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June 28, 2018

The Honorable Mike Crapo
Chairman
Senate Committee on Banking, Housing & Urban Affairs
538 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Senate Committee on Banking, Housing & Urban Affairs
538 Dirksen Senate Office Building
Washington, D.C. 20510

Re: Legislation Considered by the Committee on June 26, 2018 and June 28, 2018

Dear Chairman Crapo and Ranking Member Brown:

On behalf of the North American Securities Administrators Association (NASAA),[1] I am writing to provide NASAA's perspective on certain legislative proposals that have been the subject of hearings by the Committee on Banking, Housing and Urban Affairs during the week of June 25, 2018.

1. The "Cybersecurity Disclosure Act" (S. 536)

The "Cybersecurity Disclosure Act" would amend the Securities Exchange Act of 1934 to require that publicly traded companies disclose in their annual filings with the U.S. Securities and Exchange Commission (SEC) whether any member of their governing body, such as their board of directors or general partner, possesses expertise or experience in cybersecurity. The bill does not impose any requirements on issuers beyond disclosure of the specified information.

Incentivizing publicly traded companies to consider whether they have adequate cybersecurity expertise in their governing body is an appropriate step given that cyberattacks on U.S. companies continue to increase in both frequency and sophistication. Cybersecurity risk and preparedness can have major implications for businesses and their investors.[2] Further, investors, issuers, and consumers stand to be well-served by policies that encourage companies to consider cybersecurity risks proactively, as opposed to after a data breach or other intrusion has occurred, when the harm may be

[1] The oldest international organization devoted to investor protection, the North American Securities Administrators, Inc. was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

[2] In 2017, I authored an op-ed highlighting the growing concern over the number of cyberattacks perpetrated against companies and the efforts state securities regulators are taking to assist mid-sized investment advisers to improve their cybersecurity practices. (See: Borg, Joseph P. "Everyone has a Role in Protecting against Cyberattacks". September 5, 2017. Available at www.americanbar.org/content/dam/aba/administrative/business_law/newsletters/CL680000/full-issue-201709.authcheckdam.pdf).

irreversible. In fact, we note that since the bill's introduction in 2017, the SEC has issued guidance that compliments and supports the legislation's premise.[3]

NASAA is pleased to support S. 536.

2. The "Fair Investment Opportunities for Professional Experts Act" (S. 2756)

S. 2756, the "Fair Investment Opportunities for Professional Experts Act", would amend the Securities Act of 1933 to add specified, inflation-adjusted income and net-worth standards to the "accredited investor" definition. In addition, the bill extends "accredited investor" status to new categories of natural persons who would qualify as "accredited" irrespective of income or net-worth.

NASAA is not wholly opposed to efforts to modernize the accredited investor standard, including in a manner that would increase the size of this marketplace, as is envisioned by S. 2756. Further, NASAA appreciates the steps that the sponsors of S. 2756 have taken to improve the legislation relative to similarly entitled legislation previously passed by the House of Representatives, including in consultation with NASAA.[4] Nevertheless, state regulators have a very large stake in any legislative changes that would affect the private securities markets.[5] We strongly believe that any legislation that effects a further expansion of private securities markets must also take steps to improve the oversight of these markets by providing regulators with better tools to address fraud and misconduct in these markets.[6]

Further, NASAA respectfully reminds the Committee that policies that implicate private securities markets cannot be judged in isolation. Over the past two decades, there has been a dramatic shift in how companies raise capital. Private securities once comprised just a fraction of the overall marketplace, but today they serve as a major source of capital for certain businesses, exceeding the public markets.[7] The unprecedented growth in private markets, and the decline in initial public

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[3] "U.S. SEC Calls for 'Clearer' Cyber Risk Disclosure from Companies". *Reuters*. February 21, 2018. *See:* https://www.reuters.com/article/us-usa-sec-cyber/u-s-sec-calls-for-clearer-cyber-risk-disclosure-from-companies-idUSKCN1G52FK.

