NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION

Written Testimony before the House Financial Services Committee Subcommittee on Capital Markets

Regarding

A Roadmap for Growth: Reforms to Encourage Capital Formation and Investment Opportunities for All Americans

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Submitted by

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NASAA
Organized in 1919, the North American Securities Administrators Association ("NASAA") is the oldest international organization devoted to investor protection. NASAA is a voluntary association whose membership consists of the securities regulators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, the 13 provincial and territorial securities regulators in Canada, and the securities regulator in México. In the United States, NASAA is the voice of state securities agencies that protect investors, promote responsible capital formation, and support inclusion and innovation in the capital markets. U.S. NASAA members license firms and their agents, investigate alleged violations of securities laws, file enforcement actions when appropriate, and educate the public about investment fraud. NASAA members also participate in multi-state enforcement actions and information sharing. For more information, visit: www.nasaa.org.

I. Introduction

I am Melanie Senter Lubin. I want to start by thanking the House Financial Services Committee ("HFSC") and its dedicated staff for organizing this hearing. I am honored to share the perspective of the North American Securities Administrators Association, or NASAA for short.

I am a 36-year veteran of the Division of Securities within Maryland's Office of the Attorney General. In 1998, I became the Maryland Securities Commissioner. The primary goal of the Maryland Securities Division is to protect Maryland investors from investment fraud and misrepresentation. My team uses all the tools that securities regulators have—investor education, licensing, registration, examination, and enforcement—to protect investors, promote responsible capital formation, and support inclusion and innovation in the capital markets.

I also am a 36-year veteran of NASAA. During my career, I have been involved in essentially every aspect of our collective mission. At present, I am a member of NASAA's Board of Directors. I had the honor of serving last year as NASAA's President. I also am a member of four committees—the FinTech Committee, the Federal Legislation Committee, the Investment Adviser Representative Continuing Education Committee, and the Steering Committee for the Central Registration Depository and the Investment Adviser Registration Depository systems. Since 2015, I have served as NASAA's non-voting representative to the Financial Stability Oversight Council ("FSOC"). In 2022, the Public Company Accounting Oversight Board ("PCAOB") appointed me to its new Standards and Emerging Issues Advisory Group.[1]

The breadth and depth of NASAA's work is tremendous. Approximately 300 volunteers from member agencies serve on dozens of NASAA committees and project groups, including on NASAA's Corporation Finance Section Committee and Federal Legislation Committee. At home and as part of these committees, our members protect investors from financial fraud and abuse, educate investors working to build secure financial futures, support responsible capital formation by businesses, and help ensure the integrity and efficiency of the capital markets that power our economies. To support these efforts, we work through NASAA to train regulator-members to perform their duties and coordinate on everything from investor education to reviews of securities offerings to rulemaking to enforcement. In addition, we facilitate engagement on policy proposals with many stakeholders and appear in state and federal courts as *amicus curiae*. In all that we do, we strive to ensure that present and future generations of state, provincial, and territorial regulators can continue NASAA's century-old investor protection mission.

State securities regulators play several vital roles in capital formation. Of note, we are on the frontlines of helping Main Street businesses understand their capital-raising options and the frontlines of responding to inquiries about how to raise capital in a compliant way. For example, while the nature of the services varies across jurisdictions, it is common for our regulators to maintain websites devoted to capital formation resources, collaborate with local organizations to

[1] NASAA, Maryland Securities Commissioner Melanie Senter Lubin Takes Helm as 104th President of North American Securities Administrators Association (Sept. 21, 2021); PCAOB, Standards and Emerging Issues Advisory Group Members; NASAA, Maryland Securities Commissioner Lubin to Represent NASAA on Financial Stability Oversight Council (Oct. 22, 2015).

conduct seminars for small businesses, respond regularly to inquiries, and otherwise support the business community.[2] If state securities regulators were preempted further from promoting responsible capital formation in their states, some state governments would reduce the budgets of their regulators accordingly. Smaller budgets would make it difficult for them to educate or otherwise support the great entrepreneurs and small businesses operating in their states and otherwise fulfill their investor protection mission.

II. Summary of NASAA's Written Testimony

The purpose of this hearing is to examine legislation under consideration that purports to help entrepreneurs and small businesses, increase opportunities for all investors, and strengthen public markets. We certainly support these goals and understand the importance of healthy capital markets. Unfortunately, we are concerned that these proposals will not serve these laudable goals. In our testimony, we will cover the following four key points:

1. Ample evidence exists that a significant majority of the bills under discussion will not help entrepreneurs and small businesses, increase opportunities for all investors, or strengthen public markets. We urge Congress not to advance them.

2. In particular, we urge Congress to abandon **(1)** the Small Entrepreneurs' Empowerment and Development ("SEED") Act; **(2)** the Improving Crowdfunding Opportunities Act; **(3)** H.R. 2506, the Restoring the Secondary Trading Market Act; and **(4)** the Unlocking Capital for Small Businesses Act. These proposals would preempt state securities regulators.[3] Preemption has consequences for the preempted, our peer state and federal regulators, entrepreneurs and small businesses, and investors. Importantly, state governments likely would reduce funding for the great work that state securities regulators presently perform to educate and otherwise support entrepreneurs and small businesses. Meanwhile, Congress would not increase resources for the federal government to fill the regulatory gap created by preemption.

3. To ensure our markets are around for generations to come, we need to do an even better job at promoting lasting trust in, and informed use of, our regulated capital markets. We also need to keep state and local governments on the regulatory field. The data shows that there remains a concerning amount of distrust in our regulated capital markets 15 years after the 2008-2009 Financial Crisis. The data also shows that Americans have a higher degree of trust in their state and local governments than their federal government.

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[2] In March 2023, NASAA conducted a voluntary, internal survey of state securities regulators to gather updates on the latest ways that our members are supporting entrepreneurs and small businesses. As of the date of this letter, 19 jurisdictions have had an opportunity to respond. Of the 19 respondents, 17 described activities they engage in to help local companies with capital formation questions. Of note, 16 jurisdictions assist entrepreneurs and small businesses working on offerings under $500,000 at least a few times a year if not more frequently. Indeed, the Arkansas Securities Department informed us that they are assisting on capital raises under $500,000 on a weekly basis now. Several members, such as the Maine Office of Securities, were pleased to report they have received praise from other state officials for their assistance of entrepreneurs and small businesses.

[3] *See, e.g.,* H.R. ___, the Small Entrepreneurs' Empowerment and Development ("SEED") Act; H.R. ___, the Improving Crowdfunding Opportunities Act; H.R. 2506, the Restoring the Secondary Trading Market Act, 118th Congress, 1st Session; and H.R. ___, the Unlocking Capital for Small Businesses Act.

4. To reinvigorate our capital markets, we should follow the capital formation agenda outlined in NASAA's Report and Recommendations for Reinvigorating Our Capital Markets dated February 2023 and briefly summarized in this testimony.[4] In short, we offer several specific ways that Congress can help entrepreneurs and small businesses, increase opportunities for all investors, and strengthen public markets.

III. The Capital Formation Agenda Under Discussion, Much Like the Prior JOBS Acts, Would Fail to Achieve Its Goals.

A little over a decade ago, Congress embraced a new approach intended to help entrepreneurs and small businesses, increase opportunities for all investors, and strengthen public markets. Specifically, Congress passed two packages of bills that informally are called the JOBS Act 1.0 and the JOBS Act 2.0 (together, the "JOBS Acts").[5] The JOBS Acts included a mix of changes working at cross purposes to grow the public markets while expanding private markets at the same time. The passage of the JOBS Acts occurred notwithstanding opposition from stakeholders such as AARP, AFL-CIO, Consumer Federation of America, Council of Institutional Investors, former SEC Chairman Arthur Levitt, Main Street Alliance, NASAA, and U.S. PIRG.[6]

As the 2010s progressed, more policymakers began to question the ability of the JOBS Acts to achieve their stated goals. For example, in 2018, Congress debated, yet failed, to pass a JOBS Act 3.0.[7] During a related hearing, Senator Sherrod Brown (D-OH) stated, "Several of today's bills have their roots in the JOBS Act and look to make changes that will supposedly increase capital formation or boost the number of IPOs back to levels from the 1990s. I am concerned that more time has been spent thinking about a JOBS Act 2.0 or 3.0 and finding laws that should be scaled back instead of trying to understand if the original JOBS Act actually

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[4] *See* NASAA Report and Recommendations for Reinvigorating Our Capital Markets (Feb. 7, 2023).

[5] *See* Jumpstart Our Business Startups Act (the "JOBS Act 1.0"), Pub. L. No. 112-106, 126 Stat. 306 (Jan. 3, 2012). Following the 2012 JOBS Act, Congress passed the Fixing America's Surface Transportation Act (the "FAST Act"), Pub. L. No. 114-94 (Dec. 4, 2015), which was unofficially dubbed "JOBS Act 2.0."

[6] *See* Organizations and Individuals Critical of Anti-investor Provisions in the House JOBS Act and Companion Senate Bills (Mar. 12, 2012). Other organizations and individuals included AFSCME, Americans for Financial Reform, Chicago Consumer Coalition, Columbia Law School Professor John Coffee, Consumer Action, Consumer Federation of California, Consumer Federation of the Southeast, Empowering and Strengthening Ohio's People, Former SEC Chief Accountant Lynn Turner, Florida Consumer Action Network, Harvard Professor of Business and Law John Coates, Massachusetts Communities Action Network, Motley Fool Mutual Fund Manager Bill Mann, National Education Association, National Association of Consumer Advocates, National Consumers League, NEDP, ProgressOhio, Public Citizen, Renaissance Capital's K, SAFER, University of Florida Finance Professor Jay Ritter, Virginia Citizens Consumer Council, and Will Will Win, Inc.

[7] On July 17, 2018, the U.S. House of Representatives passed the "JOBS and Investor Confidence Act of 2018," S.488, 115th Congress (2017-2018), which was a compilation of 32 bills that were considered "JOBS Act 3.0." *See* Glenn Pollner, Elizabeth Ising & Thurston Hamlette, JOBS Act 3.0, Harvard Law School Forum on Corporate Governance (Aug. 6, 2018).

created any jobs."[8] Concerned once again with the possible adverse impact of these measures on investors and the capital markets, stakeholders such as Americans for Financial Reform, Columbia Law School Professor John Coffee, Consumer Federation of America, and NASAA opposed further deregulatory JOBS Act measures.[9]

Nevertheless, some policymakers continue to support this approach. Notably, starting in or about 2018, the then-Chairman of the U.S. Securities and Exchange Commission ("SEC", "Commission" or agency herein, as appropriate) used the agency's existing rulemaking authorities to enact various JOBS Act 3.0 measures that Congress did not advance. For example, in 2020, a divided Commission voted three (3) to two (2) to amend the SEC's definition of an "accredited investor" to designate the General Securities Representative license (Series 7), the Private Securities Offerings Representative license (Series 82), and the Investment Adviser Representative license (Series 65) as qualifying natural persons for accredited investor status pursuant to Rule 501(a)(1) under the Securities Act of 1933 ("Securities Act").[10]

As explained below, more JOBS Act legislation will not achieve different results. To the contrary, the results likely will be larger private securities markets that expose retail and institutional investors and the general public alike to the direct and indirect consequences of fraud and scams that have metastasized in the opacity of these markets. Moreover, as outlined below, these larger, dark markets may have systemic consequences for our financial markets and undermine our management of financial market stability.[11]

A. The Emerging Growth Company Regime Failed to Increase the Number of Companies That Become and Remain Public.

In 2012, Congress took steps to address the deterioration of the public markets, pointing to the slackening pace of initial public offerings ("IPOs") and the decline in the number of companies listed on exchanges which, in turn, yielded fewer attractive investment opportunities for retail investors. In particular, in Title I of the JOBS Act 1.0, Congress created a new "IPO on-ramp" for an "emerging growth company" ("EGC") to reduce the perceived burdens of becoming a public company and thereby encourage more companies to conduct an IPO.

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[8] *See, e.g.*, Opening Statement of Senator Brown at the Senate Banking Committee Hearing on Proposals to Increase Access to Capital (June 26, 2018).

[9] *See, e.g.,* Open Letter to Congress from Americans for Financial Reform and Consumer Federation of America on H.R. 3555, H.R. 6021, and H.R. 6177 (July 11, 2018); Testimony of Professor John Coffee, Columbia University Law School (May 23, 2018); Testimony of William Beatty, Past-President of the North American Securities Administrators Association, *The JOBS Act at Four: Examining Its Impact and Proposals to Further Enhance Capital Formation* (Apr. 14, 2016).

[10] *See* SEC Chairman Jay Clayton, Testimony on "Oversight of the Securities and Exchange Commission," (Nov. 17, 2020) (summarizing the SEC's recent rulemakings related to capital formation); Press Release 2020-248, SEC Proposes Conditional Exemption for Finders Assisting Small Businesses with Capital Raising (Oct. 7, 2020); Press Release 2020-191, SEC Modernizes the Accredited Investor Definition (Aug. 26, 2020); Press Release 2020-273, SEC Harmonizes and Improves "Patchwork" Exempt Offering Framework (Nov. 2, 2020); Press Release 2020-58, SEC Adopts Amendments to Reduce Unnecessary Burdens on Smaller Issuers by More Appropriately Tailoring the Accelerated and Large Accelerated Filer Definitions (Mar. 12, 2020).

[11] *See* Andrea Seidt, A Sideline View of Exempt and Unregistered Offerings in 2022 (Mar. 16, 2023).

Congress defined an EGC as a company with total annual gross revenues of less than $1 billion in its most recent fiscal year, thereby encompassing most companies that had gone public before 2012.[12] Congress permitted EGCs to go public while disclosing two prior years of audited financial statements instead of three and to stay public for five years without having to comply with executive compensation disclosure requirements.[13] Title I also allowed EGCs to "test the waters" by communicating with investors prior to the launch of an IPO, eliminated firewalls that prevented research analysts from communicating with the IPO underwriters and clients of the research analysts' own financial institution, and allowed companies to seek confidential review by SEC staff of draft registration statements prior to making them available to the public.[14] In addition, Congress permitted EGCs to stay public for up to five years without having to comply with the mandatory audit firm rotation requirement or the auditor attestation requirement established by Congress in the early 2000s following numerous auditing scandals.[15]

In 2015, Congress further relaxed disclosure requirements for EGCs.[16] For example, Congress permitted EGCs to omit from their IPO registration statements certain historical financial information otherwise then-required by Regulation S-X.[17] Specifically, the JOBS Act 2.0 permitted EGCs that file an IPO registration statement (or submit a confidential draft registration statement) on Form S-1 or Form F-1 to omit Regulation S-X financial information for historical periods otherwise required as of the time of filing (or confidential submission), provided that **(1)** the omitted financial information relates to a historical period that the EGC reasonably believes will not be required to be included in the Form S-1 or Form F-1 at the time of the offering; and **(2)** prior to the distribution of a preliminary prospectus to investors, the registration statement is amended to include all financial information required by Regulation S-X at the date of such amendment.[18]

As shown in the table below,[19] the EGC regime has failed to achieve the goal of stimulating IPOs.[20] While IPO volumes in 2013 and 2014 were higher, the subsequent declines suggest that 2013 and 2014 IPO volumes are largely attributable to economic conditions rather

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[12] *See* JOBS Act 1.0 at § 101.

