdens for issuers. These changes are not expected to adversely affect investor protection, since the information in question relates to technical aspects of the securities transfer process and does not address securities ownership rights as such.

v. Integration

The final rules, similar to the proposed rules, will expand the current Rule 147 integration safe harbor such that offers and sales pursuant to amended Rule 147 or Rule 147A will not be

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460 *Id.*

integrated with: (i) any offers or sales of securities made prior to the commencement of the offering, (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. Compared to the integration safe harbor in current Rule 147, the expanded integration safe harbor in the final rules will provide issuers with greater certainty that they can engage in other exempt or registered offerings either prior to or near in time of an intrastate offering without risk of becoming ineligible to rely on Rule 147 or Rule 147A. Similarly, the addition of Section 4(a)(6) to the list of exempt offerings that will not be integrated with a Rule 147 or Rule 147A offering will provide certainty to issuers that they can conduct concurrent crowdfunding offerings as per the provisions of the respective exemptions. This flexibility and ensuing regulatory predictability will be especially beneficial for small issuers who likely face greater challenges in relying on a single financing option for raising sufficient capital. While the expanded scope of the integration safe harbor may raise concerns that an issuer could more easily structure a single transaction as a series of exempt offerings to avoid securities registration,[461] the final rules provide for non-integration only to the extent that the issuer meets the requirements of each of the offering exemptions being used to raise capital.[462] Furthermore, the final rules require an issuer to wait at least 30 calendar days between its last offer made to investors other than qualified institutional buyers or institutional accredited investors in reliance on Rule 147 or Rule 147A and the filing of a registration statement with the Commission, which will provide additional protection to investors in

[461] *See* NASAA Letter

[462] *See also* note 177.

registered offerings who might otherwise be influenced by an earlier intrastate offering. Therefore, we do not believe that the adoption of the integration safe harbor will result in reduced investor protections.

vi. Intrastate Broker-Dealer Exemption and Additional Considerations

We are also providing guidance regarding the use of the Internet by a person that seeks to rely on the intrastate broker-dealer exemption.[463] Our guidance clarifies that a person whose business otherwise meets the requirements of the intrastate broker-dealer exemption should not cease to qualify for the exemption solely because it has a website that may be viewed by out-of-state persons, so long as the broker-dealer takes measures reasonably designed to ensure that its business remains exclusively intrastate. This guidance will provide greater certainty to market participants about intermediaries' ability to participate in intrastate offerings that seek to raise capital via online media without having to register as a broker-dealer with the Commission. Such certainty may increase both the demand for and the supply of intermediaries in Rule 147 and Rule 147A offerings, which could facilitate a greater number of intrastate offerings, especially crowdfunding offerings. At the same time, despite the measures taken by broker-dealers that are reasonably designed to ensure that their businesses remain exclusively intrastate, the risk of non-compliance with the exemptions under Section 5 may somewhat increase for issuers if out-of-state investors, attracted by the intrastate broker's website, invest in the offering through misrepresentations of their residency status.

[463] Exchange Act Section 15(a)(1) exempts from broker-dealer registration requirements under Section 15(b) a broker-dealer whose business is exclusively intrastate and who does not use any facility of a national securities exchange.

vii. Alternatives Considered

The paragraphs below discuss major alternatives that we considered in addition to the alternatives discussed in the individual sub-sections above.

(a) "Doing Business" Tests

As an alternative to the "doing business" tests in the final rules, we considered lowering the percentage thresholds for the existing tests but retaining the requirement that all tests be satisfied. For example, compared with the current 80% threshold requirements, requiring issuers to have the majority of their assets, derive the majority of their revenue, and 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, while still providing some indicia of the in-state nature of the issuer's business.[464] Such a change would also provide a consistent standard for the "doing business" tests in Rule 147 and Rule 147A, aligning the current tests with the new majority employees test and tests from other rules that use a majority threshold for determining issuer status, such as the test for determining foreign private issuer status.[465] In this way, such an alternative could encourage greater reliance on Rule 147 and Rule 147A and thereby promote additional capital formation through exempt intrastate offerings. However, lowering the percentage thresholds would necessarily weaken the required nexus between the issuer and the state contemplated by current Rule 147 and Section 3(a)(11). To the extent that such a change would result in less effective state regulation, there could be increased concerns that investor protections in exempt intrastate offerings may be reduced.

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[464] *See, e.g.*, Milken Letter.

[465] *See* Securities Act Rule 405 and Exchange Act Rule 3b-4.

As another alternative to the final rules, we considered eliminating the requirement to qualify under any of the "doing business" tests. This alternative would significantly ease the burden for potential issuers in complying with Rules 147 and 147A, while also modernizing the rules to better align them with current 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 intrastate exemptions as a capital raising option. In view of broad changes in modern business practices, the principal place of business requirement may be sufficiently effective in establishing the local nature of an offering pursuant to Rule 147 or Rule 147A for purposes of compliance with the "doing business" in-state requirement at the federal level. The alternative will enable a larger number of issuers to qualify under the intrastate exemptions, which could increase capital formation. Relative to the adopted approach, this alternative also could 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 imposing a uniform approach at the federal level that may function more effectively in some states than others.

However, eliminating the "doing business" tests could allow issuers with widely-dispersed operations over more than one state or even no business operations (besides having a principal place of business in-state) to make greater use of amended Rule 147 or new Rule 147A. Without sufficient local presence or an appropriate nexus with the issuer and the state, local oversight of such issuers could weaken, with a consequent decrease in investor protection. Although 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, as well as by the ability of states to extend their enforcement activities to issuers whose assets are located beyond state borders, we believe the approach we are adopting in the final rules will provide issuers with sufficient flexibility to satisfy these requirements, while maintaining important indicia of the in-state nature of the issuer's business. As noted above, given the other changes we are adopting to modernize our exemptive framework for intrastate offerings, we believe it is appropriate to first observe how the updated doing business in-state requirements are used by issuers in practice before making any further changes

(b) State Law Requirements and Additional Federal Restrictions

In a change from the proposed rules, the final rules will not require that the offering be registered under state law or conducted pursuant to a state law exemption that limits the amount of securities an issuer may sell pursuant to amended Rule 147 or new Rule 147A and the amount of securities than can be purchased by an investor in the offering. These requirements, as proposed, could provide additional protections at the federal level and could mitigate investor protection concerns that may arise from the modernization of the federal regulatory regime applicable to intrastate offerings. However, as noted by some commenters, conditioning the final rules on specified state law requirements would reduce the flexibility of state regulators to design rules that best conform to the requirements of issuers and investors in their states and, by imposing a uniform standard, could disadvantage certain jurisdictions relative to others.[466] Such requirements could thus unduly restrict capital raising options of issuers, especially those issuers that sell primarily to accredited investors, and could also restrict legitimate state interests in permitting larger offerings within their jurisdictions that otherwise rely on the federal intrastate exemptions.

466 *See* CFIRA Letter, Milken Letter, NASAA Letter, NextSeed letter. See also ABA Letter stating that such limits would be inconsistent "with Congressional intent that local offerings do not require federal regulation and are best left to be regulated by the states".

We also note that the maximum amount that can be raised under existing intrastate crowdfunding provisions is less than the limit of $5 million that was proposed as a limit on certain intrastate offerings. Most of these states have also adopted provisions that impose investment limitations on investors. Thus, the protections provided by such limitations will remain available to investors in many intrastate crowdfunding offerings. States also retain the flexibility to enact additional measures under state law to strengthen issuer eligibility requirements for intrastate offerings.

We recognize that conditioning the federal exemption on certain state law exemptions or requirements could raise concerns that the provisions will be utilized to conduct offerings in states that lack sufficient investor protection safeguards, leading to a "race-to-the-bottom" between state legislators and regulators through significant easing of compliance provisions in order to attract more issuers. We believe, however, that such an outcome may be unlikely because state legislators and regulators have economic and reputational incentives to provide local issuers and investors with robust capital markets that are sustainable over the long run. Robust competition between states to enact securities laws that attract issuers to their territories would result in better regulations that promote effective functioning of local financial markets among the states, issuers and investors.

We also considered excluding certain types of issuers from relying on Rule 147 or Rule 147A, since it is likely that intrastate offerings and, especially crowdfunded offerings, may have a large proportion of retail investors.[467] Further, we also considered whether to extend bad actor disqualification provisions to these rules, similar to the provisions under Rule 506(d) of

467 *See* NASAA Letter.

Regulation D.[468] Such provisions could enhance investor protections and promote regulatory consistency with other unregistered offering exemptions. However, these provisions are already a feature of most state crowdfunding exemptions, and additional restrictions at the federal level could reduce states' flexibility in enacting provisions that work best for their local jurisdictions. In this regard, we believe that states are well positioned to determine whether these or additional requirements are necessary in their jurisdictions.

(c) Exemption from Section 12(g) Requirements

Amended Rule 147 and new Rule 147A do not exempt securities issued in intrastate crowdfunding from reporting requirements under Section 12(g) of the Exchange Act.[469] As crowdfunded offerings are purchased in small amounts by a relatively large number of investors, issuers using Rule 147 or Rule 147A for state crowdfunding offerings may exceed record holder thresholds that trigger registration requirements under Section 12(g). In contrast to intrastate crowdfunding offerings, securities issued under Regulation Crowdfunding do not count toward the record holder thresholds for triggering registration under Section 12(g), subject to certain conditions. This may place an additional regulatory burden on Rule 147 and Rule 147A issuers, making them less likely to initiate intrastate crowdfunding offerings. As an alternative to the final rules, an exemption from the registration requirements under Section 12(g) for intrastate crowdfunded offerings could encourage issuers to rely on Rule 147 or Rule 147A by allowing such issuers to delay registration, and thereby avoid the regulatory obligations of ongoing reporting requirements under the Exchange Act.[470] However, as Rule 147 and Rule 147A issuers

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468 *Id*.

469 *See* Section II.C. above.