[4] Section 2(b) of S. 2756 imposes guidelines that the SEC must follow in issuing a rule to determine whether a natural person may qualify as an accredited investor by virtue of education, job, or professional experience. No similar requirements are included in H.R.1585, the "Fair Investment Opportunities for Professional Experts Act". We also note that, whereas H.R. 1585 would adjust the income and net-worth standards to account for inflation every five years, S. 2756 would adjust them every three years.

[5] State securities regulators, pursuant to their antifraud authority, are the de-facto primary regulators of offerings conducted under Regulation D, Rule 506. State regulators frequently receive complaints from those who are victimized in offerings conducted under Rule 506, and expend considerable resources policing this marketplace.

[6] Specifically, S. 2756 should be improved by incorporating modest changes to Rule 506 and Form D that will enhance the ability of the SEC and NASAA members to protect investors while minimizing the burdens to the small businesses who utilize the rule to raise capital. Such changes were proposed by the SEC in 2013, but have not yet been adopted. (*For additional information, see: https://www.sec.gov/comments/4-692/4692-34.pdf*). NASAA has also offered suggestions for how to revise the current accredited investor definition to more accurately measure investor sophistication, and to limit the exposure of less sophisticated investors to the risks of the private marketplace. (*For additional information, see: http://www.nasaa.org/wp-content/uploads/2013/10/NASAA-Letter-to-House-Leadership-Re-HR-1585-11-1-17.pdf*).

[7] See: SEC Division of Economic and Risk Analysis, Access to Capital and Market Liquidity (Aug. 8, 2017), available at https://www.sec.gov/files/access-to-capital-and-market-liquidity-study-dera-2017.pdf. See also: Scott W. Bauguess, Deputy Director, SEC Division of Economic Risk and Analysis, Private Securities Offerings post-JOBS Act. Presentation to

offerings (IPOs), can be attributed in part to Congress. Congress has made it easier for companies to raise capital in private markets and that is one of the main reasons that more companies are staying private for longer instead of pursuing IPOs.[8] Given Congress's ongoing, bipartisan interest in increasing the number of IPOs – efforts which were discussed by the Committee at a hearing earlier this week[9] – Congress should be thoughtful in taking any steps that would further expand the private markets to the potential detriment of public markets.

3. The "Helping Angels Lead Our Startups Act" (S. 588)

The "Helping Angels Lead Our Startups Act", or "HALOS Act," would direct the SEC to amend Rule 506 of Regulation D to specify that prohibitions on general solicitation and general advertising in Rule 506 offerings do not apply to sales events (also called "demo days", "venture fairs", or "pitch days") that are sponsored by a governmental entity, a college or university, a nonprofit organization, an angel investor group, a trade association, a venture forum, or a venture capital association. The bill would also limit the amount and type of information that can be communicated prior to, and at, such events.

Given that Congress has already acted to repeal the prohibition on general solicitation in certain private securities offerings under SEC Rule 506(c), it is not clear why Congress would now require the SEC to relax rules governing the use of solicitation to non-accredited investors under Rule 506(b).[10] However, in the event that Congress determines such action is appropriate, there are steps the Senate can and should take to improve the legislation prior to its becoming law.

As presently constituted, the types of entities that would be eligible to sponsor an event under S. 588 is exceptionally broad. Congress should consider whether these criteria should be made more tailored thereby narrowing the number of entities eligible to sponsor such events.[11] Further, Congress

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Accounting Standards Executive Committee (Feb. 25, 2016), available at https://www.sec.gov/info/smallbus/acsec/private- securities-offerings-post-jobs-act-bauguess-022516.pdf.

[8] As Healthy Markets Association Executive Director Tyler Gellasch recently testified to a subcommittee of the House Financial Services Committee, "It's not a great mystery why in the last few years the trend has developed whereby there are more private offerings in the U.S. today than public ones. In the past, the law and SEC rules simply didn't permit all these private offerings. Over the past two decades, however, Congress and the SEC have spent years constructing ad hoc exemptions and exceptions designed to allow firms, their executives, and their early investors to sell securities without incurring the costs or burdens typically associated with public offerings. While some of these exemptions and exceptions may have been well-intended, the undeniable result has been that they have grown so dramatically that they have undermined the public markets." (See: Testimony of Tyler Gellasch before the House Financial Services Committee, Subcommittee on Capital Markets, Securities and Investment (May 23, 2018).