[13] *See* JOBS Act 1.0 at §§ 102-104.

[14] *See* JOBS Act 1.0 at §§ 105-106.

[15] *See* JOBS Act 1.0 at § 104.

[16] *See* JOBS Act 2.0 at §§ 71001-71003.

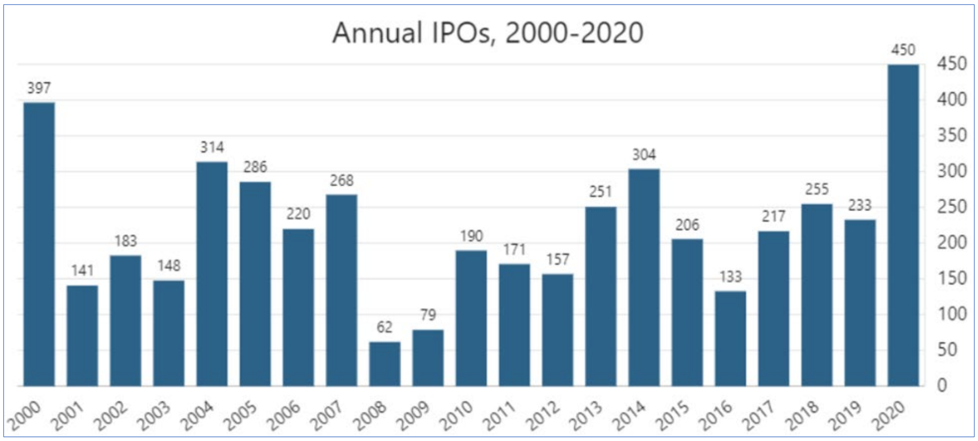
[17] Regulation S-X is an SEC regulation under the Securities Act that outlines how registrants should disclose financial statements on specified registration statements, periodic reports, and other filings except as otherwise specifically provided in the SEC forms. Regulation S-X most commonly arises in the context of drafting a Form S-1, Form 10-K, or Form 8-K. *See* 17 CFR § 210.

[18] *See* SEC, Fixing America's Surface Transportation Act: Questions and Answers (last updated Aug. 17, 2017).

[19] *See* Tim Fries, Despite Pandemic, 2020 Saw 450 IPOs Raise Over $156 Billion, The Tokenist (Dec. 14, 2020).

[20] One notable exception has been found in the biotech industry, a major proponent of the JOBS Act. An analysis by Craig Lewis and Josh White showed that "annual biotech IPO volume from 2012 to 2018 increased by 219 percent over a similar period before the JOBS Act." Moreover, biotech companies account for just over 30 percent of all IPOs in the U.S. after the JOBS Act. Craig Lewis & Josh White, Deregulating Innovation Capital: The Effects of the JOBS Act on Biotech Startups, Review of Corporate Finance Studies (forthcoming) (Nov. 13, 2022).

than the passage of the IPO on-ramp in 2012. While the number of IPOs increased substantially in 2020, the proliferation of special purpose acquisition companies ("SPACs"), not the EGC regime, drove that uptick.[21]



B. The EGC Regime Failed in Part Because Other Titles in the JOBS Acts Incentivized Companies to Remain Private.

Congress established the EGC regime to make it easier for companies to become and remain public. At the same time, however, Congress passed reforms designed to make it easier for companies to raise unlimited amounts of capital in the private markets and essentially forestall indefinitely the need to pursue an IPO or become a reporting company under the Securities Exchange Act of 1934 ("Exchange Act"), or both. By deregulating the private markets, Congress disincentivized companies from going or remaining public.

First, Congress undermined the EGC regime by amending Section 12(g) of the Exchange Act, and specifically the thresholds for shareholders of record, to effectively give most companies the ability to stay private indefinitely no matter how widely held or widely traded their shares are.[22] A shareholder of record is one who holds official title to the shares. Importantly, one shareholder in fact can be an entity such as a brokerage firm or private fund that holds securities on behalf of numerous beneficial owners who hold the contractual right to sell or vote the shares.[23] Before 2012, Exchange Act Section 12(g) required companies to become public reporting companies, regardless of the method used to distribute the shares, if they had assets of at least \$10 million and a class of securities that were "held of record" by at least 500 persons.[24] According to the SEC, "the registration requirement of Section 12(g) was aimed at issuers that had 'sufficiently active trading markets and public interest and consequently were in

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[21] *See* Jay R. Ritter, Special Purpose Acquisition Company (SPAC) IPOs Through 2021 (last updated Jan. 24, 2023). NASAA generally supports rules to encourage companies to bring their securities to the public market through registered offerings. We have expressed concerns regarding the use of SPACs and have supported a number of SEC proposals to address those concerns. *See, e.g.,* NASAA Comment Letter to SEC Regarding File No. S7-13-22: Special Purpose Acquisition Companies, Shell Companies, and Projections (June 13, 2022).

[22] *See* JOBS Act 1.0 at §§ 501-502 and 601.

[23] *See* NASAA Letter to Congress in Support of Reed Amendment #1931 (Mar. 22, 2012).

[24] *See* Usha Rodrigues, The Once and Future Irrelevancy of Section 12(g), 2015 U. ILL. L. REV. 1529, 1530.

need of mandatory disclosure to ensure the protection of investors.'"[25] As a result of the JOBS Acts, Congress made it possible for companies to stay private so long as the issuer that is not a bank, bank holding company or savings and loan holding company has less than $10 million of total assets and the securities are "held of record" by either 2,000 persons, or 500 persons who are not accredited investors, excluding those who received shares as part of an employee compensation plan.[26]

Second, Congress made other changes to the securities laws that allowed companies to raise significant amounts of money from the general public without having to produce critical initial disclosures and periodic reports that are the hallmark of public companies. For example, in Title II of the JOBS Act 1.0, Congress eliminated the longstanding prohibition against the use of general solicitation by those who engage in certain private offerings under Rule 506 of SEC Regulation D.[27] Title III created a new exemption to allow companies to raise capital through "crowdfunding," a technique of selling small amounts of securities to large numbers of investors, generally through online portals.[28] Title IV directed the SEC to expand the ability of companies to raise capital under SEC Regulation A.[29]

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[25] *See* SEC, Reporting by Small Issuers, Release No. 23,407, 1986 WL 703825 at *2 (July 8, 1986). *See also* Anat Alon-Beck, Mythical Unicorns and How to Find Them: The Disclosure Revolution, Columbia Business Law Review (2022 Forthcoming), Case Western Reserve University Research Paper Series in Legal Studies, Paper No. 2022-6 (May 10, 2020), at 22 ("The original intent behind instituting limits on shareholders of record was to capture firms which [were] already broadly trading.").

[26] *See, e.g.,* JOBS Act 1.0 at §§ 501-502; SEC, Changes to Exchange Act Registration Requirements to Implement Title V and Title VI of the JOBS Act: A Small Entity Compliance Guide (May 24, 2016).

[27] *See* JOBS Act 1.0 at § 201. *See* SEC, General Solicitation – Rule 506(c) (last updated Apr. 6, 2023) ("Rule 506(c) permits issuers to broadly solicit and generally advertise an offering, provided that: all purchasers in the offering are accredited investors; the issuer takes reasonable steps to verify purchasers' accredited investor status; and certain other conditions in Regulation D are satisfied. Purchasers in a Rule 506(c) offering receive 'restricted securities.' A company is required to file a notice with the Commission on Form D within 15 days after the first sale of securities in the offering. Although the Securities Act provides a federal preemption from state registration and qualification under Rule 506(c), the states still have authority to require notice filings and collect state fees. Rule 506(c) offerings are subject to 'bad actor' disqualification provisions.").

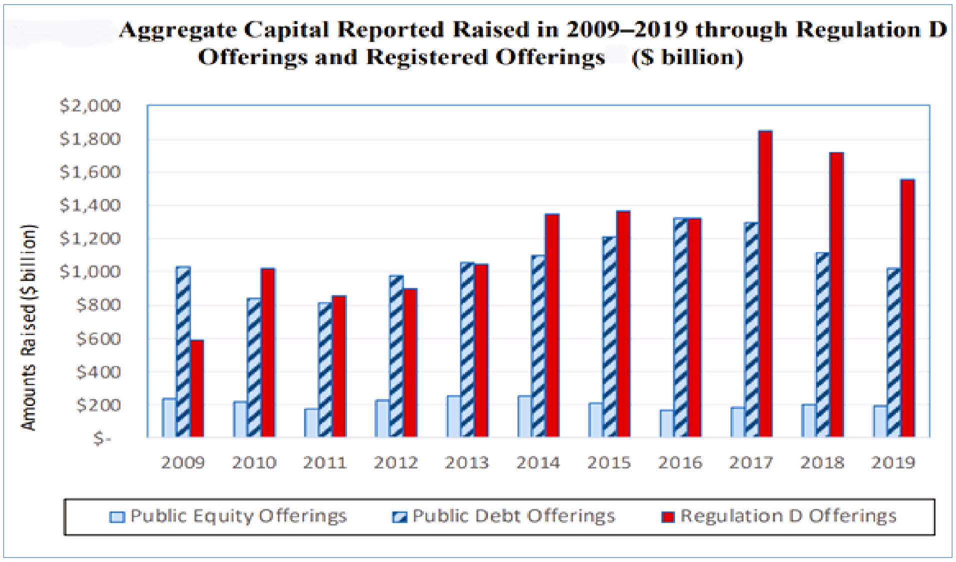
[28] *See* JOBS Act 1.0 at §§ 301-305. Since 2012, changes have been made to Regulation Crowdfunding ("Regulation CF"). *See also* SEC, Regulation Crowdfunding (last updated Apr. 6, 2023) ("Regulation Crowdfunding enables eligible companies to offer and sell securities through crowdfunding. The rules: require all transactions under Regulation Crowdfunding to take place online through an SEC-registered intermediary, either a broker-dealer or a funding portal; permit a company to raise a maximum aggregate amount of $5 million through crowdfunding offerings in a 12-month period; limit the amount individual non-accredited investors can invest across all crowdfunding offerings in a 12-month period; and require disclosure of information in filings with the Commission and to investors and the intermediary facilitating the offering. Securities purchased in a crowdfunding transaction generally cannot be resold for one year. Regulation Crowdfunding offerings are subject to 'bad actor' disqualification provisions."). Offerings under the Regulation CF exemption of the Securities Act are not potentially subject to state registration or qualification. However, many states have notice filing requirements and fees for these transactions.

[29] *See* JOBS Act 1.0 at §§ 401-402. Since 2012, changes have been made to Regulation A. *See also* SEC, Regulation A (last updated Apr. 6, 2023) ("Regulation A is an exemption from registration for public offerings. Regulation A has two offering tiers: Tier 1, for offerings of up to $20 million in a 12-month period; and Tier 2, for offerings of up to $75 million in a 12-month period. For offerings of up to $20 million, companies can elect to proceed under the requirements for either Tier 1 or Tier 2. There are certain basic requirements applicable to both Tier 1 and Tier 2 offerings, including company eligibility requirements, bad actor disqualification provisions, disclosure, and other

C. The JOBS Acts Amplified Measures Enacted Between the 1980s and 2000s That Fostered Robust Private Markets in the United States.

Ninety years ago, Congress passed the first federal securities laws. They protected the primacy of our public securities markets.[30]

Today, public offerings of securities are no longer the dominant form of capital formation in the United States by an extraordinary margin. As shown in the table below, SEC Regulation D offerings—99.9 percent of which are under Rule 506—have eclipsed the amounts of capital raised in public offerings.[31]



matters. Additional requirements apply to Tier 2 offerings, including limitations on the amount of money a non-accredited investor may invest in a Tier 2 offering, requirements for audited financial statements and the filing of ongoing reports. Issuers in Tier 2 offerings are not required to register or qualify their offerings with state securities regulators."). Issuers in Tier 1 offerings may be required to register or qualify their offerings with state securities regulators. Many states have notice filing requirements and fees for Tier 1 and Tier 2 transactions.

[30] Since the 1930s, there have been exceptions to the general rule that offerings conducted in the United States must be registered with the SEC, and offerings meeting certain conditions have been exempted from mandatory disclosure requirements. The most notable of these exemptions was for offerings that did not involve a "public offering" of securities. Conceptually, fulsome public disclosures were considered unnecessary when a sale of securities did not involve an offer to the public. *See* SEC v. Ralston Purina Co., 346 U.S. 119, 122 (1953), citing H.R. Rep. No. 85, 73rd Congress, 1st Session. In a seminal case addressing this question, the Supreme Court in 1953 considered an offering to employees of the issuer and noted that "the number of offerees is not determinative of whether an offering is public." According to the Supreme Court, to be a transaction not involving a public offering, it must be directed to persons who "do not need the protection of the [Securities Act of 1933]" because they are able to "fend for themselves." Further, in view of the broadly remedial purposes of the Securities Act, the Supreme Court held that it is reasonable to place on an issuer the burden of proving that purchasers of its securities had access to the kind of information which registration under the Securities Act would disclose.

[31] Regulation D includes a second exemption under Rule 504, but Rule 506 offerings make up more than 99.9 percent of offerings conducted under Regulation D. *See* SEC, Report to Congress on Regulation A / Regulation D Performance As Directed by the House Committee on Appropriations in H.R. Rept. No. 116-122 (Aug. 2020) at 16.

The path toward the primacy of our unregistered Regulation D market in the United States began in roughly the early 1980s. Key developments occurred in 1982, 1996, 2010, and 2020, as briefly described below.

In 1982, the SEC decided to exempt Rule 506 offerings from registration with the SEC.[32] At that time, the SEC believed the change would allow sales to a limited number of people. Importantly, these individuals would have bargaining power or financial wherewithal such that they could "fend for themselves" in the absence of the protections inherent in registration requirements that reduce the normal informational asymmetries between buyers and sellers of securities.[33] In general, the new Rule 506 provided that sales of securities to unlimited numbers of accredited investors and up to 35 sophisticated non-accredited investors would not be considered a public offering that requires registration, but only if the offeror did not use any form of general solicitation. Accredited investors were defined as natural persons with a net worth in excess of $1 million (either alone or together with a spouse) or an income of $200,000 per year (or married couples with a combined income of $300,000).