470 *See* CFIRA Letter, CrowdCheck Letter, Guzik Letter, Milken Letter. *See also* 2015 Small Business Forum Recommendations.

will not be required to submit financial reports on an ongoing basis, such a provision may result in less information about these issuers being available to the market to the possible detriment of existing and prospective investors. Such concerns are mitigated under Regulation Crowdfunding as issuers relying on that exemption are required to file ongoing financial reports with the Commission. Under Rule 147 and Rule 147A, however, issuers will not be subject to any federal ongoing reporting requirements, which could make the additional protections provided by registration under Section 12(g) especially beneficial to the issuers' investors.

3. Analysis of Amendments to Rule 504

The final rules related to Rule 504 will increase the maximum aggregate amount that can be raised under a Rule 504 offering, in a 12-month period, from $1 million to $5 million and will disqualify certain bad actors from participation in Rule 504 offerings. Additionally, in order to account for the increase in the Rule 504 aggregate offering amount limitation, we are adopting technical amendments to the notes to Rule 504(b)(2) that will update the current illustrations in the rule regarding how the aggregate offering limitation is calculated in the event that an issuer sells securities in multiple offerings pursuant to Rule 504, within the same twelve-month period.[471] All other provisions of current Rule 504 of Regulation D will remain unchanged.

a. Increase in Maximum Aggregate Amount to $5 million

As shown in the 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. Compared 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 accredited investors and up to 35 non-accredited investors, capital raising activity

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

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.[472] Given the high 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 company. Angel investments in 2015 amounted to approximately $25 billion, and the average angel deal size was approximately $346,000.[473] According to PWC MoneyTree, in 2008, U.S. VCs made $1.5 billion of seed investments in 440 companies.[474] This represents 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 investments at the seed stage have included investments as large as $2.5 million per entity.[475] Given these changes, amending the Rule 504 offering size from $1 million to $5 million would better comport with market trends that indicate demand for larger seed capital infusions.

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472 *See* Seed Capital Release.

473 According to a recent report, angel investments amounted to $24.6 billion in 2015, with approximately 71,100 entrepreneurial ventures receiving angel funding and approximately 304,930 active angel investors. Seed/startup stage investments accounted for approximately 28% of the $24.6 billion. *See* Jeffrey Sohl, *The Angel Investor Market in 2015: A Buyer's Market*, Center for Venture Research, May 25, 2015, *available at* https://paulcollege.unh.edu/sites/paulcollege.unh.edu/files/webform/Full%20Year%202015%20Analysis%20Report.pdf.

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

475 *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"

Four parallel developments may further change the regulatory landscape surrounding existing Rule 504. First, the use of current Rule 504 could be diminished by interstate crowdfunding offerings pursuant to Regulation Crowdfunding, which allows issuers to raise up to $1 million over a 12-month period with unlimited access to non-accredited investors, permits general solicitation, and provides preemption from state regulation and exemption from Exchange Act reporting, subject to certain conditions. Second, at least 34 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 three states allow issuers to conduct intrastate crowdfunding under the Rule 504 exemption.[476] 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 regional crowdfunding offerings under state law.[477] Since amended Rule 147 and new Rule 147A will be restricted to intrastate offerings, Rule 504 will be the most likely federal exemption that could be used for such regional offerings.

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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.

476 Maine's provisions currently permit interstate crowdfunding utilizing the Rule 504 exemption, and Mississippi and Vermont dually offer intrastate crowdfunding under Section 3(a)(11) and interstate crowdfunding under Rule 504. *See* NASAA Letter.

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

Fourth, Tier 1 of amended Regulation A, which became effective in June 2015 and has similar eligibility criteria as Rule 504, allows offerings up to $20 million without any restrictions on resale of 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 rely on the exemption.[478] To the extent that amended Rule 504 permits issuers to raise larger amounts of capital at lower costs than other unregistered capital markets, the final rules 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 shift to the amended Rule 504 market. Such potential trends would increase competition for supply of and demand for capital between the different unregistered markets, especially the exemptions pursuant to amended Rule 147, Rule 147A, Rule 506 of Regulation D, Regulation A, Regulation Crowdfunding, and Sections 4(a)(2) and 3(a)(11). Further, modernizing our exemptive scheme in order to provide issuers, and especially small businesses, with more viable options for capital raising could foster an environment that encourages new market participants with promising ventures to enter the capital markets, thereby enhancing the overall level of capital formation in the economy and investment opportunities. The amendments could also encourage new

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[478] *See* CFA Letter, CFIRA Letter, NASAA Letter.

interstate and regional approaches to crowdfunding and other offering methods[479] and lead to greater coordination for regional review of capital raising options.

Increasing the Rule 504 offering amount limit could also increase the number of investors (including non-accredited investors) that can access such exempt offerings, thereby providing them with a wider array of investment opportunities to diversify their investment portfolios. This, in turn, could have positive effects on the supply of capital and the allocative efficiency of unregistered capital markets. To the extent that non-accredited investors are less capable of evaluating investment opportunities than accredited investors,[480] an increase in the number of Rule 504 offerings could raise investor protection concerns.

A higher offering amount limit, together with a potential increase in the number of investors that can access Rule 504 offerings, may raise concerns about a potential increase in the incidence of fraud under the final rules. The Commission's experience with the elimination of the prohibition against general solicitation for Rule 504 offerings in 1992[481] and its subsequent reinstatement in 1999 as a result of heightened fraudulent activity[482] illustrates the potential for fraud in the Rule 504 market. It should be noted, however, that in 1998 and 1999 the Commission concluded that the increase in fraud occurred because of rule provisions that permitted general solicitation of investors and free transferability of issued securities.[483] As a

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479 *Id*.

480 *See* Staff of the U.S. Securities and Exchange Commission, Report on the Review of the Definition of "Accredited Investor" (Dec. 18, 2015) at 43-46 *available at* https://www.sec.gov/corpfin/reportspubs/special-studies/review-definition-of-accredited-investor-12-18-2015.pdf (describing criticisms of the current definition of accredited investor).

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

482 *See* Seed Capital Release.

483 *Id. See also* Proposed Revision of Rule 504 of Regulation D, the "Seed Capital" Exemption, No. 33-7541 (May 21, 1998). As the Commission noted at the time it proposed to eliminate the unrestricted status 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

result, under that regime, a non-reporting company was able to 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 final rules will only increase the aggregate offering amount limitation of Rule 504, thereby retaining existing restrictions on general solicitation and the restricted securities status of most offered securities. State registration requirements may also mitigate the risk for investor abuse in Rule 504 offerings.

Enforcement cases over the past several years involving Rule 504 offerings could also raise concerns about the potential for increased incidence of fraud under the final rules. 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.[484] Securities issued in reliance on Rule 504(b)(1)(iii) are exempt from state registration, and issuers relying on the exemption are permitted to market the securities using general solicitation so long as sales are made only to accredited investors.[485] 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 concerns could be

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, the Commission 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 the Commission recognized that resale restrictions would have "some impact upon small businesses trying to raise 'seed capital' in bona fide transactions," it 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."

484 *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).

485 The extent to which general solicitation may be used in connection with an offering conducted in reliance on Rule 504(b)(1)(iii) will depend on the specific state exemption being relied upon. In this regard, the NASAA Model Accredited Investor Exemption specifies that only a tombstone ad may be used in making a

mitigated by the inclusion of bad actor disqualification provisions in Rule 504, as discussed below.

b. Bad Actor Disqualification Provisions and Additional Amendments

The amendments to Rule 504 will include bad actor disqualification provisions that are substantially similar to related provisions in Rule 506 of Regulation D. [486] Consistent with Rule 506(d), the final rules will require that the covered person's status be assessed at the time of the sale of securities. As in Rule 506(d), the disqualification provisions will not preclude the participation of bad actors whose disqualifying events occurred prior to the effective date of the final rules, which could expose investors to risks that arise when bad actors are associated with an offering. However, similar to Rule 506(e), issuers will be required to disclose bad actor disqualifying events that occurred prior to the effectiveness of the final rules. The risks to investors from participation of covered persons who otherwise would be disqualified may therefore be partly mitigated as investors will have access to relevant information that could inform their investment decisions. Disclosure of prior bad actor disqualifying events may make it more difficult for issuers to attract investors, and as a result, issuers may experience a similar impact to being disqualified. 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.[487] If disqualification

general solicitation. *See* Model Accredited Investor Exemption, available from the NASAA website at http://www.nasaa.org/wp-content/uploads/2011/07/24-Model_Accredited_Investor_Exemption.pdf..

486 *See* Rule 506(d) of Regulation D, 17 CFR 230.506(d).

487 *See also* ABA Letter, CFA Letter.

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 on such persons 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 subject to regional coordinated review programs that could be registered in one jurisdiction but offered and sold in multiple other 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. Similarly, other covered persons may experience reductions in revenue or market share (for market intermediaries) or demotion or termination of employment or other limitations on career advancement (for individuals) as a result of disqualification from Rule 504 offerings. In addition, issuers may incur costs and transactional delays 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.

The final rules will provide, by reference to Rule 506(d), a reasonable care exception, similar to other exemptions and safe harbors 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, compared with an alternative of not providing a reasonable care exception, 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 will create a more consistent regulatory regime under Regulation D that will simplify due diligence requirements and thereby benefit issuers and investors that participate in different types of exempt offerings.[488]

The amendment to Rule 504(b)(2) will update the current illustrations of how the aggregate offering limitation is calculated in the event that an issuer sells securities in multiple offerings pursuant to Rule 504 within the same twelve-month period. By enabling market participants to calculate more easily the amounts permitted to be sold, this amendment will facilitate issuer compliance with the increased aggregate offering limitation.

c. Alternatives Considered

As an alternative to the final rules, we considered raising the offering limit under Rule 504 to an amount less than $5 million. For example, adjusted for inflation, the $1 million in

[488] *See* NASAA Letter.