[9] *See: Legislative Proposals to Increase Access to Capital*, Hearing Before the Senate Comm. on Banking, Housing, and Urban Affairs, 115th Cong. (Jun. 26, 2018).

[10] In Title II of the JOBS Act of 2012, Congress expanded companies' ability to attract buyers to their private offerings by permitting general solicitation and advertising. This exemption, codified under SEC Rule 506(c), can be claimed provided that issuers only sell to accredited investors and that they take "reasonable steps" to verify that the investors are accredited. The HALOS Act would go further and exempt demo days from the prohibition on general solicitation and advertising, thereby allowing companies to generally solicit and advertise and still be able to use 506(b), which unlike Rule 506 (c), does not require issuers to take reasonable steps to determine whether investors are accredited.

[11] As University of University of Mississippi Law School Professor Mercer Bullard testified to the Committee this week, S. 588 "will allow virtually any type of public entity to advertise and host an event that can be attended by any person for the purpose of any issuer pitching a securities offering." *See:* https://www.banking.senate.gov/imo/media/doc/Bullard%20Testimony%206-26-18.pdf

should require the filing of Form D with the SEC and the relevant state regulator prior to the event.[12] The information included in Form D would be particularly valuable to state regulators who will be tasked with ensuring that "demo days" and similar events sponsored in their jurisdictions are legitimate and compliant with the law. Finally, Congress should clarify that attendance at an event does not in itself establish a pre-existing relationship for purposes of Rule 506(b).

4. The "Compensation for Cheated Investors Act" (S. 2499)

S. 2499, the "Compensation for Cheated Investors Act", would direct the Financial Industry Regulatory Authority (FINRA) to establish a fund to provide investors with the full value of unpaid arbitration awards issued against brokerage firms or brokers regulated by FINRA. The bill would also require FINRA to provide enhanced public disclosure of information pertaining to the total number of arbitration awards issued in favor of investors against brokerage firms or brokers regulated by FINRA.

NASAA welcomes the introduction of S. 2499, and wholeheartedly supports the intent behind the legislation, which is to ensure that wronged investors are not literally left holding the bag when it comes to the payment of arbitration awards issued against broker-dealer firms and their representatives. Unpaid arbitration awards remain an unresolved and well-documented investor protection concern. In failing to pay arbitration awards, broker-dealers fail to comply with their legal, regulatory and ethical obligations. NASAA has been a longstanding proponent of measures to address this problem.[13] We look forward to working with Congress and other stakeholders to finding a solution so that no investor awards or settlements go unpaid.

5. The "Expanding Access to Capital for Rural Job Creators Act" (S. 2953)

S. 2953, the "Expanding Access to Capital for Rural Job Creators Act", would amend the Securities Exchange Act of 1934 to add "rural-area small businesses" to the scope of small businesses with unique challenges and issues from which the SEC Advocate for Small Business Capital Formation is required to (1) identify problems with securing access to capital; and (2) issue an annual report containing a summary of the most serious issues encountered by such businesses and their investors.

As the closest regulators to the investing public, NASAA's members regularly work with and assist local businesses seeking investment capital. On the basis of this experience, we strongly agree with legislation's premise – which is that rural communities and the small businesses located in these communities can face unique barriers to accessing capital.

NASAA is pleased to support S. 2953.

Thank you for your consideration of NASAA's views. If I may be of further assistance, please don't hesitate to contact me or Michael Canning, NASAA's Director of Policy and Government Affairs, at (202) 737-0900.

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[12] NASAA has repeatedly urged Congress to require the filing of Form D prior to sale or general solicitation of securities offerings exempt from registration under Regulation D. Under the current rules, Form D need not be filed until 15 days after the first sale, so an issuer can advertise for investors without filing the form. The lack of any pre-solicitation filing makes it impossible for state enforcement personnel to easily determine whether an offering is being conducted in accordance with the securities laws.

[13] *See, e.g.*, Letter from NASAA President Joseph Borg to March E. Asquith regarding FINRA Regulatory Notice 17-33 (Dec. 20, 2017).

Sincerely,

Joseph P. Borg
NASAA President and Alabama Securities Commission Director