In 1996, Congress passed the National Securities Markets Improvement Act ("NSMIA") and in so doing preempted state review and qualification of Rule 506 offerings.[34] Thereafter, companies were allowed to raise unlimited amounts of capital from unlimited numbers of accredited investors with no specific disclosure obligations and no regulatory review at either the federal or state level. This also had the effect of disincentivizing companies from pursuing exchange listings of their securities to avail themselves of the registration exemptions then available under state laws for securities listed on a national exchange.

In 2010, pursuant to Section 413(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), Congress required the SEC to update the definition of "accredited investors" to exclude the value of a person's primary residence for purposes of determining whether the person qualifies as an "accredited investor" on the basis of having a net worth in excess of $1 million.[35] Neither Congress nor the SEC has since changed the income and net worth thresholds of the SEC's definition. In turn, and given inflation, an exemption that originally allowed unregistered securities to be sold to 1.6 percent of the U.S. population in the early 1980s now allows those sales to occur to approximately 13 percent of the population.[36]

[32] *See* SEC Final Rule, Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers and Sales, Release No. 33-6389, 47 FED. REG. 51 (Mar. 16, 1982) at 11251.

[33] *See, e.g.,* Joint Professor Letter; Consumer Federation of America Comment Letter Regarding the SEC Concept Release on Harmonization of Securities Offering Exemptions (Oct. 1, 2019) at 9-13. *See also* Craig McCann, Susan Song, Chuan Qin & Mike Yan, HJ Sims Reg D Offerings: Heads, HJ Sims Wins - Tails, Their Investors Lose, SLCG Economic Consulting (2022). *See also* Inactive and Delinquent Reg D Issuers (2022); Regulation D Offerings Summary Statistics (2022) and Broker-Sold Regulation D Offerings Summary Statistics (2022), all by Craig McCann, Chuan Qin & Mike Yan.

[34] *See* NSMIA, Pub. L. No. 104-290, 110 Stat. 3416 (Oct. 11, 1996).

[35] *See* Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010) at § 413(a).

[36] *See* SEC Proposed Rule, Amending the "Accredited Investor" Definition, Release Nos. 33-10734 and 34-87784 (Dec. 18, 2019), at 77, 134.

Meanwhile, Congress and the Commission have made changes since 2010 to relax and effectively expand the scope of the exemption for Rule 506 offerings. Of note, the Commission adopted Rule 506(c) in 2013 to satisfy a JOBS Act 1.0 mandate.[37] Rule 506(c) provides that a company can broadly solicit and generally advertise an offering and still be deemed in compliance with the exemption of Rule 506 provided/if the company takes steps to verify that all investors are accredited investors.[38] As explained above, the Commission adopted changes in 2020 to the definitions of an "accredited investor" that allow individuals for the first time to qualify as "accredited investors" by virtue of their financial sophistication and without regard to their financial wherewithal.[39]

Moreover, Congress and the Commission have made it easier to trade Rule 506 securities. Originally, the purchaser of a security in an offering under Rule 506 was restricted from reselling the security for a period of two years.[40] In 1997, the Commission amended Rule 144(d) under the Securities Act to reduce the holding period for restricted securities from two years to one year, thereby increasing the attractiveness of Regulation D offerings to investors and to issuers. In 2007, the Commission made additional changes, again to ease the trading of these securities.[41] In 2015, Congress codified an informal exemption that securities practitioners had been using for private resales of securities by non-issuers (such as employees, executive officers, directors, and large shareholders) that were acquired in a private offering.[42] The new Section 4(a)(7) exemption under the Securities Act permitted private resales of restricted securities to "accredited investors" where no general solicitation is used and certain information concerning the issuer and the transaction is provided to the purchaser of the security.[43] Together, these changes have reduced the need for companies to turn to the public markets to provide a way for

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[37] *See* JOBS Act 1.0 at § 201.

[38] *See* SEC, Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings: A Small Entity Compliance Guide (last modified Sept. 20, 2013).

[39] *See* SEC Final Rule, Accredited Investor Definition, Release Nos. 33-10824 and 34-89669 (Aug. 26, 2020). *See also* Press Release 2020-273, SEC Harmonizes and Improves "Patchwork" Exempt Offering Framework (Nov. 2, 2020) ("When issuers use various private offering exemptions in parallel or in close time proximity, questions can arise as to the need to view the offerings as "integrated" for purposes of analyzing compliance. This need results from the fact that many exemptions have differing limitations and conditions on their use, including whether the general solicitation of investors is permitted. If exempt offerings with different requirements are structured separately but analyzed as one "integrated" offering, it is possible that the integrated offering will fail to meet all the applicable conditions and limitations. The amendments establish a new integration framework that provides a general principle that looks to the particular facts and circumstances of two or more offerings, and focuses the analysis on whether the issuer can establish that each offering either complies with the registration requirements of the Securities Act, or that an exemption from registration is available for the particular offering.")

[40] *See* Letter from Keith F. Higgins, Chair, Committee on Federal Regulation of Securities, American Bar Association, to John W. White, Director, SEC Division of Corporation Finance (Mar. 22, 2007).

[41] *See* SEC, Revision of Holding Period Requirements in Rules 144 and 145, Release No. 33-7390 (Feb. 20, 1997); SEC Votes to Adopt Three Rules to Improve Regulation of Smaller Business, Release No. 2007-233 (Nov. 15. 2007).

[42] *See* JOBS Act 2.0 at § 76001.

[43] *See* SEC, Recently Enacted Transportation Law Includes a Number of Changes to the Federal Securities Law (last updated Feb. 6, 2017).

founders, early investors, and employees to sell their shares. Also, these changes have allowed unregistered securities to be more widely distributed.

As the above illustrates, the expansion of the private markets has occurred in a piecemeal, incremental fashion during the last four decades without a critical assessment of the cumulative effect these changes have had on our capital markets. Today, the exemption under federal securities laws for Rule 506 offerings no longer meaningfully limits offerings to the type of investor that the Supreme Court, Congress, and the SEC once envisioned as able to "fend for themselves." Also, the regulatory requirements for these so-called "non-public offerings" often do not reflect the size, economic importance, or disparate ownership of the company issuing the securities.

D. The Dominance of the Private Markets May Have Systemic Implications.

As a result of the Dodd-Frank Act, the United States now has better systems in place for identifying and monitoring potential threats to the stability of our financial markets. Nevertheless, we respectfully submit that these systems may not be working effectively enough with respect to the growth and now dominance of the private securities and funds markets. While certain officials at the SEC are concerned by this issue, and the Office of Financial Research at the U.S. Department of the Treasury ("OFR") is monitoring it as best it can without sufficient data, it may well be the case that policymakers are not taking the threat seriously enough.[44]

As a general matter, the overall quality of certain key aspects of our markets has declined in recent decades. First, the overall quality of disclosure in our markets is worse than it was decades ago. This is in large part because of the deregulation of Rule 506 offerings and the policy decision to allow companies to raise an unlimited amount of money under this exemption. Second, as a general matter, corporate governance and internal controls in our early-stage markets are weaker than in decades past. Last, the overall quality of market regulation and policymaking – from rulemaking to examination to enforcement to investor education to federal legislation – is worse because these processes suffer when legislators, regulators, and other key stakeholders lack a clear line of sight into our securities markets.

Today, few disclosures are required or made voluntarily under Rule 506 of SEC Regulation D.[45] Generally, private companies raising capital under Rule 506 do not have to make their offering disclosures accessible to the SEC or state securities regulators. Instead, they can

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[44] The Office of Financial Research posits that financial stability vulnerabilities could stem from extreme valuations and sentiment. If the growth of private markets impedes the ability of market participants to properly assess the value of an offering, extreme valuations and sentiment could occur, leading to financial instability. *See* Office of Financial Research 2022 Annual Report to Congress (Jan. 12, 2023), ("Financial stability vulnerabilities that stem from market risk are more salient when valuations and sentiment are both at extremes…"). *See also* SEC Commissioner Allison Herren Lee, Going Dark: The Growth of Private Markets and the Impact on Investors and the Economy (Oct. 12, 2021); SEC Commissioner Caroline Crenshaw, Grading the Regulators and Homework for the Teachers: Remarks at Symposium on Private Firms: Reporting, Financing, and the Aggregate Economy at the University of Chicago Booth School of Business (Ap. 14, 2022).

[45] SEC Commissioner Crenshaw discussed the history and trends of Rule 506 of Regulation D earlier this year. *See* SEC Commissioner Caroline Crenshaw, Big 'Issues' in the Small Business Safe Harbor: Remarks at the 50th Annual Securities Regulation Institute (Jan. 30, 2023).

submit an 8-page form notice ("Form D notice") to the SEC and the applicable states where securities have been sold without registration under the Securities Act in an offering based on a claim of a qualifying exemption. The notice is published in the SEC's database called EDGAR and includes basic information regarding the securities issuer, the offering, the investors, and related fees. Of note, Form D itself includes a disclaimer designed to make clear to investors that the information in the notice may contain inaccurate or incomplete information. In addition to the weaknesses of the required Rule 506 disclosures, voluntary disclosures made in Rule 506 offerings about business plans and projections often are tainted with inaccuracies or overly optimistic assessments.

Importantly, the decline in the overall quality of our disclosures has consequences for businesses and regulators tasked with managing the stability of our financial markets. By way of example, the limited regulatory oversight of Rule 506 disclosures, coupled with what is often inaccurate and incomplete information in the disclosures, can and often does lead to the mispricing of the securities and inflated valuations. This occurs notwithstanding the presumed ability of the investors to "fend for themselves" in these transactions. The extent of mispricing can cause widespread harm to investors and non-investors alike when the bubbles finally burst. An illustrative example of such events is the recent mispricing and ultimate collapse of FTX Trading Ltd. and its affiliates.[46]

Similarly, the overall quality of corporate governance and internal controls in our early-stage markets is also weaker than in decades past. Founder-friendly terms that are common in private offerings can and often do lead to a culture of weak corporate governance and internal controls at these companies, making fraud or other misconduct more likely. In addition, the overall reduction in disclosure in our markets makes it more difficult even for diligent public companies to prepare accurate financial statements and financial risk disclosures. By way of example, issuers that rely on private and public companies for supplies may have trouble assessing their own risks if they cannot access timely, accurate information about the financial health and risks of their commercial partners.

Last, the overall quality of market regulation and policymaking – from rulemaking to examination to enforcement to investor education to federal legislation – suffers when legislators, regulators, and other key stakeholders lack a clear line of sight into our securities markets. In a 2021 speech, former SEC Commissioner Allison Herren Lee commented on this problem. She stated, "The increasing inflows into these [private] markets have also significantly increased the overall portion of our equities markets and our economy that is non-transparent to

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[46] On August 5, 2021, Samuel Bankman-Fried submitted a Form D to the SEC on behalf of FTX Trading Limited. The notice disclosed that the company had relied on a securities offering exemption in order to offer $1 billion of equity in his company without first registering the securities with the SEC. The notice disclosed that seventy-seven (77) investors had already invested in the offering. View the Form D filing on EDGAR. On November 2, 2021, Mr. Bankman-Fried submitted another Form D to the SEC. In this one, he notified the SEC that FTX Trading Limited had relied on a securities offering exemption in order to offer $415,341,812 of equity in his company without first registering the securities with the SEC. The notice disclosed that eighty-five (85) investors had already invested in the offering. View the Form D filing on EDGAR. *See also* NASAA Letter to Congress Regarding the Lessons from the FTX Bankruptcy (Nov. 30, 2022); FSOC, 2022 Annual Report (Dec. 16, 2022) at 86 ("The proposed amendments are designed to enhance the [FSOC]'s ability to monitor systemic risk and bolster the SEC's regulatory oversight of private fund advisers and investor protection effort…").

investors, markets, policymakers, and the public…. [I]nvestors, policymakers, and the public know relatively little about them compared to their public counterparts…. And here we are again watching a growing portion of the US economy go dark, a dynamic the Commission has fostered – both by action and inaction."[47]

IV. Congress Should Reject the Capital Formation Agenda Under Discussion.

Efforts are underway to pass legislation that would require us to continue down a deregulatory path that we know based on past similar efforts will not help us support entrepreneurs and small businesses, increase opportunities for all investors, and strengthen public markets. Specifically, in February and March 2023, the HFSC Subcommittee on Capital Markets held three hearings and noticed 31 proposals in connection with the same. Roughly, the subcommittee organized the hearings and proposals around the following topics: **(1)** reforms to support small businesses; **(2)** changes to the definitions of "accredited investor" under federal securities law; and **(3)** changes to incentivize companies to become and remain public. NASAA's Report and Recommendations for Reinvigorating Our Capital Markets was entered into the hearing record.[48]

Below, we describe the proposals and explain our present positions. In short, we support two of the 31 proposals because they are common sense improvements to our regulatory framework. We oppose 29 of the 31 proposals as written for various reasons, but principally because they would not achieve their stated goal or goals. When describing each proposal, we have used the text noticed in February or March 2023 unless the proposal has since been introduced and the text is available, in which case we describe the as-introduced version.[49]

V. Congress Should Pursue Policies That Help Entrepreneurs and Small Businesses and Oppose the Proposals Under Discussion as Anti-State or Anti-Business, or Both.

The HFSC is debating a mix of proposals pertaining to various aspects of our private markets. By way of example, there are a handful of proposals relating to specific exemptions for raising capital under state or federal securities laws, or both. In addition, there are proposals that would relax requirements for private funds, including ones that would or may invest in other private funds.

As explained below, NASAA has concerns with these proposals. Moreover, we strongly oppose four of these proposals because they would preempt state securities regulators.

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[47] *See also* SEC Commissioner Allison Herren Lee, Going Dark: The Growth of Private Markets and the Impact on Investors and the Economy (Oct. 12, 2021).

[48] *See* Hearing Entitled: Empowering Entrepreneurs: Removing Barriers to Capital Access for Small Businesses (Feb. 8, 2023) at 1:38:01.

[49] On April 13, 2023, Representatives Barr (R-KY), Garbarino (R-NY), Luetkemeyer (R-MO), McHenry (R-NC), Sessions (R-TX), Steil (R-WI), Wagner (R-MO), and Williams (R-TX) introduced 16 bills that appear to all be based on discussion drafts that were noticed in connection with the February and March hearings. As of April 16, 2023, the text was not publicly available. We wish to thank the staff for Representatives Barr, Luetkemeyer, Sessions, Steil, and Williams who promptly provided NASAA with copies of the as-introduced versions. To the extent the other offices have not had an opportunity to share the as-introduced with NASAA, we have used the discussion drafts for purposes of preparing this testimony.