1988 would equate to approximately $2 million today.[489] 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. 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 could limit the use of Rule 504 as a capital raising option for issuers.

We also considered increasing the maximum offering limit under amended Rule 504 to an amount greater than $5 million. For example, we could align the maximum offering limit to that of the Tier 1 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-accredited investors have no investment limits under the Rule 504 provisions. Moreover, enforcement cases over the past several years have highlighted instances of fraud in Rule 504(b)(1)(iii) offerings.[490] A higher maximum offering amount may thus lead to greater investor protection concerns.

In light of concerns about potential abuses involving securities issued in reliance on Rule 504(b)(1)(iii),[491] we considered, as an alternative, to impose resale restrictions on such securities. This 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 specified time period. However, these restrictions would reduce the liquidity of Rule

[489] Annual inflation rates (1988-2015) based on consumer price index data, for all urban consumers, obtained from the Bureau of Labor Statistics. *See* http://data.bls.gov/cgi-bin/surveymost?cu.

[490] *See* note 484 and related discussion above.

[491] *Id*.

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 somewhat greater investor interest and lower the expected risk premium, which would mitigate, to some extent, the higher costs arising from less liquid securities. We note that states are free to enact additional restrictions in such offerings if they deem them necessary or appropriate.

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

4. Analysis of Repeal of Rule 505

The final rules also eliminate the exemption under Rule 505 of Regulation D. Rule 505, like Rule 504, was created under Section 3(b)(1) of the Securities Act to exempt offerings of up to $5 million over a 12-month period. As discussed in the baseline analysis, reliance on Rule 505 is much less frequent than even Rule 504 and has declined steadily in the past 15-20 years in terms of the number of new offerings and the amount of capital raised.[492]

We believe that amended Rule 504, by allowing offerings up to $5 million, will likely further diminish the utility of current Rule 505 for issuers that are currently eligible to use both

[492] During the period 2009-2015, there were 1,588 new offerings of less than or equal to $5 million by non-fund issuers that relied on Rule 505 compared to 64,862 such offerings that relied on Rule 506. Including offerings in which the issuer checked both the Rule 505 and Rule 506 exemptions on the Form D (2,170 new offerings), the proportion of Rule 505 offerings in Regulation D offerings rises from 2% to 5.3%. *See* Section V.A.2 and Table 5.

exemptions because Rule 504 provides access to an unlimited number of non-accredited investors and restricted access to general solicitation.[493] Other exemptions from registration may also provide an alternative to Rule 505 offerings. For example, Rule 506(b) enables issuers to raise unlimited amounts of capital along with providing preemption from state registration, although being limited to 35 non-accredited investors who need to be sophisticated, either individually or through a purchaser representative. Similarly, while Regulation A offerings have greater disclosure requirements, they may be sold to non-accredited investors and have the added benefit of unrestricted resales of securities. We recognize that reporting companies that are potential Rule 505 issuers may find it relatively harder to shift to another type of unregistered offering as they are excluded from using Rule 504, Regulation A and Regulation Crowdfunding. Such issuers, however, constitute a small proportion of current Rule 505 issuers and, absent disqualifying bad actor events, could likely avail themselves of Rule 506. Alternatively, Rule 505 issuers, particularly those that are reporting companies, could also raise capital through a registered offering if they seek investment from non-accredited investors and investors who prefer securities issued through registered offerings. In view of recent changes to Form S-1[494] and the availability of shelf registration to eligible reporting issuers, the costs of raising capital through a registered offering for issuers that are reporting companies, may be comparable to costs of a Rule 505 offering that solicits non-accredited investors and requires registration under state regulations. Whether Rule 505 issuers, particularly those that are reporting companies, switch to an unregistered offering such as a Rule 506 offering or a registered offering will depend on how these issuers assess the costs of registration relative to benefits such as broader

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493 Unlike offerings conducted pursuant to Rule 506, Rule 504 and Rule 505 offerings are subject to state securities law registration and qualification requirements.

494 *See* note 435 above.

access to non-accredited investors and investors who prefer securities issued through registered offerings.[495]

The impact of the elimination of Rule 505 will depend on whether issuers are able to access alternate capital markets and raise the desired amount of capital at a comparable cost and in a timely manner, as they would in the current Rule 505 market. To the extent that issuers are not able to raise sufficient or any amount of capital in such alternate markets, overall capital formation in the economy and allocative efficiency of capital markets could decline. We believe that Rule 505 issuers likely will be able to shift to other exemptions or alternately to follow-on registered offerings in case of issuers that are reporting companies, at little or no additional cost. In the short term, the repeal likely will increase competition amongst markets for attracting potential Rule 505 issuers and investors, but in the long-run, it may decrease the overall level of competition amongst the various capital markets to attract new issuers and investors.

As discussed above, the impact on efficiency, competition and capital formation of the repeal of Rule 505 also will depend on investor willingness and ability to purchase in an alternate unregistered capital market. For example, unsophisticated investors that may be eligible to purchase in a Rule 505 offering may not be able to purchase in a Rule 506 offering and hence may find their set of investment opportunities reduced. Further, as Rule 506 offerings are preempted from state registration, potential Rule 505 investors may be reluctant to purchase in a Rule 506 offering once Rule 505 is repealed, due to investor protection concerns. Similarly, Rule 504 offerings are subject to fewer investor disclosure requirements at the federal level, relative to a Rule 505 offering, that could also raise potential investor protection concerns. The net impact on the overall level of investor participation could thus depend on the type of offering

495 *See* discussion in Section V(B)(1) and note 436.

that primarily substitutes for the repealed Rule 505 market.

Overall, we believe that the repeal of Rule 505 will not have a significant impact or any impact on capital formation because issuers will likely be successful at finding commensurate capital supply in an alternate unregistered capital market. Repeal of Rule 505 will streamline the existing exemptive framework to provide a clearer and less complex set of rules and regulations for the issuer to choose among.

As an alternative to the repeal of Rule 505, we considered increasing the maximum amount that can be raised over a period of 12 months to a higher amount. For example, adjusting for inflation, $5 million in 1988 would equate to approximately $10 million today. Retention of Rule 505 with a higher offering limit would allow issuers (in contrast to Rule 506) to access to up to 35 non-accredited investors without having to ensure that these investors are sophisticated investors. It would also allow reporting companies (in contrast to Rule 504) to avail themselves of the exemption for raising capital. However, we believe that in view of the widespread use of Rule 506 and the decreased use of Rule 505 in capital formation in the Regulation D market, a higher ceiling is not likely to increase reliance on the exemption.

VI. PAPERWORK REDUCTION ACT

A. Rules 147(f)(1)(iii) and 147A(f)(1)(iii)

Rule 147 and new Rule 147A contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[496] Specifically, Rules 147(f)(1)(iii) and 147A(f)(1)(iii) each contain a provision requiring issuers relying on the rules to "obtain a written representation from each purchaser as to his or her residence." There are two titles for these collection of information requirements. The first title is: "Rule 147(f)(1)(iii) Written

[496] 44 U.S.C. 3501 *et seq.*

Representation as to Purchaser Residency," a new collection of information. The second title is: "Rule 147A(f)(1)(iii) Written Representation as to Purchaser Residency," a new collection of information. We are requesting comment on these collection of information requirements in this adopting release, and intend to submit these requirements to the Office of Management and Budget ("OMB") for review in accordance with the PRA and its implementing regulations.[497] If approved, responses to the new collection of information requirement would be mandatory for issuers seeking to rely upon the rules to conduct exempt intrastate offerings. An agency may not sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

In the Proposing Release, we solicited comment on our proposal to eliminate the requirement in Rule 147(f)(1)(iii) to obtain a written representation as to the purchaser's residency. In response to comments received, we have decided not to eliminate the requirement and are adopting an identical requirement in new Rule 147A(f)(1)(iii) under the Securities Act.[498]

Both Rule 147(f)(1)(iii) and new Rule 147A(f)(1)(iii) will require the issuer to obtain from the purchaser a written representation as to the purchaser's residency. The representation is not required to be presented in any particular format, although it must be in writing. Representations obtained by the issuer are not required to be kept confidential, and there is no mandatory retention period. The hours and costs to the issuer and purchaser associated with preparing, furnishing, obtaining and collecting these written representations constitute paperwork

497 In the Proposing Release, we did not submit a PRA analysis because we proposed to eliminate the written representation requirement in Rule 147(f)(1)(iii), and our other proposed amendments to Rule 147 did not contain a "collection of information" requirement within the meaning of the PRA. At this time, we do not have any comments regarding overall burden estimates for the final rules. This release is requesting such comments.

burdens and costs imposed by these collection of information requirements.

The required written representation by the purchaser as to his or her residence is identical under both Rule 147(f)(1)(iii) and new Rule 147A(f)(1)(iii). Similarly, both rules define the residence of the purchaser in the same manner, as follows:

> (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 the offer and sale to it, it has its principal place of business within such state or territory. Principal place of business is defined as the state or territory in which the officers, partners or managers of the issuer primarily direct, control and coordinate the activities of the issuer.
>
> (2) Individuals shall be deemed to be residents of a state or territory if such individuals have, at the time of the offer and sale to them, their principal residence in the state or territory.

We expect that the determination of a purchaser's residence will be easiest for natural persons.[499] This determination may be more difficult for purchasers who have more than one place of residence. We also expect this determination to be more difficult for purchasers who are legal entities, such as corporations, partnerships, limited liability companies and trusts which will have to undertake a factual inquiry to determine in what state or territory their "principal place of business" is located.

We anticipate that the requirement for issuers to obtain a written representation from each purchaser as to his or her residence, as required under Rule 147(f)(1)(iii) and Rule

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[498] *See* text accompanying notes 119, 120, and 121 above.

[499] *See* Section II.B.2(c) above.