Preserving state authority is critical because it is that authority that allows us to continue to protect investors and promote responsible capital formation by entrepreneurs and small businesses across the United States from urban centers to rural communities.

A. NASAA Strongly Opposes the Four Proposals That Would Preempt State Securities Regulators.

Four proposals under consideration would take away the authority of state governments to decide if and how state securities regulators will regulate certain securities transactions occurring within their states, as well as certain professionals operating within their states. Naturally, it is disappointing for state securities regulators to watch certain federal lawmakers praise the important work of state securities regulators, scold the federal government for not supporting small businesses and investors enough, and then antithetically introduce or otherwise support legislation that takes away the very authority that state securities regulators need to promote responsible capital formation and otherwise protect investors.

NASAA's opposition to the anti-state authority bills is two-fold.[50] First, we fundamentally disagree with the principle that the way to pursue more capital raising is to take away the authority of state governments to decide if and how their securities regulators will review securities offering materials for compliance with basic fairness standards and/or the authority to receive notification of an offering or sale that has occurred within their state. This is especially so when these offerings will be offered and sold by businesses at the local level. State securities regulators regularly witness firsthand the value that comes from having small businesses engage directly with local regulators regarding small-dollar offerings. This engagement helps entrepreneurs better understand their options for raising capital. It also deters fraud and other misconduct that can harm business owners and investors alike. Last, it facilitates investor access to information necessary to make informed investment decisions, thus enhancing the fairness and efficiency of our capital markets. In sum, further erosion of the authority of state securities regulators can be dangerous for the businesses and investors operating in our communities and counterproductive to the federal government's goals of supporting hard-to-reach entrepreneurs, small businesses, and investors.

Second, the explosive growth of America's marketplace for private securities offerings the last several decades, including without limitation deals under Regulation A, Regulation CF, and Regulation D of the Securities Act, has created significant policy challenges for Congress, as well as for state and federal securities regulators. One facet of the challenge is the widespread and growing disparity in access to investment opportunities. This challenge would not exist, or at least not exist to the extent it does, if we had not spent decades pursuing and enacting regulations and laws that tilt the markets heavily in favor of private securities markets and private funds.

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[50] NASAA consistently raised concerns regarding anti-state authority bills proposed in the 117th Congress. *See, e.g.,* Maryland Securities Division Commissioner Melanie Senter Lubin, Written Testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs Regarding Protecting Investors and Savers: Understanding Scams and Risks in Crypto and Securities Markets (July 28, 2022); NASAA Letter to Appropriations Committee Leadership Regarding Securities Policy Riders (Dec. 1, 2022); NASAA Letter to Committee Leadership Regarding Opportunities to Strengthen Diversity in Our Capital-Markets (Dec. 12, 2022).

The proposals under discussion are **(1)** H.R. ___, the Small Entrepreneurs' Empowerment and Development ("SEED") Act; **(2)** H.R. ___, the Improving Crowdfunding Opportunities Act; **(3)** H.R. 2506, the Restoring the Secondary Trading Market Act; and **(4)** H.R. ___, the Unlocking Capital for Small Businesses Act.

First, **H.R. ___, the Small Entrepreneurs' Empowerment and Development ("SEED") Act**, would establish a safe harbor for so-called "micro-offerings." The harbor would exempt the sale of securities from registration requirements under the Securities Act if the aggregate amount of all securities sold by the issuer during the 12-month period preceding the sale does not exceed $250,000. The SEED Act would also preempt the authority of the states to require registration with, or notice to, the states where these offerings are made.[51]

NASAA strongly opposes the SEED Act for four key reasons. First, this legislation is unnecessary. There are more avenues than ever to raise capital, especially for an offering of $250,000 or less. Second, this legislation injects new complexity to an exemption framework that is complex already.[52] Third, we cannot protect investors if we lack a line of sight into companies selling these securities. We also cannot help entrepreneurs and small businesses in our states if we do not know they are operating there. Registration and notice filings are the regulatory tools we use to know who is operating in our states. Fourth, absent these filings (which essentially are communications to the states), state securities regulators may first learn about the transactions through other communications such as a call from a concerned citizen or investor and be obligated to open an investigation, all without the benefit of the information that would have been communicated through these filings. For some issuers, it may require more resources to respond to the investigation than it would have required to prepare a basic filing. At the end of the day, all this legislation would do is reduce educational and compliance support for the very entrepreneurs and small businesses that state securities regulators presently are helping.

Second, **H.R. ___, the Improving Crowdfunding Opportunities Act**, would prohibit state securities regulators from requiring securities issuers to report information to the states regarding trades of their securities made through funding portals. It also would reverse an SEC interpretation of Regulation CF that treats crowdfunding portals as issuers for liability purposes by stating portals will not be treated as issuers unless they knowingly lie to or mislead investors or otherwise engage in a fraud upon them.[53] In addition, this legislation would exclude funding portals from the recordkeeping and reporting requirements of the federal Bank Secrecy Act. Last, the proposal would permit impersonal investment advice and recommendations by funding portals that do not purport to meet the objectives or needs of a specific individual or account.[54]

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[51] On April 13, 2023, Representative Patrick McHenry (R-NC) introduced this legislation as H.R. 2609. NASAA will review H.R. 2609 once the text is available.

[52] *See, e.g.*, SEC Overview for Exemptions to Raise Capital (last updated Apr. 6, 2023) (setting forth a chart that provides certain regulatory information and requirements that govern 10 different avenues for raising capital under existing exemptions from federal securities laws).

[53] *See* 17 CFR § 227.503(a)(3)(ii).

[54] On April 13, 2023, Representative Patrick McHenry (R-NC) introduced this legislation as H.R. 2607. NASAA will review H.R. 2607 once the text is available.

For several reasons, NASAA strongly opposes the Improving Crowdfunding Opportunities Act. While the SEC's mission includes the facilitation of capital formation and the protection of investors, the SEC does not take the kind of grassroots approach to this work that is typical of state agencies. The SEC was slow to establish a new regime for crowdfunding transactions,[55] has been slow or unwilling to take enforcement actions in crowdfunding-related cases that involve losses under $1 million, and lacks the resources to engage with startups throughout the United States regarding their options for raising capital under state and federal crowdfunding laws.[56] Given the SEC's record of deprioritizing crowdfunding issuers and investors, Congress should understand that further preemption of the states in this area would expand the *de facto* regulatory gap that exists with respect to the regulation of crowdfunding transactions. That gap, coupled with the funding portal liability contemplated under this proposal, likely will lead to more aggressive practices by funding portals, fewer remedies for harmed investors, and ultimately damage the credibility of offerings made under the SEC's Regulation CF.

Third, **H.R. 2506, the Restoring the Secondary Trading Market Act**, would prohibit states from deciding for themselves whether and how to regulate certain secondary trading of securities that occurs "off-exchange," or over the counter, so long as the issuer makes certain information regarding the securities publicly available under SEC Regulation A and SEC Rule 15c2-11. This legislation pertains to a lesser-used path for raising capital, specifically the path for Tier 2, Regulation A offerings. The offering limit for these transactions within a 12-month period is $75 million. In addition to other requirements, such offerings can be sold to non-accredited investors. However, such sales to non-accredited investors are subject to investment limits based on the greater of annual income and net worth, unless the securities have been listed on a national securities exchange. That said, national securities exchanges have shown little interest in listing these securities due to their lack of quality and derivatively a lack of investor demand.[57]

NASAA strongly opposes **H.R. 2506, the Restoring the Secondary Trading Market Act**. As a general matter, this legislation is unnecessary. Presently, most states, including the Commonwealth of Pennsylvania, maintain what regulators call a "manual exemption."[58] These orders or rules effectively waive regulatory obligations that issuers of these securities would otherwise have under ongoing reporting requirements so long as the issuers make company

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[55] The SEC adopted final rules permitting companies to offer and sell securities through crowdfunding in 2015, three years after enactment of the JOBS Act 1.0. *See* Press Release 2015-249, SEC Adopts Rules to Permit Crowdfunding (Oct. 30, 2015).

[56] Roughly two dozen states enacted crowdfunding laws before the SEC implemented Regulation CF. *See* Stacy Cowley, Tired of Waiting for U.S. to Act, States Pass Crowdfunding Laws and Rules (June 3, 2015) ("Twenty-two states and the District of Columbia have enacted such rules, nine of them in the last six months. Eleven states are considering creating such laws and procedures. Three more states — Florida, Illinois and New Mexico — have rules or legislation awaiting the governor's signature.").

[57] *See* SEC Report to Congress: Access to Capital and Market Liquidity (Aug. 2017) at 53 ("Additionally, a lack of secondary market liquidity may discourage investors from participating in Regulation A offerings at valuations that the issuer finds attractive.").

[58] *See* Exemptions, Pennsylvania Department of Banking and Securities.

disclosure available to investors in a designated securities manual. In many states, the SEC's EDGAR website can be a designated source. NASAA is committed to further review of the manual exemption and promulgating a model rule that will make it easier for the remaining jurisdictions to consider and, if appropriate, adopt a manual exemption. In April 2023, the NASAA Board of Directors approved the publication of a concept release to seek internal comment and public comment that would inform NASAA's rulemaking. In addition to other input, the request for comment will seek data on the use of the manual exemption and suggestions for how the exemption could be improved from an investor protection standpoint.

Setting aside the concern of necessity, NASAA also opposes the legislation because it will not solve the longstanding illiquidity problems in the Regulation A market. Previously, the federal government preempted the states from primary offerings conducted under Tier 2, Regulation A because it believed such preemption would stimulate use of this pathway for raising capital. Yet, this market still suffers from a lack of demand among other reasons because investors want to avoid high costs, high information asymmetries, and high investment minimums associated with these deals.[59] Similarly, a variety of factors having nothing to do with state regulations, including inefficiencies in share transfer recordkeeping and the fact that the issuer usually has a right of first refusal, still hinder the secondary trading of these securities. Inaction with respect to those factors, coupled with further preemption of state governments, would not spur additional demand for these securities.[60]

Relatedly, NASAA opposes **H.R. ____, the Regulation A+ Improvement Act of 2023**. This legislation would amend the federal securities laws to increase the dollar limit of certain securities offerings presently exempt from federal registration requirements to $150 million annually, adjusted in future years for inflation. The legislation contains no state preemption provisions because Congress took away the choice of the states to review and register these offerings. Rather than codifying the SEC's decision in 2020 to increase the maximum offering amount under Tier 2 of Regulation A from $50 million to $75 million, this legislation would increase the cap to $150 million.

In short, we oppose this legislation because there is no reason to believe, for the reasons stated previously herein, that such reforms would stimulate additional investor demand in the Regulation A market.[61] If Congress wanted to take additional action with respect to the

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[59] *See* Faith Anderson, Prepared Remarks of Faith Anderson for the SEC Investor Advisory Committee Regarding the Growth of Private Markets (Mar. 2, 2023) at 4.

[60] *See* Andrea Seidt, Prepared Remarks of Andrea Seidt for the SEC SBCFAC Regarding Secondary Market Liquidity (Aug. 2, 2022) at 2.

[61] In August 2020, the SEC issued a report—as mandated by Congress—on the performance of Regulation A and Regulation D. SEC staff examined Regulation A offerings conducted between June 2015 and the end of 2019. During this time period, the total amount raised under Regulation A was $2.4 billion, including $2.2 billion under Tier 2 and $230 million under Tier 1. Issuers sought an average of $30.1 million in Tier 2 offerings but raised on average only $15.4 million. In Tier 1 offerings, issuers sought an average of $7.2 million and raised $5.9 million. Data is not available to show the extent to which retail investors other than accredited investors were participants in these offerings. The SEC staff found that the typical issuer does not experience an improvement in profitability, continuing to realize a net loss in the years following an offering that utilizes Regulation A. This was based on available data, which necessarily overstated the success rate because it only included issuers that continued to file

Regulation A market, it would be useful to direct the SEC to conduct a holistic study on U.S. capital markets and, in doing so, research and analyze whether it even makes sense to maintain the Regulation A regulatory framework given the persistent lack of demand for these deals.

The fourth and final preemption bill under discussion is **H.R. ___, the Unlocking Capital for Small Businesses Act**. This bill would exempt "finders" from registration under federal law and effectively prohibit state registration. In addition, it would permit securities brokers to be treated as a "finder" in a given calendar year if they are paid less than $500,000; conduct fewer than 16 unrelated transactions; or do deals valued at less than $30 million.

In addition to regulating finders, the Unlocking Capital for Small Businesses Act would amend Exchange Act Section 15 to impose a broker-dealer-light regulatory regime on private placement brokers. The proposal would direct the SEC to promulgate regulations with respect to private placement brokers that are no more stringent than those imposed on funding portals, as well as regulations that require the rules of any national securities association to allow a private placement broker to become a member of such association subject to reduced membership requirements. In addition, the bill would require private placement brokers to make certain written disclosures to all parties to a transaction before effecting the transaction, including disclosures related to payment for services rendered or any direct or indirect beneficial interest in the issuer of the private placement broker, of a member of the immediate family of the private placement broker, of an associated person of the private placement broker, or of a member of the immediate family of such associated person. The bill defines "private placement broker" as "a person that **(A)** receives transaction-based compensation—**(i)** for effecting a transaction by—**(I)** introducing an issuer of securities and a buyer of such securities in connection with the sale of a business effected as the sale of securities; or **(II)** introducing an issuer of securities and a buyer of such securities in connection with the placement of securities in transactions that are exemption from registration requirements under the Securities Act of 1933; and **(ii)** that is not with respect to—**(I)** a class of publicly traded securities; **(II)** the securities of an investment company (as defined in section 3 of the Investment Company Act of 1940); or **(III)** a variable or equity-indexed annuity or other variable or equity-indexed life insurance product; **(B)** with respect to a transaction for which securities-based compensation is received—**(i)** does not handle or take possession of the funds or securities; and **(ii)** does not engage in an activity that requires registration as an investment adviser under State or Federal law; and **(C)** is not a finder as defined [under the bill]".[62]

NASAA strongly opposes the Unlocking Capital for Small Businesses Act because it would take away the authority of states to decide how best to structure a regulatory framework appropriate for the types of activities conducted by these investment professionals. Prior to conducting business in a state, most securities brokers must go through a licensing and registration process. It is an essential gatekeeping process through which regulators learn about

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periodic reports after the offerings and not those that ceased operations and reporting. Despite the infusion of capital, only 45.8 percent of issuers continued filing periodic reports for three years following the offering. *See* SEC, Report to Congress on Regulation A / Regulation D Performance As Directed by the House Committee on Appropriations in H.R. Rept. No. 116-122 (Aug. 2020) at 88, 89, 91, 94, and 98.

[62] On April 13, 2023, Representative Andrew Garbarino (R-NY) introduced this legislation as H.R. 2590. NASAA will review H.R. 2590 once the text is available.

these businesses and demonstrate that the professionals understand the basics of state securities laws before they solicit investors. Again, state securities regulators cannot protect investors or otherwise support responsible capital formation if we lack a line of sight into who is promoting securities in our states. While NASAA is pursuing or otherwise supporting sensible changes that would make the licensing and registration process easier for these investment professionals, we likely would need the collaboration and cooperation of the SEC and the Financial Industry Regulatory Authority ("FINRA") to align all applicable SEC and FINRA rules with any changes advanced by state securities regulators. To this point, we continue to urge Congress to call on the SEC and FINRA to work with state securities regulators to evaluate potential changes to the existing regulatory framework.

B. NASAA Opposes the Three Proposals Relating to Private Funds That Would Expand the Private Markets.

NASAA also opposes the three bills under discussion that would only add to the explosive growth of private investment funds in recent decades. Those bills are as follows:

- **H.R. 2579, the Developing and Empowering Our Aspiring Leaders Act ("DEAL") of 2023**, would require the SEC to expand the definition of a qualifying investment, for purposes of the exemption from registration for venture capital fund advisers under the Investment Advisers Act ("the Advisers Act"). Specifically, the SEC would be required to include equity securities issued by qualifying portfolio companies, as well as investments in other venture capital funds, as qualifying investments. Venture capital funds presently must file with the SEC as an Exempt Reporting Adviser and ensure that more than 80 percent of their activities are in qualifying investments defined as direct investments into private companies.[63]

- **H.R. ___, the Improving Capital Allocation for Newcomers ("ICAN") Act of 2023**, would modify and expand the Qualifying Venture Capital Fund Exemption under Section 3(c)(1) of the Investment Company Act of 1940 ("Investment Company Act" or the "1940-Act"). Specifically, it would increase the cap on aggregate capital contributions and uncalled capital commitments from $10 million to $150 million and increase the allowable number of beneficial owners from 250 to 600. It also would increase the current beneficial owners limit for funds that rely on the broader exemption in Section 3(c)(1) from 100 to 200 beneficial owners.[64] In 2018, Congress established a new exemption from registration for a newly created category of "qualifying venture capital funds." Previously, venture capital funds and other investor syndicates or groups could

[63] If such conditions are not met, those venture capital funds must instead become registered as an investment adviser, which adds initial and ongoing costs for the venture capital fund. *See* 17 CFR § 275.203(I)-1(2) ("Immediately after the acquisition of any asset, other than qualifying investments or short-term holdings, holds no more than 20 percent of the amount of the fund's aggregate capital contributions and uncalled committed capital in assets (other than short-term holdings) that are not qualifying investments, valued at cost or fair value, consistently applied by the fund.").

[64] *See* 15 CFR § 80a-3(c)(1).

have up to 100 "beneficial owners" or investors who are accredited investors and rely on an exemption from registration. The new exemption allowed qualifying venture capital funds to have up to 250 "beneficial owners" or investors who are accredited investors as long as the fund has no more than $10 million in commitments. Congress directed the SEC to index the $10 million limitation for inflation every five years.[65]

- **H.R. 2578, the Small Business Investor Capital Access Act**, would amend the private fund adviser exemption under the Advisers Act to adjust the threshold for inflation since the date of enactment of the Private Fund Investment Advisers Registration Act of 2010 and then adjust the threshold thereafter annually to reflect the changes in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics of the U.S. Department of Labor. As background, the JOBS Act 2.0 amended the exemption from investment adviser registration for any adviser solely to "private funds" with less than $150 million in assets under management in Advisers Act section 203(m) by excluding the assets of "small business investment companies" ("SBICs") when calculating "private fund assets" towards the registration threshold of $150 million.[66] Stated differently, the JOBS Act 2.0 amended the private fund adviser exemption by deeming SBICs to be venture capital funds for purposes of the exemption.[67]

Regarding the above bills, NASAA understands and appreciates the spirit of what the proponents are trying to accomplish. We also want to make sure the securities regulatory framework both protects investors and promotes responsible capital formation for entrepreneurs and small businesses.

However, NASAA opposes these bills on the basis that they would weaken regulatory oversight and contribute significantly to the further expansion of the private markets at the expense of the public markets. During the last decade or so, private investment funds have created a seemingly bottomless source of capital for private companies. This dynamic allows private companies to substantially delay going public or remain private indefinitely. As stated earlier, there may be systemic consequences for our financial markets of these developments. Even if there are not systemic consequences at this time, it would still be a step in the wrong direction to make it even easier for private companies to turn to private funds for capital.

C. NASAA Urges Congress to Direct Complementary Reforms to the Filing of SEC Forms D Before Advancing the Helping Angels Lead Our Startup Act.

In the mix of bills under consideration is one that NASAA likely would support if Congress were to amend it to require changes to the SEC's Form D submission requirements.

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[65] *See* S. 2155, the Economic Growth, Regulatory Relief and Consumer Protection Act, Pub. L. No. 115-174, 132 Stat. 1296 (May 24, 2018) at § 504.

[66] *See* JOBS Act 2.0 at § 74002.

[67] *See* SEC Final Rule, Exemptions from Investment Adviser Registration for Advisers to Small Business, Release No. IA-4839 (Jan. 5, 2018).

H.R. 1553, the Helping Angels Lead Our Startup Act of 2023, also known as the HALOS Act of 2023, would direct the SEC to revise Regulation D to not extend the prohibition on general solicitation or general advertising to events with specified kinds of sponsors, including angel investor groups unconnected to broker-dealers or investment advisers, so long as certain conditions are met. In particular, the advertising could not refer to any specific offering of securities by the issuer. The sponsor could not provide investment recommendations or advice to attendees, engage in investment negotiations with attendees, charge certain fees, or receive certain compensation. Last, no specific information regarding a securities offering could be communicated beyond the type and amount of securities being offered, the amount of securities already subscribed for, and the intended use of proceeds from the offering.

As background, in 2020, the SEC approved SEC Rule 148, along with other amendments to the Securities Act, to "facilitate capital formation and increase opportunities for investors by expanding access to capital for small and medium-sized businesses and entrepreneurs across the United States." Rule 148 accomplishes this by clarifying what entrepreneurs can say in their presentations to audiences at demo day events without crossing the line of "general solicitation" and what steps sponsors of demo day events must follow to avoid engaging in activities that require registration as broker-dealers or investment advisers. A "demo day" refers to an event, including a meeting or seminar, that is organized by a university, a group of angel investors, an accelerator, an incubator or similar organization where start-ups, small businesses and other entrepreneurs have an opportunity to make presentations about their business ideas or plans to an audience that may include potential investors. Rule 148(a)(5) defines the term "angel investor group" as "a group of accredited investors that holds regular meetings and has defined processes and procedures for making investment decisions, either individually or among the membership of the group as a whole, and is neither associated nor affiliated with brokers, dealers, or investment advisers."[68]

Should this legislation be enacted, it would likely stimulate additional growth in the already very large offerings made under Regulation D and, therefore, NASAA encourages Congress to oppose this legislation unless and until the SEC makes complementary changes to Form D. Specifically, the SEC should mandate the filing of a Form D prior to the commencing of general solicitation in any Rule 506(c) offering, or failing that, by the date of the first sale of securities in any offering conducted pursuant to Rules 506(b) and 506(c) of Regulation D. Also, the SEC should adopt rules requiring the filing of a closing amendment upon the termination of these offerings. The information in Form D would be of particular value to state regulators who

[68] *See* SEC Final Rule, Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets, Release Nos. 33-10884 and 34-90300 (Nov. 2, 2020). *See also* NASAA Comment Letter to the SEC Regarding File No. S7-05-20, Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets (June 1, 2020), (NASAA stated in its comment letter that "the proposed 'demo day' rule is not sufficiently limited to prevent general solicitations or general advertisements." NASAA specifically pointed out that "the inclusion of 'nonprofit organizations,' 'incubators,' and 'accelerators' in the proposed rule could be abused." NASAA also argued "limiting the proposed compensation restrictions to 'compensation for making introductions' and 'compensation with respect to the event that would require registration of the sponsor as a broker or dealer,' as proposed, again does not foreclose the creation or operation of entities designed to attract investors to private issuers, but who are compensated indirectly by issuers for doing so." Last, NASAA shared, "As proposed, it would be impossible to enforce such a fuzzy distinction between permitted and prohibited offer communications.") at 7.

would be tasked with ensuring that "demo days," and similar events sponsored in their jurisdictions, are legitimate and compliant with the law. When Congress considered such reforms in 2018, Representative Maxine Waters (D-CA), who was also the primary Democratic sponsor of the bill and its Democratic Floor Manager, explicitly addressed the need for the Senate to amend the HALOS Act to require the filing of Form D with the SEC and state securities regulators.[69]

VI. Congress Should Pursue Policies That Increase Opportunities for All Investors and Oppose the Proposals Under Discussion as Premature or Anti-Investor, or Both.

Among the bills under consideration are measures intended to increase opportunities for all investors. In particular, the proposals would amend or otherwise affect the SEC's definition of an "accredited investor," SEC Rule 701, and various requirements applicable to closed-end funds. While we support efforts to strengthen inclusion, those efforts should be designed to encourage wise investing strategies in public markets where access to information is critical especially for novice investors.

A. Congress Should Keep Investor Protection Top of Mind When Expanding the SEC's Definition of an "Accredited Investor."

As a threshold matter, NASAA commends lawmakers for their efforts to expand access to and participation in our securities markets by investors of all ages and backgrounds. We agree that in many cases wealth measures are an inadequate screening criterion for measuring the type of sophistication necessary to invest in private markets, especially with respect to natural persons who meet the current thresholds simply by accumulating retirement savings over time.

In March 2023, NASAA shared its views regarding changes to the SEC's definition of an "accredited investor" with the Director of the SEC's Division of Corporation Finance. Specifically, we explained that, if the SEC were to amend its definition of an "accredited investor," the Commission should **(1)** exclude assets accumulated or held in defined contribution plans from inclusion in natural person accredited investor net worth calculations and **(2)** adjust the income and net worth thresholds to account for inflation since 1982 and index those thresholds going forward. By way of background, around the same time the natural person accredited investor thresholds were established, there was a marked shift in the benefits employers offered to employees. The increased use of defined contribution plans over defined benefit plans now leaves most workers responsible for providing the bulk of their own retirement savings.[70] It should be a priority to guard these assets from exposure to the riskiest offerings in our markets. Like a primary residence, which Congress excluded from accredited investor net worth calculations, retirement assets are not appropriate for speculative private investing. Older

[69] "There are several provisions that we did not reach bipartisan agreement on in time, including reforms to private offerings under regulation D that requires issuers to file disclosures before their first [sale] and after the termination of the offering. I am pleased that the chairman has offered to continue working on this and other issues with me, and I hope that the Senate has its own chance to make these and other changes." (See: Congressional Record Volume 164, Number 120. Tuesday, July 17, 2018. Pages H6295-H6312).

[70] *See* CBO, The Role of Defined Benefit and Defined Contribution Plans in the Distribution of Family Wealth (Nov. 18, 2020).

investors in particular cannot afford the losses because they lack the time horizon necessary to recover from such losses.[71]

While we commend lawmakers for their continued effort to promote inclusion in our markets, we urge Congress to pause further consideration of bills that would amend the SEC's definition of an "accredited investor" until the SEC's Division of Corporation Finance has determined whether to recommend to the Commission that the agency amends the definition of an "accredited investor."[72] We also urge Congress to abandon certain proposals or parts of proposals that are incompatible with the securities regulatory framework and otherwise anti-investor, as outlined below. However, should Congress disagree with our call for delay and oversight rather than premature legislation, NASAA offers the comments below regarding the proposals under discussion.

To begin with, five proposals under consideration would require the SEC to amend or expand the SEC's definition of an "accredited investor" in ways that the SEC decided not to during its 2020 rulemaking. These included **(i)** qualification by professional certifications; **(ii)** qualification by education or job experience; **(iii)** qualification by examination; **(iv)** qualification by self-certification; and **(v)** investment limits for individuals who do not meet the current income or net worth thresholds. Of these ideas, the SEC opted to permit qualification for a small set of professional certifications. It did not amend the rules to implement the other ideas. The SEC staff also considered many of these ideas when the agency issued a report in 2015 on the review of the definition of an "accredited investor."[73]

When rejecting the above ideas in 2020 with the exception of limited qualification by professional certification, the SEC noted its concerns as follows: First, "Although other professional certifications, designations, and credentials, such as other FINRA exams, a specific accredited investor exam, other educational credentials, or professional experience received broad commenter support, we are taking a measured approach to the expansion of the definition and including only the Series 7, 65, and 82 in the initial order. While we recognize that there may be other professional certifications, designations, and credentials that indicate a similar level of sophistication in the areas of securities and investing, we believe it is appropriate to consider these other credentials after first gaining experience with the revised rules." Second, "[w]e are not adopting an amendment that would permit individuals to self-certify that they have the requisite financial sophistication to be an accredited investor. We agree with some of the concerns raised by commenters with respect to the lack of standards applicable to such an approach. We note that the Commission will have an opportunity to evaluate its experience with the revised rules in connection with its quadrennial review of the accredited investor definition." Last, "Limiting investment amounts for individuals who do not meet the current income or net worth thresholds could provide protections for those individuals who are less able to bear financial losses….This alternative, however, would reduce the amount of capital available from

[71] *See* NASAA Comment Letter to the SEC Regarding Private Market Reforms (Mar. 7, 2023).

[72] The SEC Division of Corporation Finance is considering recommending that the Commission propose amendments to Regulation D, including updates to the accredited investor definition, and Form D. *See* SEC, Regulation D and Form D Improvements (Fall 2022).