147A(f)(1)(iii), will result in a burden and cost to issuers to meet these requirements in order to sell securities in an exempt intrastate offering. For purposes of the PRA, for each of Rule 147 and Rule 147A, we estimate that the total annual paperwork burden for all affected issuers arising from this collection of information requirement will be approximately 175 hours of issuer (company) personnel time and approximately $70,000 for the services of outside professionals at an average cost of $400 per hour.

Similarly, we anticipate that the written representation required by purchasers, including the obligation to determinate the state or territory of their residence, as required under Rule 147(f)(1)(iii) and Rule 147A(f)(1)(iii), will result in a burden incurred by purchasers in order to purchase securities in an exempt intrastate offering. For purposes of the PRA, for each of Rule 147 and Rule 147A, we estimate that the total annual paperwork burden for all affected purchasers arising from this collection of information requirements will be approximately 1,750 hours of purchaser time and no cost incurred for the services of outside professionals.

In deriving our estimates, we assume that:

- Approximately 700 issuers[500] will conduct a Rule 147 and Rule 147A offering each year, respectively, and each issuer will spend an average of fifteen minutes to obtain and collect the written representation from each purchaser in the offering as to his or her state or territory of residence;
- Each of the approximately 700 issuers will retain outside professional firms to spend an average of fifteen minutes helping the issuer comply with this

[500] We rely upon the number of offerings under Rules 504 and 505 of Regulation D for the year ended December 31, 2015 as a proxy for the average annual number of offerings under Rule 147 and new Rule 147A. Based on staff analysis of Form D filings, there were 519 new Form D filings reporting reliance on Rule 504 and 179 new Form D filings reporting reliance on Rule 505 in 2015. *See* Figure 1 in Section

requirement to obtain and collect the written statement of residency from each purchaser in the offering at an average cost of $400 per hour;

- Each Rule 147 and Rule 147A offering will have an average of approximately 10 purchasers of securities, resulting in approximately 7,000 purchasers per year for each exemption; and
- Each purchaser in a Rule 147 and Rule 147A offering will spend an average of approximately fifteen minutes preparing a written statement of residency to provide to the issuer and will incur no cost for the services of outside professionals to satisfy this requirement.

Since Rule 147 does not require the issuer to file any type of notice form with the Commission, it is difficult to determine accurately the number of Rule 147 offerings conducted annually or estimate the annual number of offerings that will be made in reliance on the updated rule and the new Rule 147A exemption. As a result, we are using the number of offerings made in reliance on the exemptions in Rules 504 and 505 of Regulation D for the year ended December 31, 2015 as a proxy to estimate the average annual number of Rule 147 offerings, given that both Rule 147 and Rules 504 and 505 provide exemptions to Securities Act registration designed to facilitate smaller issuers raising seed capital. Given that Rule 147A is very similar to Rule 147, as amended, we are using this same methodology and estimate for the number of offerings under newly adopted Rule 147A.

It is also difficult to provide any standardized estimates of the burdens and costs involved for the issuer to obtain and collect these written statements of purchaser residency. We expect,

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V.A.1, above. For purposes of these PRA estimates, we estimate that an average of 700 issuers will conduct a Rule 147 and new Rule 147A offering each year, respectively.

however, that the burdens and costs to issuers may be higher or lower depending on the size of the offering and the number of purchasers acquiring securities in the offering, which may, in turn, be affected by the state or territory where the offering occurs.

These estimates include the time and cost to the issuer to implement a system to obtain and collect the written statements of residency by purchasers in their offerings, including the preparation of written materials, such as subscription agreements or questionnaires to potential purchasers. These estimates also include the time and cost incurred by an issuer's in-house and outside counsel and executive officers of collecting these written statements received from purchasers in their offerings.

In deriving our estimates, we recognize that these burdens and costs will likely vary among issuers based on the size of their offerings and the number of purchasers acquiring securities in their offerings. We believe that some issuers will experience burdens and costs in excess of these estimated averages and other issuers may experience less than these estimated average burdens and costs.

Similarly, it is difficult to provide any standardized estimates of the burdens and costs to purchasers in determining their state or territory of residence and preparing their related written statements of residency to the issuer. We expect, however, that the burden to purchasers may be higher or lower depending on whether the purchaser is a natural person or legal entity, and, if a legal entity, the extent of the entity's activities in other states or territories. If a legal entity, we realize there may be a wide range of management structures, involving management teams potentially residing in multiple states or territories, thereby complicating the determination of the purchaser's principal place of business.

These estimates include the time and cost to the purchaser to determine the purchaser's state or territory of residence and prepare a written statement of residency for the issuer. In the case of purchasers who are legal entities, these estimates also include the time and cost incurred by purchasers' in-house counsel and executive officers to undertake a factual inquiry to determine the state or territory of the purchaser's principal place of business.

In deriving our estimates, we recognize that the burdens and costs will likely vary between natural person and legal entity purchasers. In the case of purchasers who are legal entities, these burdens and costs will be based on a number of factors, including the location and structure of their management teams. We believe that some natural person and legal entity purchasers will experience burdens and costs in excess of our estimated averages, and that others may experience burdens and costs less than our estimated averages.

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 collections of information are 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 the burden of the collections 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 collections 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 Commission by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/final.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-22-15 on the subject line; or
- Use the Federal eRulemaking 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.

Comments should be received on or before: [INSERT DATE THAT IS 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]. Comments submitted in response to this notice will be summarized and/or included in the request for OMB approval of this information collection; they also will become a matter of public record.

B. Amendments to Rule 504 of Regulation D

The 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 amendments. The first title is: "Form D" (OMB Control No. 3235-0076), an existing collection of information.[501] The second title is: "Regulation D Rule 504(b)(3) Felons and Other Bad Actors Disclosure Statement," (OMB Control No. 3235-0746), a new collection of information. Although the amendments to Rule 504 do not alter the information requirements set forth in Form D, the amendments are expected

[501] 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).

to increase the number of new Form D filings made pursuant to Regulation D. Additionally, the mandatory bad actor disclosure provisions that will be required under Rule 504 contain "collection of information" requirements within the meaning of the PRA. We published a notice requesting comment on these collection of information requirements in the Proposing Release, and we submitted the proposed amendments to the Office of Management and Budget ("OMB") for review and approval in accordance with the PRA and its implementing regulations.[502] While several commenters provided qualitative comments on the possible costs of the proposed amendments, we did not receive comments on our PRA analysis and thus are adopting our estimates substantially as proposed, except as otherwise noted herein.

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 applied 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 assigned a control number to the new collection, as specified above. Responses to the new collection of information will be mandatory for issuers raising capital under Rule 504 of Regulation D.

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

502 44 U.S.C. 3507(d); 5 CFR 1320.11.

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 the amendments are not altering the information requirements of Form D, the 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 amendments to Form D. However, we estimate that the 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. We do not believe this increase will be materially offset by a decrease in the number of Form D filings that are made with the Commission attributable to our repeal of Rule 505 of Regulation D.

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)[503]	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	25,900	4	103,600	25,900	77,700	$31,080,000

For the year ended 2015, there were 22,854 new Form D filings. The annual number of new Form D filings rose from 13,764 in 2009 to 22,854 in 2015, an average increase of approximately 1,515 Form D filings per year, or approximately 9%. Assuming the number of Form D filings continues to increase by 1,515 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 25,900.

We estimate that the amendments to Rule 504 will 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 six years. To estimate how the amendments to Rule 504 will 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 Rule 144(d) under the Securities Act[504] to reduce the holding period for restricted securities from two years to one year,[505] thereby increasing the attractiveness of Regulation D offerings to investors and to issuers. Prior to

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503 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 have prepared a new estimate based on the historical trend of the annual number of new Form D filings. Based on an average increase of approximately 1,515 new Form D filings per year over the past six years, we believe that the average number of new Form D filings in each of the next three years will be approximately 25,884, or 25,900 rounded to the nearest hundredth.

504 17 CFR 230.144(d).

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

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 amendments, we estimate for purposes of the PRA that there will be a similar 20% increase over the number of new Form D offerings that relied on either Rule 504 or 505 in 2015 after the amendments become effective.[506] In 2015, there were 519 new Form D filings reporting reliance on Rule 504 and 179 new Form D filings reporting reliance on Rule 505.[507] We estimate that there will be approximately 100 new Form D filings in each of the next three years attributable to the amendments.[508]

Based on these increases, we estimate that the total 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 will be 26,000 hours of issuer personnel time and $31,200,000 for the services of outside professionals.

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506 We include the number of new Form D filings that rely on Rule 505 in these estimates since we are repealing Rule 505, which has provided an alternative Regulation D exemption available for both non-reporting and reporting issuers under the Exchange Act. Rule 505 has a maximum offering limitation of no more than $5 million in a twelve month period. We believe that issuers who are non-reporting under the Exchange Act that have previously relied upon Rule 505 will rely upon Rule 504 upon effectiveness of the amendments, which will raise the maximum offering limitation under Rule 504 from $1 million to $5 million. Reporting issuers under the Exchange Act, who would have otherwise relied upon Rule 505, will now have to rely upon Rule 506 of Regulation D, once the repeal of Rule 505 becomes effective, since Rule 504 is unavailable to reporting issuers.

507 Only 10 of the 179 new Form D filings that reported reliance on Rule 505 in 2015 were filed by reporting issuers under the Exchange Act. The remaining 169 new Form D filings were filed by non-reporting issuers.

508 We estimate the number of new Form D filings attributable to the amendments over the next three years, as follows: 698 new Form D filings in 2015 relying on either Rules 504 or 505, less 10 new Form D filings made by reporting issuers under Rule 505 in 2015, multiplied by 20%, equals 138. Rounding 138 to the nearest hundredth provides an estimate of 100 new Form D filings attributable to the amendments.