[73] *See* SEC, Report on the Review of the Definition of "Accredited Investor" (Dec. 18, 2015).

these newly eligible accredited investors, make capital formation more difficult, and likely increase the implementation costs associated with verifying an investor's status as an accredited investor and her eligibility to participate in an offering. We also believe the individuals who will become newly eligible to qualify as accredited investors under the final amendments have the financial sophistication to assess investment opportunities and avoid allocating an inappropriately large fraction of their income or wealth in exempt offerings."[74]

The five legislative proposals that take up ideas the SEC rejected in its 2020 rulemaking are as follows:

- **H.R. 835, The Fair Investment Opportunities for Professional Experts Act**, would amend the Securities Act to modify the definition of an "accredited investor" to codify the SEC's existing definition, as well as incorporate new requirements to adjust net worth and income standards for inflation and to make it possible to qualify as an accredited investor based on education or job experience. The amended definition under H.R. 835 would include **(1)** an individual whose net worth or joint net worth with their spouse exceeds $1 million (adjusted for inflation), excluding from the calculation of their net worth their primary residence and a mortgage secured by that residence in certain circumstances; **(2)** an individual whose income over the last two years exceeded $200,000 (adjusted for inflation) or joint spousal income exceeded $300,000 (adjusted for inflation) and who has a reasonable expectation of reaching the same income level in the current year; **(3)** an individual who is licensed or registered with the appropriate authorities to serve as a broker or investment adviser; and **(4)** an individual determined by the SEC to have qualifying education or job experience and whose education or job experience is verified by FINRA. The bill also would direct the SEC to revise the definition of "accredited investor" in Regulation D of the Securities Act, which exempts certain offerings from SEC registration requirements, to conform to the changes set forth in H.R. 835.

- **H.R. ____, The Equal Opportunity for All Investors Act**, would amend the Securities Act to add a new way for individuals to qualify as an accredited investor. Specifically, individuals of any net worth or income level could qualify by passing an examination designed to ensure the individual understands and appreciates the risks of investing in private companies, as well as ensure the individual "with financial sophistication or training would be unlikely to fail." The SEC would have two (2) years from the date the legislation becomes law to establish this examination. A registered national securities association such as FINRA could administer the examination.

- **H.R. 1579, The Accredited Investor Definition Review Act**, would amend the Securities Act and the Dodd-Frank Act to codify the SEC's 2020 rulemaking with respect to the decision to permit qualification based on certain certifications, designations, or credentials and to direct the SEC to review and adjust or modify

[74] *See* SEC Final Rule, Accredited Investor Definition, Release No. 33-10824 (Aug. 26, 2020).

the list of certifications, designations, and credentials accepted with respect to meeting the requirements of the definition of "accredited investor" within 18 months of the date of the bill's enactment and then not less frequently than once year five years thereafter.[75]

- **H.R. 1574, The Risk Disclosure and Investor Attestation Act**, would amend the Securities Act to direct the SEC within one year of enacting the legislation to issue rules that permit individuals to qualify as accredited investors by attesting to the issuer that the individual understands the risks of investment in private issuers, using the form that the Commission adopts by rulemaking, which may not be longer than two (2) pages in length.

- **H.R. ___, The Investment Opportunity Expansion Act**, would add additional investment thresholds for an individual to qualify as an accredited investor. The legislation would direct the SEC to treat any individual whose aggregate investment, at the completion of such transaction, in securities with respect to which there has not been a public offering is not more than 10 percent of the greater of **(i)** the net assets of the individual or **(ii)** the annual income of the individual as an accredited investor.

We are pleased that the Fair Investment Opportunities for Professional Experts Act would require figures to be indexed to inflation. However, respectfully, NASAA cannot support any of these bills at this time. However, we may be able to support some of these ideas upon review of the SEC's findings from its ongoing review of the SEC's "accredited investor" definition. As a general matter, NASAA agrees that certain certifications can be one aspect in assessing an investor's financial sophistication. However, such standards should be coupled with demonstrable experience.[76] As a general matter, NASAA strongly opposes the idea of self-certification by investors. For some of the same reasons we place a mortgage underwriter between a lender and a borrower, we believe it is important to have some protections other than the review and execution of a form between an issuer and the investors.

In addition to the above five proposals, the HFSC is considering a proposal that takes up an idea the SEC did not propose during the 2020 rulemaking. Specifically, **H.R. ___, To Expand the Definition of "Accredited Investor,"** would revise the definition of "accredited investor" to include individuals receiving individualized investment advice or individualized investment recommendations from investment adviser professionals. The bill also would direct the SEC to revise 17 CFR § 203.501(a) and any other definition of "accredited investor" in a rule from the Commission to conform to the changes set forth in the legislation. SEC staff have studied this idea of permitting qualification by use of an investment professional. In 2015, SEC staff concluded as follows: "Revising the accredited investor definition to include individuals advised by professionals appears to run counter to the Commission's prior determination to allow persons who are unable to evaluate the merits and risks of private offerings to participate

[75] SEC Final Rule, Accredited Investor Definition, Release No. 33-10824 (Aug. 26, 2020).

[76] *See* Letter from Christopher Gerold to Vanessa Countryman re: Amending the "Accredited Investor" Definition (Mar. 16, 2020).

in those offerings only if the issuer provides them with additional information about the issuer. In addition, there may be significant overlap between individuals who receive advice from professionals and those who meet the existing financial standards in the accredited investor definition."[77]

We generally agree with SEC staff that this idea is incompatible with the present regulatory framework and associated expectations for both investment advisers and issuers. Relatedly, this idea may drive investors into relationships with financial advisers where the net result is that the investors are paying higher fees for investing without returns that compensate for the higher fees. Furthermore, this idea could pull significant amounts of capital away from the public securities markets and towards the private securities markets thereby undermining the goal of strengthening the public markets.

In addition to the above bills, the HFSC is considering two more bills that indirectly would affect the SEC's definition of an "accredited investor." Again, while NASAA urges Congress to use its oversight rather than legislative tools, we recognize Congress may wish to take action and thus offer our preliminary comments below.

First, **H.R. 2612, the Gig Worker Equity Compensation Act**, would extend SEC Rule 701, which exempts certain sales of securities made to compensate employees, consultants, and advisors, to apply to gig workers providing goods for sale, labor, or services for renumeration to either an issuer or customers of an issuer to the same extent as such exemptions apply to the employees of the issuer. [78] The legislation also would direct the SEC to annually adjust the $10 million disclosure threshold for inflation and preempt state law with respect to wage rates or benefits that creates a presumption that an individual is an employee. Within three (3) years of enactment of the bill, the Government Accountability Office ("GAO") would have to produce a report studying the impacts of the legislation.[79] Congress last raised the above-mentioned disclosure threshold from $5 million to $10 million in 2018.[80]

As background, this legislation pertains to the longstanding practice of using non-cash equity incentives for employees. Such incentives often have a reputation as "golden handcuffs" because employees given such incentives may feel tied to their employers in ways an employee with a salaried-based compensation may not.[81] Moreover, these Rule 701 offerings are illiquid and subject to valuation risk given the lack of public financial disclosure by non-reporting issuers. The shares awarded to employees may have inferior rights to those issued to founders or

[77] *See* SEC, Report on the Review of the Definition of "Accredited Investor" (Dec. 18, 2015).

[78] *See* 17 CFR § 230.701.

[79] On April 13, 2023, Representative Patrick McHenry (R-NC) introduced this legislation as H.R. 2612. NASAA will review H.R. 2612 once the text is available.

[80] *See* Economic Growth, Regulatory Relief, and Consumer Protection Act §§ 507, ("60 days after the date of the enactment of this Act, the Securities and Exchange Commission shall revise section 230.701(e) of title 17, Code of Federal Regulations, so as to increase from $5,000,000 to $10,000,000 the aggregate sales price or amount of securities sold during any consecutive 12-month period in excess of which the issuer is required under such section to deliver an additional disclosure to investors.").

[81] *See* Anat Alon-Beck, Bargaining Inequality: Employee Golden Handcuffs and Asymmetric Information, Maryland Law Review, Forthcoming, Case Legal Studies Research Paper No. 2022-2 (Feb. 23, 2022).

institutional investors, and the employee's shares may suffer substantial dilution because of subsequent offerings. Instead of addressing these concerns, this legislation would allow companies to extend such equity awards to gig workers or customers, who are even less likely than employees to have bargaining power and insights into important company information. This increases the risk that companies will take unfair advantage of these arrangements, especially early startups where cash flow is limited. It could also facilitate the use of stock compensation to incentivize promoters to improperly tout and "pump" the price of the issuer's securities.

NASAA commends lawmakers for trying to find ways to better compensate our nation's hard-working gig workers. However, we urge Congress to look to other remedies that will ensure gig workers are fairly compensated and not to pass the Gig Worker Equity Compensation Act. These individuals deserve better than illiquid securities. Many of them also would not be able to "fend for themselves" in such arrangements. Rather than passing this legislation, Congress should demand that the SEC examine ways to strengthen SEC Rule 701 in favor of employees who are investors. If the SEC were able to make such changes, then maybe it would be more advisable to extend SEC Rule 701 to gig workers.

Second, **H.R. 2627, the Increasing Investor Opportunities Act**, would amend the Investment Company Act to prohibit the SEC from placing a limit, as they currently do, on closed-end companies investing in private funds. Specifically, the legislation would prohibit the SEC from restricting the investments of closed-end funds in private funds solely or primarily because of the private funds' status as private funds and restrict exchanges from prohibiting the listing or trading of a closed-end fund's securities solely or primarily by reason of the amount of the company's investment in private funds.[82]

In recent decades, SEC staff have explored ways to use 1940-Act registered fund structures to provide non-accredited investors with access to private investments. One idea is the use of closed-end funds. Closed-end funds do not offer daily redemptions to investors. To that point, it may be that such investment vehicles are suited for investment in longer-term, illiquid private investments. Nevertheless, SEC staff historically has raised investor protection concerns if closed-end funds of private funds are offered to nonaccredited retail investors. Today, at the urging of SEC staff, most closed-end funds have less than 15% of their assets in private funds.[83]

We urge Congress not to pass the Increasing Investor Opportunities Act. We agree with the concerns articulated by the SEC staff regarding investor access in the absence of meaningful objective guidance from an investment professional. In the absence of such support from regulators (whether a 15% cap on private investments or otherwise), closed-end funds invested in private funds effectively would become yet another costly, complex product with likely limited benefit for the retirement savings of hardworking Americans.

[82] On April 13, 2023, Representative Ann Wagner (R-MO) introduced this legislation as H.R. 2627. NASAA will review H.R. 2627 once the text is available.

[83] *See* Dalia Blass, Speech: PLI Investment Management Institute (July 28, 2020). SEC staff have communicated the 15% concept to industry informally.

VII. Congress Should Pursue Policies That Strengthen Our Public Markets and Oppose the Proposals Under Discussion as Antithetical to the Growth of Our Public Markets.

Also under discussion are many proposals meant to strengthen public markets. However, the proposals are premised on deregulatory approaches that we know do not work. Specifically, several proposals would extend the EGC regime by either relaxing EGC privileges even further or extending them to other types of issuers. In several cases, the legislation would require Congress and the SEC to expend additional limited resources on rewriting SEC rules that went into effect as recently as 2020. This would generate unnecessary expenses ultimately borne by investors and taxpayers without significant benefit to our securities markets and the investors and businesses that operate within it. In addition, the HFSC Subcommittee on Capital Markets is debating a mix of additional unrelated proposals that would change laws applicable to research analysts, e-delivery of regulatory disclosures, and other matters of importance to our regulatory framework. As explained below, NASAA has no reason to believe based on data and experience that these measures would achieve their expressed purpose. If anything, they may frustrate other efforts to ensure robust and well-regulated public securities markets in the United States.

A. Congress Should Oppose Legislation Relating to the Emerging Growth Company Regime That Will Not Strengthen Our Public Markets.

To begin with, **H.R. 2625, Helping Startups Continue to Grow Act**, would make it easier for EGCs to remain EGCs longer. Presently, a company qualifies as an EGC if it has total annual gross revenues of less than $1.07 billion during its most recently completed fiscal year and, as of December 8, 2011, had not sold common equity securities under a registration statement. A company continues to be an EGC for the first five fiscal years after it completes an IPO, unless one of the following occurs: **(1)** its total annual gross revenues are $1.07 billion or more; **(2)** it has issued more than $1 billion in non-convertible debt in the past three years; or **(3)** it becomes a "large accelerated filer," as defined in Exchange Act Rule 12b-2.[84] Under this legislation, EGCs would have 10 years instead of five years to undertake certain additional disclosure requirements applicable to more mature public companies. In addition, the triggers for losing EGC status would be relaxed. In particular, the legislation would raise the total annual gross revenue limit for an EGC from $1 billion to $2 billion and eliminate the "large accelerated filer" trigger for loss of EGC status.

Again, a key lesson of the JOBS Act 1.0 is that the reduction of the disclosure requirements for EGCs did not lead to an increase in IPOs or improve the quality of public offerings. The puzzle we all need to solve is why. In addition to the measures in the JOBS Acts that were counterproductive, we believe the ability to submit fewer disclosures and the ability to have weaker internal controls—to the end of saving the companies money—can generate other costs for EGCs. Fewer disclosures and weaker internal controls likely make it more difficult for investors and market observers to price EGC securities, which in turn can diminish their value. Whatever companies saved in accounting and related expenses, they likely lost it through the undervaluation of their securities and weaker demand for their securities.

[84] *See* SEC, Emerging Growth Companies (last updated Apr. 6, 2023). *See also* 17 CFR § 12b-2.

In addition, there are three bills under consideration that would clarify but also relax obligations for EGC issuers with respect to financial statements and other registration statement materials. They are as follows:

- **H.R. 2608, a bill to amend the Federal securities laws to specify the periods for which financial statements are required to be provided by an emerging growth company.**

- **H.R. 2497, a bill to permit an issuer, when determining the market capitalization of the issuer for purposes of testing the significance of an acquisition or disposition, to include the value of all shares of the issuer.**

- **H.R. 2610, a bill to amend the Securities Exchange Act of 1934 to specify certain registration statement contents for emerging growth companies, to permit issuers to file draft registration statements with the Securities and Exchange Commission for confidential review, and for other purposes.**

The first proposal would make clear that EGCs would not have to present acquired company financial statements for any period prior to the earliest audited period of the EGC presented in connection with its IPO. Also, in no event would an EGC that loses its EGC status be required to present financial statements of the issuer or the acquired company for any period prior to the earliest audited period of the EGC presented in connection with the IPO.[85]

The second proposal would direct the SEC to revise regulations to permit an issuer, when determining its market capitalization for purposes of testing the significance of an acquisition or disposition, to calculate the registrant's aggregate worldwide market value based on the applicable trading value, conversion value, or exchange value of all of the registrant's outstanding classes of stock (including preferred stock and non-traded common shares that are convertible into or exchangeable for traded common shares) and not just the voting and non-voting common equity of the registrant.