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

	Number of responses (A)[509]	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	26,000	4	104,000	26,000	78,000	$31,200,000

<u>Regulation D Rule 504(b)(3) Felons and Other Bad Actors Disclosure Statement (OMB Control No. 3235-0746)</u>

Under the amendments, Rule 504 will disqualify issuers from reliance on Rule 504 if such issuer would be subject to disqualification under Rule 506(d) of Regulation D.[510] Consistent with the requirements of Rule 506(e), the amendments require the issuer in a Rule 504 offering to furnish to each purchaser, a reasonable time prior to sale, a written description of any disqualifying events that occurred before effectiveness of the amendments and within the time periods described in the list of disqualification events set forth in Rule 506(d)(1) of Regulation D,[511] for the issuer or any other "covered person" associated with the offering. For purposes of the mandatory disclosure provision described in the note to Rule 504(b)(3),[512] issuers will be required to ascertain whether any disclosures are required in respect of covered persons involved in their offerings, prepare any required disclosures and furnish them to purchasers.

509 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 503 above. Based on an average increase of approximately 1,515 new Form D filings per year over the past six years, we estimate that the number of new Form D filings after the amendment to Rule 504 would be the average number of new Form D filings we estimate in each of the next three years of 25,900, plus the additional 100 filings we estimate would be filed as a result of the amendment to Rule 504.

510 *See* Rule 504(b)(3); *see also* 17 CFR 230.506(d).

511 17 CFR 230.506(d)(1).

The disclosure 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 required disclosure to investors in the offering constitute reporting and cost burdens imposed by the collection of information.

The disclosure or paperwork burden imposed on issuers appears in an instruction to 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 Rule 504 will be required to furnish disclosure of any relevant past events that would have triggered disqualification under Rule 504(b)(3) that relate to the issuer or any other covered person. If there are any such events, a disclosure statement will be required to be furnished, a reasonable time before sale, to all purchasers in the offering. The disclosure requirement will serve to protect purchasers by ensuring that they receive information about any covered persons that were subject to such disqualifying events.

The disclosure requirement will not apply to triggering events occurring after the effective date of the amendments, because those events will 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 take to comply with the disclosure requirement are expected to mirror the steps they would take to determine whether they are disqualified from relying on Rule 504. For purposes of estimating burdens and costs, we have assumed that issuers planning or conducting a Rule 504 offering will undertake a factual inquiry to determine whether they are

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[512] *See* Note to Rule 504(b)(3).

subject to any disqualification in order to utilize the reasonable care provisions set forth in Rule 506(d)(2)(iv). Disqualification and mandatory disclosure will 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 the amendments and mandatory disclosure applicable to events occurring before that date. Therefore, we expect that the factual inquiry process for the disclosure statement requirement will impose a limited incremental burden on issuers.

The burdens and costs may vary depending on the size of the issuer and the circumstances of the particular Rule 504 offering. We do not anticipate that it will 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 period to be covered by the inquiry will end with the effective date of the new disqualification rules. However, issuers may incur additional burden and costs 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 anticipate that the Regulation D Rule 504(b)(3) Felons and Other Bad Actors Disclosure Statement will result in an incremental increase in the burdens and costs for issuers that rely on the Rule 504 exemption. For purposes of the PRA, we estimate the total annual increase in paperwork burden for all affected Rule 504 issuers to comply with our collection of information requirements will be approximately 880 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 will 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,[513] we assume that:

- Approximately 800 issuers[514] relying on Rule 504 of Regulation D will spend on average one additional hour to conduct a factual inquiry to determine whether any covered persons had a disqualifying event that occurred before the effective date of the amendments; and
- On the basis of the factual inquiry, approximately eight issuers (or approximately 1%) will 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 amendments; and
- For purposes of the Rule 504(b)(3) disclosure statement, approximately eight issuers will retain outside professional firms to spend three hours on disclosure preparation at an average cost of $400 per hour.

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

514 Based on staff analysis of Form D filings, there were 519 new Form D filings reporting reliance on Rule 504 and 179 new Form D filings reporting reliance on Rule 505 in 2015. *See* Figure 1 in Section V.A.1, above. Of the 179 new Form D filings reporting reliance on Rule 505 in 2015, 10 new Form D filings were made by reporting issuers under the Exchange Act and 169 new Form D filings were made by non-reporting issuers under the Exchange Act. For purposes of the PRA estimates, and based on the data provided for Rule 504 and Rule 505 offerings in 2015, we assume that approximately 800 issuers would file a Form D indicating reliance on Rule 504 after the effectiveness of the amendments to Rule 504 (calculated as follows: 519 new Rule 504 filings and 169 new Rule 505 filings by non-reporting issuers in 2015, rounded to the nearest hundredth, or 700 new Form D filings, plus 100 additional new Form D filings attributable to the amendments to Rule 504). This figure includes non-reporting issuers under the Exchange Act that, before adoption of amendments to Rule 504, would have conducted offerings pursuant to Rule 505, but that after adoption of the amendments to Rule 504 and repeal of Rule 505 will likely conduct their offerings pursuant to Rule 504.

The increase in burdens and costs associated with conducting a factual inquiry for the disclosure statement requirement should be minimal given that issuers are likely to conduct simultaneously a similar factual inquiry for purposes of determining disqualification from Rule 504.

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 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 sizes, management structures, and offering participants associated with Rule 504 offerings and that different issuers may develop a variety of different factual inquiry procedures.

Where the issuer or any covered person will be subject to an event covered by Rule 504(b)(3) that existed before the effective date of these rules, the issuer will 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 may need 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, newly hired executive officers or new 20% shareholders, any of which will result in a different group of covered persons. In deriving our estimates, we recognize that the burdens will likely vary among individual companies based on a number of factors, including the size and complexity of their organizations. We believe that some companies will experience costs in excess of this estimated average and other companies may experience less than the estimated average costs.

VII. FINAL REGULATORY FLEXIBILITY ACT ANALYSIS

The Regulatory Flexibility Act ("RFA")[515] requires the Commission, in promulgating rules under Section 553 of the Administrative Procedure Act,[516] to consider the impact of those rules on small entities. The Commission has prepared this Final Regulatory Flexibility Analysis ("FRFA") in accordance with Section 604 of the RFA.[517] This FRFA relates to the amendments to Rules 147 and 504, new Rule 147A and the repeal of Rule 505, all of which rules are under the Securities Act. An Initial Regulatory Flexibility Analysis (IRFA) was prepared in accordance with the RFA and included in the Proposing Release.

A. Need for the Rules

The amendments to Rule 147 are designed to modernize the safe harbor, consistent with the Section 3(a)(11) exemption from registration for intrastate securities offerings. New Rule 147A, which will be similar to amended Rule 147 but will have no restriction on offers and will allow issuers to be incorporated or organized out-of-state, establishes a new Securities Act

[515] 5 U.S.C. 601 *et seq.*

[516] 5 U.S.C. 553.

exemption for intrastate offerings of securities by local companies. Together, the amendments to Rule 147 and new Rule 147A are designed to facilitate capital formation by making it easier to engage in exempt intrastate offerings while maintaining appropriate protections for investors who purchase securities in these offerings.

The amendments to Rule 504 are designed to facilitate capital formation by increasing the flexibility of state securities regulators to implement regional coordinated review programs that will facilitate regional offerings. The amendments to Rule 504 will 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 will maximize the flexibility of state securities regulators to implement regional coordinated review programs and provide for greater consistency across Regulation D. We believe our amendment to Rule 504 to increase its aggregate offering ceiling from $1 million to $5 million will significantly diminish the utility of Rule 505 of Regulation D, and we are therefore repealing that rule.

B. Significant Issues Raised by Public Comments

In the Proposing Release, we requested comment on all aspects of the IRFA, including the number of small entities that would be affected by the proposed amendments, 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. We did not receive any comments specifically addressing the IRFA. We did, however, receive comments from members of the public on matters that could potentially impact small entities. These comments are discussed at length by topic in the corresponding subsections of Sections II. and III. above.

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[517] 5 U.S.C. 604.

Many commenters recommended making changes to the proposed rules that, in their view, would make the exemptions a more viable capital raising option for smaller issuers. Numerous commenters supported[518] the proposal to eliminate the Rule 147 limitation on offers to in-state residents while continuing to require that all sales be made to in-state residents. However, many commenters also supported[519] and the 2015 Small Business Forum recommended[520] retaining Rule 147 as a safe harbor under Section 3(a)(11), while adopting a substantially similar new exemption pursuant to the Commission's general exemptive authority under Section 28 as an alternative to the Section 3(a)(11) exemption for companies that are conducting an intrastate offering. Many commenters opposed any limits at the federal level on offering size or investment size,[521] and the 2015 Small Business Forum recommended permitting the states to set their own limits as appropriate.[522] In addition, several commenters supported[523] and the 2015 Small Business Forum recommended[524] exempting securities issued in reliance upon Rule 147 from the reporting requirements of Section 12(g) of the Exchange Act. Several commenters also supported interpreting the intrastate broker-dealer exemption under the

518 ABA Letter; City of Adrian Letter; Bishop Letter; Brelion Letter; CFA Letter; CFIRA Letter; CrowdCheck Letter; CrwdCorp Letter; Ely Letter; Guzik Letter; Love Letter; MacDougall Letter; Milken Letter; NASAA Letter; Newcomer Letter; NextSeed Letter; Pearl Letter; Terdal Letter; Wolff Letter; Zeoli Letter. *See also* Congressional Letter (expressing general support for the proposed amendments to Rule 147).

519 ABA Letter; City of Adrian Letter; Bishop Letter; California Bar Letter; CFIRA Letter; Congressional Letter; CrowdCheck Letter; Guzik Letter; Milken Letter; NASAA Letter; NextSeed Letter; Pearl Letter; Wallin Letter; Orloff Letter; Zeoli Letter. No commenters supported eliminating Rule 147 as a safe harbor under Section 3(a)(11).

520 *See* 2015 Small Business Forum Recommendations.

521 ABA Letter; Campbell Letter; CFIRA Letter; Congressional Letter; CrowdCheck Letter; Guzik Letter; Milken Letter; NASAA Letter; NextSeed Letter; WBA Letter.

522 *See* 2015 Small Business Forum Recommendations.

523 CFIRA Letter; CrowdCheck Letter; Guzik Letter; Milken Letter; City of Adrian Letter.

524 *See* 2015 Small Business Forum Recommendations.

Exchange Act to include intermediaries whose activities are limited to facilitating intrastate offerings using the Internet.[525]

Amended Rule 147 and new Rule 147 take into account some of the suggestions by commenters and the recommendations of the 2015 Small Business Forum on ways to make the intrastate offering exemptions more useful for small entities. For example, the final rules retain Rule 147 as a safe harbor under Section 3(a)(11), while adopting a substantially similar new exemption pursuant to the Commission's general exemptive authority under Section 28 as an alternative to the Section 3(a)(11) exemption for companies that are conducting an intrastate offering. As described above, the final rules will modernize existing Rule 147 and maintain a consistent approach across the two intrastate offering provisions, where possible. Also, given the comments received, the recommendations of the 2015 Small Business Forum and the local intrastate nature of the exemptions, amended Rule 147 and new Rule 147A will not contain any limits at the federal level on offering size or investment size.

As noted in Section II.C above, however, we are not persuaded that securities issued in reliance upon Rule 147 or Rule 147A should be exempt from the reporting requirements of Section 12(g) of the Exchange Act. Given the lack of ongoing reporting requirements under these rules, we believe that the Section 12(g) record holder and asset thresholds continue to provide an important baseline above which issuers should generally be subject to the disclosure obligations of the Exchange Act. As the shareholder base and total assets of these issuers grow, we believe that the additional protections that will be provided by registration under Section 12(g) are necessary and appropriate.

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525 NASAA Letter; NextSeed Letter; WBA Letter.

Additionally, as noted in Section II.B.2.c above, in response to the request by several commenters to interpret the intrastate broker-dealer exemption under the Exchange Act to include intermediaries whose activities are limited to facilitating intrastate offerings using the Internet,[526] we are providing guidance that a broker-dealer whose business otherwise meets the requirements of the intrastate broker-dealer exemption should not cease to qualify for the intrastate broker-dealer exemption solely because it has a website that may be viewed by out-of-state persons, so long as the broker-dealer takes measures reasonably designed to ensure that its business remains exclusively intrastate.

A few commenters also recommended changes to Rules 504 and 505 that, in their view, would make the exemptions a more viable capital raising option for smaller issuers. Two commenters suggested[527] and the 2015 Small Business Forum recommended[528] that the Rule 504 offering amount limit be increased to $10 million. In addition, one commenter suggested[529] and the 2015 Small Business Forum recommended[530] that securities sold under Rule 504 be exempt from the requirements of Section 12(g). For Rule 505, one commenter suggested that the Commission consider changes to Rule 505 to facilitate very small offerings by early stage companies, such as a simple debt-only offering exemption for smaller issuers.[531] Another commenter noted that, if the proposed changes to Rule 504 are adopted, Rule 505 would be substantially similar to Rule 504, making Rule 505 unnecessary, unless the Commission

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526 NASAA Letter; NextSeed Letter; WBA Letter.

527 CrowdCheck Letter; CFIRA Letter.

528 *See* 2015 Small Business Forum Recommendations.

529 Milken Letter.

530 *See* 2015 Small Business Forum Recommendations.

531 Milken Letter.

increases the aggregate offering amount that may be raised under Rule 505 in any twelve-month period.[532]

As supported by many commenters, the final amendments to Rule 504 will increase the offering amount limit from $1 million to $5 million.[533] We believe that the $5 million threshold will facilitate issuers' ability to raise capital, while remaining within the statutory requirements of Section 3(b)(1). As noted in Section III.B above, although two commenters and the 2015 Small Business Forum recommended that the Commission increase the Rule 504 offering amount limit to $10 million, we are not exceeding the maximum offering amount permitted under Section 3(b)(1). Although, as several commenters noted, we could use our exemptive authority under Section 28 of the Securities Act to raise the maximum offering amount above $5 million,[534] in accord with the suggestion of one of those commenters,[535] we believe it appropriate to first observe market activity under a new maximum offering amount of $5 million before raising the Rule 504 offering limit any higher.

As noted in Section III.B above, we are not persuaded that securities issued in reliance upon Rule 504 should be exempt from the reporting requirements of Section 12(g) of the Exchange Act. Similar to Rules 147 and 147A, given the lack of ongoing reporting requirements under Rule 504, we believe that the Section 12(g) record holder and asset thresholds continue to provide an important baseline above which issuers should generally be subject to the disclosure

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532 ABA Letter. This commenter recommended, for example, that the offering amount limit could be raised from $5 million to $10 million or some larger amount, thereby preserving Rule 505 as a viable alternative exemption.

533 ABA Letter; CFA Letter; CFIRA Letter; CrowdCheck Letter; Milken Letter; NASAA Letter.

534 ABA Letter; Milken Letter.

535 ABA Letter ("If the increase to $5 million is adopted, after there is experience with the use and operation of new Rule 504, the Commission may wish to consider using its exemption authority under Section 28 to increase the dollar limitation amount that may be offered under Rule 204.").

obligations of the Exchange Act. As the shareholder base and total assets of these companies grow, we believe that the additional protections that will be provided by registration under Section 12(g) are necessary and appropriate.

After considering the comments, we are repealing Rule 505. As discussed in Section III.C, amending Rule 504 to increase the aggregate offering amount limit from $1 million to $5 million may further reduce the incentives to use Rule 505 by issuers contemplating an exempt offering. We also believe that, even if we were to raise the Rule 505 aggregate offering amount limit from $5 million to $10 million, or some higher amount, such a higher limit would not increase the utility of the Rule 505 exemption as compared to Rule 506 which has no limit, given the historically diminished utility of Rule 505 as compared to Rule 506.[536] Further, although Rule 505 provides issuers the ability to sell securities to up to 35 non-accredited investors without having to make a finding, as in Rule 506(b)(2)(ii), that such persons have the knowledge and experience in financial matters that they are capable of evaluating the merits and risks of the prospective investment, [537] this provision does not appear to have historically resulted in the Rule 505 exemption being widely utilized.[538] We will continue to evaluate whether we should replace Rule 505 with a substantially different exemption with new criteria, such as an exemption limited to a very small aggregate offering amount by early stage companies, or an exemption limited only to "simple debt securities" with very modest compliance requirements.

In the light of the changes discussed above, we believe that the final rules provide smaller issuers with an appropriately tailored regulatory regime that takes into account the needs of small entities to have viable intrastate capital formation options, while maintaining appropriate investor

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[536] *See* note 22 above.

[537] *Cf.* 17 CFR 506(b)(2)(ii).

protections.

C. Small Entities Subject to the Rules

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.[539] For purposes of the RFA, 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.[540]

While we lack data on the number and size of Rule 147 offerings 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 used by U.S. incorporated entities that are likely small businesses seeking to raise small amounts of capital locally without incurring the costs of registering with the Commission. Currently, most states that have enacted crowdfunding provisions require issuers that intend to conduct intrastate crowdfunding offerings to rely upon Rule 147. Since December 2011, when the first state crowdfunding provision was enacted, 179 state crowdfunding offerings have been reported to be filed with the respective state regulators.[541] Of these offerings, 166 were reported to be approved or cleared, as of June 20, 2016.[542] We expect that almost all of the entities conducting these offerings were small issuers.

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538 *See* Unregistered Offerings White Paper.

539 17 CFR 230.157.

540 17 CFR 270.0-10(a).

541 Based on estimates provided by NASAA in a meeting with staff of the SEC Division of Corporation Finance on July 20, 2016, *available at https://www.sec.gov/comments/s7-22-15/s72215-32.pdf*.

542 *Id.*

It is difficult to predict the number of small entities that will use amended Rule 147 and new Rule 147A due to the many variables included in the amendments. Nevertheless, we believe that the final rules will increase the overall number of offerings relying on the intrastate exemptions due to the ability to make out-of-state offers under Rule 147A, the expanded number of issuers that will be eligible to use the intrastate exemptions due to the lack of an in-state incorporation requirement in Rule 147A and the modernized "doing business" requirements of Rules 147 and 147A, and other significant changes summarized in Section II above.

The amendments to Rule 504 will 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, 2015, 20,736 issuers made 22,854 new Form D filings, and of these Form D filings, 493 issuers relied on the Rule 504 exemption. Based on the information reported by issuers on Form D, we estimate that there were 269 small issuers[543] relying on the Rule 504 exemption in 2015. This number likely underestimates the actual number of small issuers relying on the Rule 504 exemption, however, because 41% of issuers that are not pooled investment funds and 38% of issuers that are pooled investment funds declined to report their amount of revenues or assets on their Form D filed with the Commission.

It is difficult to predict the number of small entities that will use amended Rule 504 due to the variables included in the amendments. Nevertheless, we believe that the final rules for Rule 504 will increase the overall number of offerings relying on the exemption due to the

[543] Of this number, 265 of these issuers are not pooled investment funds, and 4 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. To estimate the number of small issuers, for non-pooled investment funds, we have included issuers that disclosed up to $5 million in revenues, including those with no revenues, and for pooled

increase in the offering amount limit from $1 million to $5 million, as summarized in Section III above.

The repeal of Rule 505 will affect small issuers that rely on this exemption from Securities Act registration. For the year ended December 31, 2015, of the 20,736 issuers that made new Form D filings, 163 issuers relied on the Rule 505 exemption. Based on the information reported by issuers on Form D, we estimate that there were 112 small issuers[544] relying on the Rule 505 exemption in 2015. This number likely underestimates the actual number of small issuers relying on the Rule 504 exemption, however, because 25% of issuers that are not pooled investment funds and 38% of issuers that are pooled investment funds declined to report their amount of revenues or assets on their Form D filed with the Commission.