The third proposal would make clear that the registration statement of the EGCs need not include profit and loss statements for more than the preceding two years rather than the three preceding fiscal years. This bill also would amend the law to permit any issuer to submit to the Commission a draft registration statement for confidential nonpublic review by SEC staff prior to public filing, provided that the initial confidential submission and all amendments thereto are publicly filed with the Commission no later than 10 days before the issuer's requested date of effectiveness of the registration statement.[86] The SEC presently accepts voluntary draft

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[85] On April 13, 2023, Representative Patrick McHenry (R-NC) introduced this legislation as H.R. 2608. NASAA will review H.R. 2608 once the text is available.

[86] On April 13, 2023, Representative Patrick McHenry (R-NC) introduced this legislation as H.R. 2610. NASAA will review H.R. 2610 once the text is available.

registration statement submissions from all issuers for nonpublic review provided certain procedures are followed.[87]

We applaud efforts to find opportunities to add useful clarity to the securities regulatory framework. The above-described bills, however, are more deregulatory than clarifying in nature and purpose.

NASAA opposes the first bill on the basis that any ambiguity should be resolved in favor of investors and the SEC. There very well may be circumstances where it does make sense to have the EGC provide audited financial statements for a period earlier than two years, including in the case of acquired company financial statements and for follow-on offerings involving an EGC that lost its EGC status during the IPO registration. This legislation would prohibit the SEC from exercising judgment where needed to require this additional information.

NASAA opposes the second bill (H.R. 2497) on the basis that the SEC adopted a new rule in 2020 to amend the significance tests in the definition of "significant subsidiary" and the financial disclosure requirements in Regulation S-X for acquisitions and dispositions of businesses.[88] The changes in 2020 were intended to improve for investors the financial information about acquired or disposed businesses, facilitate more timely access to capital, and reduce the complexity and costs to prepare the disclosure. The amendments affected all domestic and foreign issuers with classes of securities registered under the Exchange Act or the Investment Company Act that need to make significance determinations relating to a subsidiary or an acquired or disposed business, as well as issuers offering securities in certain registration statements under the Securities Act or Regulation A offering statements. The significance tests within the "significant subsidiary" definition in Rule 1-02(w), Rule 405, and Rule 12b-2 include an investment test, an asset test, and an income test that are applied when determining if a subsidiary is deemed significant for the purposes of certain Regulation S-X and Regulation S-K requirements as well as certain Securities Act and Exchange Act rules and forms.[89] The amendments modified the investment test that this legislation now seeks to modify. Under the amended investment test, companies determine market value by using the "Registrant's and its other subsidiaries' investments in, and advances to the tested subsidiary" as the numerator, and the "Registrant's aggregate worldwide market value of its voting and non-voting common equity, calculated daily from the last five trading days of the most recently completed month ending prior to the earlier of the registrant's announcement date or agreement date of the acquisition or disposition, or total consolidated assets where the registrant has no such aggregate worldwide market value" as the denominator.

When considering the above changes, the SEC did consider alternative options for this calculation but ultimately selected the use of an aggregate worldwide market value restricted to voting and non-voting common equity inputs. By way of example, the SEC stated, "As an alternative to the amended Investment Test, we could have required registrants to use enterprise value for the acquirer and the acquired business, rather than the value of common equity (for the

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[87] *See* SEC, Draft Registration Statement Processing Procedures Expanded (last updated June 24, 2020).

[88] *See* SEC, Financial Disclosures about Acquired and Disposed Businesses (last updated Dec. 7, 2022).

[89] *See* 17 CFR § 210.1-02(w), 17 CFR § 230.405, and 17 CFR § 12b-2.

acquirer) and investments in and advances to the acquired business…. Enterprise value, however, may not be appropriate for an acquirer or acquiree that has substantial liquid assets on its balance sheet. Additionally, enterprise value may not be a consistent indicator of relative size across registrants because capital structure (*i.e.*, leverage) may be very different among registrants in certain industries."[90]

NASAA opposes the third bill as written. NASAA has no concerns currently with the idea of reducing the amount of time that EGCs have between seeking registration on a confidential basis and the first road show. Presently, an EGC is permitted to begin registration on a confidential basis if the EGC publicly files its previously confidential registration statement at least 15 days before conducting a road show. This provision is intended to facilitate public review of the registration statement between the first public filing and IPO pricing. The proposed change to 10 days would appear to enhance efficiency and transparency, all to the benefit of our markets. However, the proposed legislation also contemplates that lawmakers would codify, with modifications, the SEC's present practice of accepting voluntary draft registration statement submissions from all issuers for nonpublic review provided certain procedures are followed. When Congress established the mechanism for EGCs to obtain confidential SEC review of registration documents under the JOBS Act, its expressed purpose was to encourage companies to go public. It is not clear why the privilege should now be extended statutorily to companies that, by definition, have already successfully completed an IPO.

In addition to the above bills extending existing EGC privileges further, there are several bills that would extend EGC privileges to all issuers, consistent in many cases with rules or other actions the SEC took in recent years. This is the sort of deregulatory creep that NASAA respectfully submits would be a step in the wrong direction if we in fact want to maintain the reputational primacy of the public markets in the United States.

To start, **H.R. 2576, a bill to amend the Securities Act of 1933 to expand the research report exception to include reports about any issuer that undertakes a proposed offering of public securities**, would extend the protection for research reports about EGCs to research reports about all securities of all issuers. The new text would read as follows: "The publication or distribution by a broker or dealer of a research report about ~~an emerging growth company~~ *an issuer* that is the subject of a proposed public offering of ~~the common equity~~ *any* securities of ~~such emerging growth company~~ *such issuer* pursuant to a registration statement that the issuer proposes to file, or has filed, or that is effective shall be deemed for purposes of paragraph (10) of this subsection and section 77e(c) of this title not to constitute an offer for sale or offer to sell a security, even if the broker or dealer is participating or will participate in the registered offering of the securities of the issuer. As used in this paragraph, the term 'research report' means a written, electronic, or oral communication that includes information, opinions, or recommendations with respect to securities of an issuer or an analysis of a security or an issuer, whether or not it provides information reasonably sufficient upon which to base an investment decision."

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[90] *See* SEC, Amendments to Financial Disclosures about Acquired and Disposed Businesses, Release Nos. 33-10786 and 34-88914 (May 20, 2020).

To put this proposal in context, securities industry professionals and their regulators have long maintained that, within a broker-dealer, the research team should function independently and free from influence from their investment banking (or sales) colleagues. This view was reinforced during the early 2000s when the nation's largest investment banks settled with the SEC, FINRA, the New York Stock Exchange, and state securities regulators to address issues of conflicts of interest within their businesses in relation to tainted recommendations made by their research analysts. Despite the lessons learned from the early 2000s, Title I of the JOBS Act 1.0 included a provision that was designed to promote publication of research reports about EGCs by deeming the reports a non-offer under the securities laws.[91] As a result, the JOBS Act effectively superseded various rules that, for example, imposed research quiet periods immediately following an IPO and prevented research analysts from participating in communications with internal sales personnel in the presence of company management. Importantly, the JOBS Act 1.0 did not provide a safe harbor for research reports from liability under state and federal antifraud provisions of the securities laws, nor should it have.

NASAA opposes this proposal. It would lead us back to the early 2000s when policymakers had to rebuild trust in our capital markets following the highly conflicted behavior of the nation's largest investment banks.

Similarly, **H.R. ____, the Encouraging Public Offerings Act**, would make clear that the SEC has authority to issue rules that would extend the testing-the-waters provisions for EGCs to all issuers. As background, in 2012, Congress created Section 5(d) of the Securities Act.[92] Section 5(d) permits an EGC and any person acting on its behalf to engage in oral or written communications with potential investors that are qualified institutional buyers ("QIBs") and institutional accredited investors ("IAIs") before or after filing a registration statement to gauge such investors' interest in a contemplated securities offering. In 2019, the SEC approved a new rule that extended this "test-the-waters" accommodation to non-EGCs.[93] Under Securities Act Rule 163B, any issuer, or any person authorized to act on its behalf, can engage in oral or written communications with potential investors that are, or are reasonably believed to be, QIBs or IAIs, either prior to or following the filing of a registration statement, to determine whether such investors might have an interest in a contemplated registered securities offering.[94] In addition, the Encouraging Public Offerings Act would extend the confidential review of draft registration statements to all issuers. The legislation permits the SEC to impose other terms, conditions, or requirements on testing-the-water communications and the confidential review of draft registration statements with respect to non-EGC issuers subject to a public notice and comment period and, prior to any rulemaking, the submission of a report to Congress containing a list of the findings supporting the basis of the rulemaking.

[91] *See* JOBS Act 1.0 at § 105.

[92] *See* JOBS Act 1.0 at § 105.

[93] *See* SEC Final Rule, Solicitations of Interest Prior to a Registered Public Offering, Release No. 33-10699 (Sept. 25, 2019).

[94] *See* 17 CFR § 230.163(b).

NASAA opposes this proposal. In addition to our concerns regarding confidential reviews of registration materials, NASAA strongly encourages Congress to reconsider and abandon the idea of directing an independent federal agency to submit a report to Congress before it conducts a rulemaking. While we encourage Congress to use its robust oversight tools and submit letters when the SEC opens proposals up for public comment, we believe it would interfere with existing administrative procedures to insert Congress in between a federal agency and the public from whom the agency will seek data and other information, as well as opinions, that can inform the agency's decisions. Moreover, there are legitimate concerns regarding testing-the-waters campaigns. Issuers that test the waters without any regulatory oversight willingly or unwittingly may engage in fraud and precondition the market based on fraudulent statements. Prior regulatory review of testing-the-waters materials serves to mitigate or eliminate such risks.

B. Congress Should Oppose Other Legislation Under Discussion That Will Not Strengthen Our Public Markets.

As stated earlier, the HFSC Subcommittee on Capital Markets is debating a handful of additional proposals that purportedly would strengthen our public markets. As explained below, NASAA has no reason to believe based on data and experience that these measures would achieve their expressed purpose. If anything, they may frustrate other efforts to ensure robust and well-regulated public securities markets in the United States.

First, **H.R. 2605, a bill to amend the Securities Exchange Act of 1934 to exclude qualified institutional buyers and institutional accredited investors when calculating holders of a security for purposes of the mandatory registration threshold under such Act, and for other purposes**, would amend Section 12(g) of the Exchange Act to exclude QIBs and IAIs from calculations of holders of record. In addition, the bill would prohibit the SEC from issuing rules to reverse these changes by amending rules to reduce the number of holders of record or modify related calculations.[95]

As explained above, the JOBS Acts raised the thresholds for registration and termination of registration for a class of equity securities under Exchange Act Section 12(g).[96] Prior to these changes, Exchange Act Section 12(g) required companies to become public reporting companies, regardless of the method used to distribute the shares, if they had assets of $10 million and a class of securities that were "held of record" by at least 500 persons.[97] According to the SEC, "the registration requirement of Section 12(g) was aimed at issuers that had 'sufficiently active trading markets and public interest and consequently were in need of mandatory disclosure to ensure the protection of investors.'"[98] As a result of the JOBS Acts, Congress made it possible

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[95] On April 13, 2023, Representative Patrick McHenry (R-NC) introduced this legislation as H.R. 2605. NASAA will review H.R. 2605 once the text is available.

[96] *See* JOBS Act 1.0 at §§ 501-502 and 601. *See* also SEC, Changes to Exchange Act Registration Requirements to Implement Title V and Title VI of the JOBS Act (May 24, 2016).

[97] *See* 17 CFR § 240.12g5-1.

[98] *See* SEC Proposed Rule, Exemption of Compensatory Employee Stock options from Registration Under Section 12(g) of the Securities Exchange Act of 1934, Release No. 34-56010 (July 5, 2007).

for companies to stay private so long as the issuer that is not a bank, bank holding company, or savings and loan holding company has less than $10 million of total assets and the securities are "held of record" by either 2,000 persons or 500 persons who are not accredited investors, excluding those who received shares as part of an employee compensation plan.[99] Title VI made similar changes for banks and bank holding companies.[100]

Increasing the thresholds in Exchange Act Section 12(g) has made it easier than ever for companies to stay private indefinitely, no matter how widely held and widely traded their shares. NASAA opposes this legislation because it would only exacerbate this trend of making it easier than ever for companies to stay private while also further reducing transparency in our capital markets. The longer the companies remain private companies, the more it deprives investors of opportunities to invest in those securities in the public markets where the investors would receive the additional protections that are associated with the public markets.

In addition, **H.R. 2603, a bill to require the Securities and Exchange Commission to revise certain thresholds related to smaller reporting companies, accelerated filers, and large accelerated filers, and for other purposes**, essentially would codify a 2020 SEC rule, albeit with modifications in favor of issuers. With this legislation, the SEC would adjust the public float threshold in 17 § CFR 229.10(f)(1)(i) from $250 million to $500 million, the annual revenue threshold in 17 § CFR 229.10(f)(1)(ii) from $100 million to $250 million, and the public float threshold in 17 § CFR 229.10(f)(1)(ii) from $700 million to $900 million. The SEC would use three-year rolling average revenues instead of annual revenues for "smaller reporting companies." The SEC would also amend the definition of "large accelerated filer" to increase the aggregate worldwide market value of the voting and non-voting common equity held by its non-affiliates threshold in 17 § CFR 240.12b-2(2)(i) from $700 million to $750 million, the accelerated filer exit threshold in 17 § CFR 240.12b-2(3)(ii) from $60 million to $75 million, and the large accelerated filer exit threshold in 17 § CFR 240.12b-2(3)(iii) from $560 million to $750 million. Last, the SEC would revise the definitions of an "accelerated filer" and a "large accelerated filer" to exclude any issuer that is a "smaller reporting company."

In 2020, the SEC adopted a new rule with several changes. For example, the amendments excluded from the accelerated and large accelerated filer definitions an issuer that is eligible to be a smaller reporting company and had annual revenues of less than $100 million in the most recent fiscal year for which audited financial statements are available. Business development companies ("BDCs") were excluded in analogous circumstances. In addition, the SEC increased the transition thresholds for an accelerated and a large accelerated filer becoming a non-accelerated filer from $50 million to $60 million and for exiting large accelerated filer status from $500 million to $560 million. Moreover, the SEC added a revenue test to the transition thresholds for exiting both accelerated and large accelerated filer status.[101]

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[99] *See* JOBS Act 1.0 at § 501.

[100] *See* JOBS Act 1.0 at § 601.

[101] *See* SEC, SEC Adopts Amendments to Reduce Unnecessary Burdens on Smaller Issuers by More Appropriately Tailoring the Accelerated and Large Accelerated Filer Definitions (Mar. 12, 2020).