D. Projected Reporting, Recordkeeping and Other Compliance Requirements

Amended Rule 147 and new Rule 147A will not impose any reporting or recordkeeping requirements, but will require that issuers conducting offerings in reliance on these rules make certain specific disclosures to each offeree and purchaser in the offering. These disclosures will be made to each offeree in the manner in which any such offer is communicated and to each purchaser of a security in writing. Amended Rule 147 and new Rule 147A will 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 rules.

In order to comply with Rules 147(d) and 147A(d), sales of securities must be made only

investment funds, we have included issuers that disclosed up to $5 million in net asset value, including those with no asset value.

544 Of this number, 107 are not pooled investment funds, and 5 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. To estimate the number of small issuers, for non-pooled investment funds, we have included issuers that disclosed up to $5 million in revenues, including those with no revenues, and for pooled investment funds,

to residents of the state or territory in which the issuer has its residence or who the issuer reasonably believes, at the time of sale, are residents of the state or territory in which the issuer has its residence. In light of the comments received on the proposal, Rules 147 and 147A will include a requirement that issuers obtain a written representation from each purchaser as to his or her residence.[545] This written representation, however, will not be sufficient, by itself, to establish reasonable belief. In addition to the written representation, an issuer will need to consider other facts and circumstances.

The amendments to Rule 504 will increase the aggregate offering ceiling from $1 million to $5 million and disqualify certain bad actors from participating in Rule 504 offerings. Issuers will need to comply with all the current requirements of Rule 504, including the filing of a Form D.[546] Also, as 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 required to register their offering with at least one state regulator. The amendments to Rule 504 will also impose a disclosure requirement with respect to bad actor disqualifying events that occurred before the effective date of the disqualification provisions and that would have triggered disqualification had they occurred after that date.[547] Such disclosure will be required to be in writing and furnished to each purchaser a reasonable time prior to sale. There no prescribed format for such disclosure.

In addition, we assume that issuers will exercise reasonable care to ascertain whether a

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we have included issuers that disclosed up to $5 million in net asset value, including those with no asset value

545 *See* Rules 147(f)(1)(iii) and 147A(f)(1)(iii).

546 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.

547 *See* Rule 504(b)(3).

disqualification exists with respect to any covered person and document their exercise of reasonable care. The steps undertaken by issuers to exercise reasonable care may vary with the circumstances. In addition, issuers will have to prepare any necessary disclosure about preexisting events. We expect that the costs of compliance will vary depending on the size and nature of the offering but will 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. Agency Action to Minimize Effect on Small Entities

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 amendments.

With respect to clarification, consolidation and simplification of the final rules' compliance and reporting requirements for small entities, amended Rule 147 and new Rule 147A do not impose any new reporting requirements. To the extent the final rules 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 is a resident, including a requirement that issuers obtain a written representation from each purchaser as to his or her residence (as currently required in Rule 147), the precise steps necessary to meet the "reasonable belief" requirement will vary according to the circumstances, and this flexible standard will be applicable to all issuers, regardless of size. Overall, the final rules are designed to streamline and modernize the rule for all issuers, both large and small.

In connection with amended Rule 147 and new Rule 147A, we do not think it feasible or appropriate to establish different compliance or reporting requirements or timetables for small entities. The final rules 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 the issuers are resident. The final rules do not contain any reporting standards and the compliance requirements they do include are minimal and designed with the limited resources of smaller issuers in mind. Similarly, we do not believe it is necessary to clarify, consolidate or simplify reporting or compliance requirements for small entities as the final rules contain more streamlined requirements for all issuers, both large and small. For example, the rules simplify the “doing business” in-state determination by amending the current requirements in Rule 147 so that an issuer’s ability to rely on the safe harbor will be based on its ability to satisfy updated and modernized issuer requirements, while continuing to require issuers to have an in-state presence sufficient to justify reliance on the Section 3(a)(11) exemption. New Rule 147A includes similar modernized “doing business” in-state requirements. With respect to using performance rather than design standards, we note that the final rules establish a “reasonable belief” standard for the determination of a prospective purchaser’s residency status, which we believe is a performance standard. Although the final rules will require a written representation from investors, the 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 amended Rule 147 and new Rule 147A, we believe such an approach would increase, rather than decrease, their regulatory burden. The final rules are designed to facilitate an issuer's access to capital, regardless of the size of the issuer. We have endeavored throughout these rules to minimize the regulatory burden on all issuers, including small entities, while meeting our regulatory objectives.

In connection with our 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 amendments 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 amendments also exclude felons and other "bad actors" from involvement in Rule 504 offerings, which we believe could benefit small issuers by increasing investor protection and trust in such offerings. Increased investor trust could potentially reduce the cost of capital and create greater opportunities for small businesses to raise capital.

With respect to clarification, consolidation and simplification of the compliance and reporting requirements for small entities, the amendments to Rule 504 do not impose any new reporting requirements. To the extent the 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 requirement will vary according to the circumstances. In general, we believe the requirement will 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.

With respect to the use of performance or design standards, we note that the "reasonable care" exception is a performance standard. With respect to exempting small entities from coverage of these amendments, we believe that such an approach would increase, rather than decrease, their regulatory burden. Regulation D was designed, in part, to provide exemptive relief for smaller issuers. Furthermore, exempting small entities from Rule 504's bad actor provisions could result in a decrease in investor protection and trust in this small offerings market, thereby potentially increasing the issuer's cost of capital. We have endeavored to minimize the regulatory burden on all issuers, including small entities, while meeting our regulatory objectives, and have included a "reasonable care" exception and waiver authority for the Commission to provide additional flexibility with respect to the application of these amendments.

VIII. STATUTORY BASIS AND TEXT OF FINAL AMENDMENTS

The amendments contained in this release are being adopted under the authority set forth in Sections 3(b)(1), 19 and 28 of the Securities Act of 1933, as amended, Sections 12, 13, 15, 23(a) and 36 of the Securities Exchange Act of 1934, Section 38(a) of the Investment Company Act of 1940 and Section 211(a) of the Investment Advisers Act.

TEXT OF FINAL AMENDMENTS

Lists of Subjects

17 CFR Part 200

Administrative practice and procedure, Authority delegations (Government agencies), Organization and functions (Government agencies).

17 CFR 230, 239, 240, 249, 270 and 275

Reporting and recordkeeping requirements, Securities.

For the reasons set out above, the Commission is amending Title 17, chapter II of the Code of Federal Regulations, as follows:

PART 200 – ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

Subpart A – Organization and Program Management

1. The authority citation for Part 200, Subpart A, continues to read, in part as follows:

Authority: 15 U.S.C. 77c, 77o, 77s, 77z-3, 77sss, 78d, 78d-1, 78d-2, 78o-4, 78w, 78ll(d), 78mm, 80a-37, 80b-11, 7202, and 7211 et seq., unless otherwise noted.

* * * * *

2. Amend § 200.30-1 by:

   a. In paragraph (a)(7), removing the references to “4(3)”, “4(3)(b)” and “77d(3)(B)” and adding in their places “4(a)(3)”, “4(a)(3)(B)” and “77d(a)(3)(B)” respectively; and

   b. In paragraph (c), removing the reference to “§230.505(b)(2)(iii)(C)” and adding in its place “§230.504(b)(3)”.

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

3. 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.

* * * * *

4. § 230.147 is revised to read as follows:

§ 230.147 Intrastate offers and sales.

(a) This rule shall not raise any presumption that the exemption provided by section 3(a)(11) of the Act (15 U.S.C. 77c(a)(11)) is not available for transactions by an issuer which do not satisfy all of the provisions of this rule.

(b) *Manner of offers and sales.* An issuer, or any person acting on behalf of the issuer, shall be deemed to conduct an offering in compliance with section 3(a)(11) of the Act (15 U.S.C. 77c(a)(11)), where offers and sales are made only to persons resident within the same state or territory in which the issuer is resident and doing business, within the meaning of section 3(a)(11) of the Act, 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 be a person resident and doing business within the state or territory in which all of the offers and sales are made.

(1) The issuer shall be deemed to be a resident of the state or territory in which:

(i) It is incorporated or organized, and it has its principal place of business, if a corporation, limited partnership, trust or other form of business organization that is organized under state or territorial law. 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;

(ii) It has its principal place of business, as defined in paragraph (c)(1)(i) of this section, if a general partnership or other form of business organization that is not organized under any state or territorial law;

(iii) Such person's principal residence is located, if an individual.

(2) The issuer shall be deemed to be doing business within a state or territory if the issuer satisfies 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.

Instruction to Paragraph (c)(1): An issuer that has previously conducted an intrastate offering pursuant to this section (§ 230.147) or Rule 147A (§ 230.147A) may not conduct another intrastate offering pursuant to this section (§ 230.147) in a different state or territory, until the expiration of the time period specified in paragraph (e) of this section (§ 230.147(e)) or paragraph (e) of Rule 147A (§ 230.147A(e)), calculated on the basis of the date of the last sale in such offering.

Instruction 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 offerees and purchasers.* Offers and sales of securities pursuant to this section (§ 230.147) shall be made only to residents of the state or territory in which the issuer is resident, as determined pursuant to paragraph (c) of this section, or who the issuer reasonably believes, at the time of the offer and sale, are residents of the state or territory in which the issuer is resident. For purposes of determining the residence of offerees and 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 the offer and sale to it, it has its principal place of business, as defined in paragraph (c)(1)(i) 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 the offer and 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.

Instruction to Paragraph (d): Obtaining a written representation from purchasers of in-state residency status will not, without more, be sufficient to establish a reasonable belief that such purchasers are in-state residents.

Instruction to Paragraph (d)(1): A trust that is not deemed by the law of the state or territory of its creation to be a separate legal entity is deemed to be a resident of each state or territory in which its trustee is, or trustees are, resident.

(e) *Limitation on resales.* For a period of six months from the date of the sale by the issuer of a security pursuant to this section (§ 230.147), any resale of such security shall be made only to persons resident within the state or territory in which the issuer was resident, as determined pursuant to paragraph (c) of this section, at the time of the sale of the security by the issuer.

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 six 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) shall be made only to persons resident within the state or territory of [identify the name of the state or territory in which the issuer was resident at the time of the sale of the securities by the issuer].";

(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; and

(iii) Obtain a written representation from each purchaser as to his or her residence.

(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 a reasonable period of time before the date of sale, the following: "Sales will be made only to residents of [identify the name of the state or territory in which the issuer was resident at the time of the sale of the securities by 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 six 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) shall be made only to persons resident within the state or territory of [identify the name of the state or territory in which the issuer was resident at the time of the sale of the securities by the issuer]."

(g) *Integration with other offerings.* Offers or sales made in reliance on this section will not be integrated with:

(1) Offers or sales of securities made prior to the commencement of offers and sales of securities pursuant to this section (§ 230.147); or

(2) Offers or sales made after completion of offers and sales of securities pursuant to this section (§ 230.147) that are:

(i) Registered under the Act, except as provided in paragraph (h) of this section (§ 230.147);

(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 (§ 230.147).

Instruction 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 Act after making offers in reliance on this section (§ 230.147) limited only to qualified institutional buyers and institutional accredited investors referenced in section 5(d) of the Act, such offers will not be subject to integration with any subsequent registered offering. If the issuer makes offers in reliance on this section (§ 230.147) to persons other than qualified institutional buyers and institutional accredited investors referenced in section 5(d) of the 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 this section (§ 230.147) and the filing of the registration statement with the Commission.

* * * * *

5. Add § 230.147A to read as follows:

§ 230.147A 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 this section (§ 230.147A) are exempt from section 5 of the Act (15 U.S.C. 77e). This exemption is not available to an issuer that is an investment company registered or required to be registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 *et seq.*).

(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 be a person resident and doing business within the state or territory in which all of the sales are made.

(1) The issuer shall be deemed to be a resident of the state or territory in which it has its principal place of business. 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.

(2) The issuer shall be deemed to be doing business within a state or territory if the issuer satisfies 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 (§ 230.147A) 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.

Instruction to Paragraph (c): An issuer that has previously conducted an intrastate offering pursuant to this section (§ 230.147A) or Rule 147 (§ 230.147) may not conduct another intrastate offering pursuant to this section (§ 230.147A) in a different state or territory, until the expiration of the time period specified in paragraph (e) of this section (§ 230.147A(e)) or paragraph (e) of Rule 147 (§ 230.147(e)), calculated on the basis of the date of the last sale in such offering.

Instruction 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 (§ 230.147A) shall be made only to residents of the state or territory in which the issuer is resident, as determined pursuant to paragraph (c) of this section, or who the issuer reasonably believes, at the time of sale, are residents of the state or territory in which the issuer is resident. 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 (§ 230.147A), 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.

Instruction to Paragraph (d): Obtaining a written representation from purchasers of in-state residency status will not, without more, be sufficient to establish a reasonable belief that such purchasers are in-state residents.

Instruction to Paragraph (d)(1): A trust that is not deemed by the law of the state or territory of its creation to be a separate legal entity is deemed to be a resident of each state or territory in which its trustee is, or trustees are, resident.

(e) *Limitation on resales.* For a period of six months from the date of the sale by the issuer of a security pursuant to this section (§ 230.147A), any resale of such security shall be made only to persons resident within the state or territory in which the issuer was resident, as determined pursuant to paragraph (c) of this section, at the time of the sale of the security by the issuer.

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 six 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) shall be made only to persons resident within the state or territory of [identify the name of the state or territory in which the issuer was resident at the time of the sale of the securities by the issuer].";

(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; and

(iii) Obtain a written representation from each purchaser as to his or her residence.

(2) The issuer shall, in connection with the issuance of new certificates for any of the securities that are sold pursuant to this section (§ 230.147A) 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 (§ 230.147A), prominently disclose to each offeree in the manner in which any such offer is communicated and to each purchaser of such security in writing a reasonable period of time before the date of sale, the following: "Sales will be made only to residents of the state or territory of [identify the name of the state or territory in which the issuer was resident at the time of the sale of the securities by 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 six 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) shall be made only to persons resident within the state or territory of [identify the name of the state or territory in which the issuer was resident at the time of the sale of the securities by the issuer]."

(g) *Integration with other offerings.* Offers or sales made in reliance on this section will not be integrated with:

(1) Offers or sales of securities made prior to the commencement of offers and sales of securities pursuant to this section (§ 230.147A); or

(2) Offers or sales of securities made after completion of offers and sales of securities pursuant to this section (§ 230.147A) that are:

(i) Registered under the Act, except as provided in paragraph (h) of this section (§ 230.147A);

(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 (§ 230.147A).

Instruction 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 (§ 230.147A) 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 Act after making offers in reliance on this section (§ 230.147A) limited only to qualified institutional buyers and institutional accredited investors referenced in section 5(d) of the Act, such offers will not be subject to integration with any subsequent registered offering. If the issuer makes offers in reliance on this section (§ 230.147A) to persons other than qualified institutional buyers and institutional accredited investors referenced in section 5(d) of the 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 this section (§ 230.147A) and the filing of the registration statement with the Commission.

* * * * *

6. Amend § 230.501 paragraph (e) by removing the reference to "§230.505(b) and."

7. Amend § 230.502 by:

a. In paragraph (b)(1), removing the reference to "§230.505 or";

b. In paragraph (b)(2)(iv), removing the reference to "§230.505 or";

c. In paragraph (b)(2)(v), removing the reference to "§230.505 or"; and

d. In paragraph (b)(2)(vii), removing the reference to "§230.505 or";

8. Amend §230.503 paragraph (a)(1) by removing the comma after "§230.504" and the reference to "§230.505,".

9. 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 violation of section 5(a) of the Securities Act.

Instruction 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).

Instruction 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].

* * * * *

10. § 230.505 is removed and reserved.

11. Amend §230.507 by:

a. In the section heading, removing the comma after "§§230.504" and the reference to "230.505"; and

b. In paragraph (a), removing the reference to "§230.505," and adding in its place "§230.504" and removing the reference to "§230.505."

12. Amend §230.508 by:

a. In paragraph (a), removing the comma after "§230.504" and the reference to "§230.505";

b. In paragraph (a)(2), removing the comma after "§230.504" and the reference to "paragraphs (b)(2)(i) and (ii) of §230.505":

c. In paragraph (a)(3), removing the comma after "§230.504" and the reference to "§230.505"; and

d. In paragraph (b), removing the comma after "§230.504" and the reference to "§230.505."

PART 239 – FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

13. The authority citation for Part 239 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78o-7 note, 78u-5, 78w(a), 78ll, 78mm, 80a-2(a), 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, 80a-37, and Sec. 71003 and Sec. 84001, Pub. L. 114-94, 129 Stat. 1312, unless otherwise noted.

14. Amend §239.500 by:

a. In the section heading, removing the reference to "4(5)" and adding in its place "4(a)(5)"; and

b. In paragraph (a)(1), removing the comma after "§230.504" and the reference to "§230.505"; and removing the reference to "4(5)" and adding in its place "4(a)(5)".

15. Amend Form D (referenced in § 239.500) by:

a. In Item 6, removing the phrase "Rule 505" and the appropriate check box;

b. Under "Signature and Submission," replace the third paragraph under "Terms of Submission" with the following sentence: "Certifying that, if the issuer is claiming a Regulation D exemption for the offering, the issuer is not disqualified from relying on Rule 504 or Rule 506 for one of the reasons stated in Rule 504(b)(3) or Rule 506(d) ."

(Note: The text of Form D does not, and the amendments will not, appear in the Code of Federal Regulations.)

PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

16. The authority citation for Part 240 continues to read, in part, as follows:

<u>Authority</u>: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7201 et. seq., and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; and Pub. L. 111-203, 939A, 124 Stat. 1376, (2010), unless otherwise noted.

17. Amend §240.15g-9 paragraph (c)(2) by removing the reference to “230.505 or”; and removing the reference to “4(2)” and adding in its place “4(a)(2)”.

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

18. The authority citation for part 249 continues to read, in part, as follows:

<u>Authority</u>: 15 U.S.C. 78a et seq. and 7201 et seq.; 12 U.S.C. 5461 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

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19. Amend the Instruction to Item 9.01 in Form 8-K (referenced in § 249.308) by removing the phrase “Rules 505 and 506 of Regulation D (17 CFR 230.505 and” and adding in its place “Rule 506 of Regulation D (17 CFR”.

(Note: The text of Form 8-K does not, and the amendments will not, appear in the Code of Federal Regulations.)

PART 270 – RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

20. The general authority citation for Part 270 continues to read in part as follows:

Authority: 15 U.S.C. 80a–1 et seq., 80a–34(d), 80a–37, and 80a–39, unless otherwise noted.

21. Amend §270.17j-1 paragraph (a)(8) by removing the references to "4(2)", "4(5)", "77d(2)" and "77d(5)" and adding in their places "4(a)(2)", "4(a)(5)", "77d(a)(2)" and "77d(a)(5)", respectively; and removing the comma after "rule 504", the reference to "rule 505,", the comma after "230.504" and the reference to "230.505,".

PART 275 – RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

22. The authority citation for Part 275 continues to read in part as follows:

Authority: 15 U.S.C. 80b-2(a)(11)(G), 80b-2(a)(11)(H), 80b-2(a)(17), 80b-3, 80b-4, 80b-4a, 80b-6(4), 80b-6a, and 80b-11, unless otherwise noted.

23. Amend §275.204A-1 paragraph (e)(7) by removing the references to "4(2)", "4(5)", "77d(2)" and "77d(5)" and adding in their places "4(a)(2)", "4(a)(5)", "77d(a)(2)" and "77d(a)(5)", respectively; and removing the comma after "230.504" and the reference to "230.505,".

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By the Commission.

Brent J. Fields

Secretary

Dated: October 26, 2016