NASAA opposes this legislation as it would again expend limited resources to make further changes to a recently modified SEC rule. While NASAA takes no position as to the exact thresholds and calculations that should be used, we oppose legislation that, particularly so soon after a new rule became effective, would take us all down a path of further reducing disclosure in our securities markets, especially when such changes are coupled with the other deregulatory legislative proposals under discussion. As state securities regulators, we are sensitive to the need to scale disclosure and offer other accommodations to reduce unnecessary burdens, particularly for new or so-called smaller issuers. However, we strongly oppose making additional changes in a piecemeal fashion without considering them within our broader efforts to incentivize companies to become and remain public companies.

H.R. 2625, a bill to lower the aggregate market value of voting and non-voting common equity necessary for an issuer of securities to qualify as a well-known seasoned issuer (WKSI), would lower the aggregate market value of voting and non-voting common equity necessary for an issuer of securities to qualify as a WKSI from $700 million to $75 million. The issuer would also be able to qualify as a WKSI if it otherwise satisfies the other requirements of the WKSI definition without reference to any requirement related to minimum worldwide market value of outstanding voting and non-voting common equity held by non-affiliates. A major benefit among others of WKSI status is that WKSIs qualify for "automatic shelf-registration," meaning that their shelf offerings are immediately effective upon filing a Form S-3 since their shelf-registration statements are not subject to SEC review. For shelf offerings, WKSIs do not need to disclose as much detail in their offering documents. For example, they do not need to specify the amount of securities they plan to sell or name selling shareholders.[102]

NASAA opposes this legislation among other reasons because of its significant consequences for transparency in our capital markets. Lowering the public float requirement of the WKSI status would reduce investor protection by preventing the SEC from conducting any pre-offering review of registrations for companies that qualify as WKSIs. It may also prove problematic for issuers who will no longer have the time to conduct a pre-offering "due diligence" review of the registration statement's contents, and thus may be subject to later litigation. Incredibly, the legislation could position EGCs into a status where they simultaneously qualify as a WKSI. This seemingly contradictory—and troubling—result would allow a new EGC to qualify as a WKSI and not be subject to any pre-offering review.

H.R. 2622, a bill to amend the Investment Advisers Act of 1940 to codify certain Securities and Exchange Commission no-action letters that exclude brokers and dealers compensated for certain research services from the definition of investment adviser, and for other purposes, would direct the Commission and its staff to not regulate certain brokers and dealers that are compensated for certain investment research services as investment advisers. As background, the European Union ("E.U.") proposed a revised Markets in Financial Instruments Directive (commonly known as "MiFID II") in the early 2010s. Under MiFID II, investment managers would have to pay for research services from their own money, from a

[102] *See* 17 CFR § 230.405.

separate research payment account, or from a combination of the two.[103] The Securities Industry and Financial Markets Association ("SIFMA") argued in a letter to the SEC that without a guarantee of no-action from SEC staff, broker-dealers in the United States with international business in the E.U. would not be able to provide research services as receipt of payment could violate the Advisers Act.[104] SEC staff issued a no-action letter in response, stating that they would not take enforcement action under the Advisers Act against a broker-dealer that receives payment for their research services.[105] In a February 2022 SEC staff report regarding investment research, SEC staff observed that some larger providers of investment research with clients in Europe that were registered previously as broker-dealers have registered as investment advisers to ensure their compliance with U.S. and E.U. laws.[106]

In our view, investment research providers with cross-Atlantic businesses should act promptly to ensure they follow all applicable laws. It is not clear to NASAA that an exclusion under the Advisers Act for these market participants would be fair to other market participants who find ways to comply with both domestic and foreign laws. Setting aside the fairness issue, it also appears unnecessary given the SEC staff's findings that many firms have complied with both domestic and foreign laws already.

H.R. 1379, the Access to Small Business Investor Capital Act, would allow registered investment companies, such as mutual funds, to exclude specified fees and expenses from the fund's fee table disclosure for investors, commonly known as the acquired fund fees and expenses ("AFFE") table, and instead provide information in a footnote. Such fees are the ones the fund incurs indirectly when purchasing shares of a BDC, which is a type of fund that invests in financially distressed or developing firms.[107]

As background, the SEC's AFFE rule requires registered funds such as mutual funds that invest in other funds, including BDCs, to include a separate line item titled "Acquired Fund Fees and Expenses" in the "Fees and Expenses" table contained in their SEC disclosure documents. The separate AFFE line item must include the registered fund's *pro rata* share of the "acquired fund's" (*i.e.*, the BDC's) expenses (including interest expense), which is then added to the registered fund's overall expense ratio. AFFE disclosure requirements have no impact on the financial statements of registered funds, including their net asset value per share calculations (*i.e.*, it only impacts the disclosure in the "Fees and Expenses" table).[108]

NASAA opposes this legislation. Respectfully, this approach obscures the "bottom-line"

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[103] *See* Directive 2014/65/EU of the European Parliament and of the Council of on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (May 15, 2014).

[104] *See* Letter from Steven Stone to Douglas Scheidt Re: Relief from the Investment Advisers Act of 1940 for Broker-Dealers Receiving Payments for Research from Investment Managers Subject to MiFID II (Oct. 17, 2017).

[105] *See* SEC, Response of the Chief Counsel's Office Division of Investment Management (Oct. 26, 2017).

[106] *See* SEC, Staff Report on the Issues Affecting the Provision of and Reliance Upon Investment Research Into Small Issuers (Feb. 18, 2022)..

[107] *See* SEC Final Rule, Fund of Funds Investments, Release No. 33-8713, (June 20, 2006).

[108] *See* SEC Final Rule, Tailored Shareholder Reports for Mutual Funds and Exchange-Traded Funds; Fee Information in Investment Company Advertisements, Release No. 33-11125 (Oct. 26, 2022).

costs of investing in certain funds. The "bottom line" or "all-in" costs of investing in a fund are important to investors, and fund disclosures should give investors that information in a form that is simple to digest. NASAA's position takes into consideration that BDC operating expenses are naturally higher than, for example, passive index funds and that BDC operating expenses are already reflected in a BDC's quarterly reported net asset value and, thus, ultimately reflected in its trading price. It also takes into consideration that requiring funds to report BDC expenses again under the current fee table disclosure requirements may result in a double counting of BDC expenses that artificially inflates acquiring fund expense ratios. In response to such concerns, we encourage BDCs making these disclosures to add any qualifying statements that may be necessary for investors to understand the information in the fee table.

Last, **H.R. 1807, the Improving Disclosure for Investors Act of 2023**, would direct the SEC to promulgate a rule within one year of enactment of the legislation to allow for certain covered entities to satisfy their obligations to deliver regulatory documents required under securities laws to investors using electronic delivery. Covered entities would include registered funds, broker-dealers, municipal securities dealers, government securities broker-dealers, investment advisers, transfer agents, and funding portals. "Electronic delivery" would include "**(A)** the direct delivery of such regulatory document to an electronic address of an investor; **(B)** the posting of such regulatory document to a website and direct electronic delivery of an appropriate notice of the availability of the regulatory document to the investor; and **(C)** an electronic method reasonably designed to ensure receipt of such regulatory document by the investor." The legislation would direct much of the substance of the SEC's new rule, including that it "provide a mechanism for investors to opt out of electronic delivery at any time and receive paper versions of regulatory documents." Self-regulatory organizations, such as FINRA, must conform their rules and practices to the new law and associated SEC rules.

NASAA supports the spirit and some of the substance of this legislation. For example, we support the use of technology to make the lives of investors easier. However, as written, this legislation ignores the reality that many investors, particularly older and sometimes vulnerable investors, have strong preferences against the use of electronic delivery. Of particular concern is Section 2(b)(1)(C). This provision would require covered entities to deliver an annual notice for not more than two years in paper form solely to remind affected investors of the ability to opt out of electronic delivery at any time and receive paper versions of regulatory documents. While we wish such notifications were sufficient, our experience suggests that it would be useful to require these notices on an annual basis for the duration of the client relationship.

VIII. Congress Should Support Common Sense Legislation.

As stated earlier, NASAA is pleased to support two of the 31 proposals under discussion. In short, they are common sense improvements to our regulatory framework that will not harm investors or businesses.

To begin with, **H.R. 2606, a bill to require auditor independence standards of the Public Company Accounting Oversight Board and the Securities and Exchange Commission applicable to past audits of a company occurring before it was a public company to treat an auditor as independent if the auditor meets established professional**

standards, would solve a problem without threatening harm to investors. In effect, this legislation would permit the auditor of a private company transitioning to public company status to comply with PCAOB and SEC independence rules for only the latest fiscal year as long as the auditor is independent under standards established by the American Institute of Certified Public Accountants, or AICPA for short, or home-country standards for earlier periods.[109]

NASAA supports the balanced approach set forth in this legislation. Requiring a private company's auditor to comply with PCAOB and SEC auditor independence rules for all prior years, rather than only the most recent year, can require hiring a different auditor to reaudit earlier periods even though the original auditor was independent under then-applicable standards. This is costly without any obvious value to the protection of investors.

In addition, **H.R. ___, to direct the SEC to update its definitions of "small entities" under the Regulatory Flexibility Act to ensure that the SEC more carefully accounts for impacts on small businesses when pursuing rulemakings**, would direct the SEC, in consultation with the Small Business Capital Formation Advisory Committee, the Office of the Advocate for Small Business Capital Formation, and the Office of Advocacy of the Small Business Administration, to conduct a study of the definition of the term "small entity" and publish a report to Congress with its findings and recommendations. The bill also would direct the SEC to engage in rulemaking to implement the recommendations and repeat the study every five years.

NASAA supports this proposal. This legislation would move the needle on an important, recurring issue—specifically, legislators and regulators assign different meanings to the term "small entity" in ways that create confusion and undermine our collective efforts. For state securities regulators, "small" typically means America's smallest businesses found on Main Street. It does not mean an EGC or a similarly large business. NASAA would prefer for this proposal to direct the SEC to invite a representative of state securities commissions to consult on this study.

IX. Congress Should Promote Trust in Our Regulated Securities Markets to Enhance Our Regulatory Framework.

In addition to our concerns regarding the possibility of repeating the failures of past JOBS Acts, we are calling on Congress to reject the capital formation agenda under discussion because it would serve to foster additional distrust in our regulated securities markets. In a survey conducted in April 2023 by Morning Consult, the percentages of Gen Z, Millennial, Gen X, and Baby Boomer respondents who expressed trust in Wall Street were 27%, 46%, 29%, and 41%, respectively.[110] In a survey conducted in March 2021 by Bankrate, 56% of investors either strongly agreed or somewhat agreed with the statement "The stock market is rigged against individual investors," compared to just 41% of non-investors.[111] In the same April 2023 Morning

[109] On April 13, 2023, Representative Patrick McHenry (R-NC) introduced this legislation as H.R. 2606. NASAA will review H.R. 2606 once the text is available.

[110] *See* Morning Consult, Tracking Trust in U.S. Institutions (Apr. 13, 2023).

[111] *See* Bankrate, More Than Half of Investors Think the Stock Market is Rigged Against the Individual (Mar. 24, 2021).

Consult survey, approximately 55% and 59% of respondents expressed trust in their state and local governments, respectively, while only 43% and 47% expressed trust in Congress and the U.S. government, respectively.[112]

Our understanding of how retail investors view our markets is consistent with the data gathered in the surveys described above. In short, retail investors mistrust our markets. As state securities regulators, we talk with retail investors regularly. They participate in our educational events. They call us with complaints or questions. We may talk to them during an investigation. Fueling their mistrust of the markets is the fact that many of them have been scammed or know somebody who has been scammed in some type of investment.

Congress should not pursue deregulatory policies, including the capital formation agenda under discussion, that would weaken investor protection and lead to further erosion of trust in our capital markets. The capital formation agenda would foster an environment where it is easier for the bad actors to operate. Generally, it is far easier for such bad actors to operate in dark, private markets than in transparent, public markets. Moreover, it is far easier for bad actors to operate when we deregulate. Taking state and local governments off the regulatory field is particularly dangerous when a growing number of Americans trust their state and local governments more than the federal government.

X. To Promote Additional Trust in Our Regulated Capital Markets, Congress Should Advance the Recommendations NASAA Made in Its February 2023 Report.

NASAA supports an agenda, which we outline below, that is designed to reinvigorate the public markets, improve opportunities for entrepreneurs and small businesses to thrive, and promote trust in our regulators and our well-established securities regulatory framework. This work will require a turn from the policies that have been pursued in recent decades—policies that were designed to expand the opaque, less regulated private markets. It also will require all of us to keep the preservation of the public's trust in us and our regulatory framework top of mind.

A. Promoting Responsible Capital Formation

First, given the dearth of information that cripples the ability of policymakers to pursue data-driven reforms, we urge Congress to require and fund a comprehensive study on public and private markets led by the SEC's Division of Economic and Risk Analysis. The study should examine the costs and benefits associated with the monumental shift from public to private markets and, in particular, review the performance of offerings conducted under Regulation A, Regulation D, and Regulation CF, as well as the effect of recent changes to the SEC's definition of an accredited investor. Second, we call upon Congress to join us in our longstanding efforts to restore oversight and transparency to the private securities markets. Among other such efforts, last Congress, NASAA endorsed S. 4857, the Private Markets Transparency and Accountability

[112] *See* Morning Consult, Tracking Trust in U.S. Institutions (Apr. 13, 2023).

Act.[113] This legislation would extend SEC reporting and disclosure requirements to companies that have **(i)** a valuation of $700 million (excluding shares held by insiders) or **(ii)** 5,000 employees and $5 billion in revenues. Such a change would establish a much-needed mechanism to move large companies into the public sphere and, importantly, could prevent a future company like FTX, WeWork, or Theranos from raising billions of dollars from investors unless it discloses fulsome information about its governance and financial condition.[114]

We also support H.R. 7977, the Promoting Opportunities for Non-Traditional Capital Formation Act,[115] which expands the functions of the SEC's Office of the Advocate for Small Business Capital Formation. Specifically, the legislation would require the SEC's Office of the Advocate for Small Business Capital Formation to **(1)** provide educational resources and host events to promote capital-raising options for underrepresented small businesses and businesses in rural areas, and **(2)** meet annually with representatives of state securities commissions to discuss opportunities for collaboration and coordination. Many state securities regulators have existing relationships with organizations that specialize in reaching rural and other hard-to-reach communities, and we believe that increased collaboration will result in better service at both the federal and state levels.

Finally, as explained above, we call upon Congress to preserve the authority of the states to register and regulate finders. The Unlocking Capital for Small Businesses Act, which was noticed in discussion draft form for a February 8, 2023, hearing of the HFSC Subcommittee on Capital Markets and introduced in the 118th Congress as H.R. 2590 on April 13, 2023, would exempt "finders" from registration under federal law and prohibit the states from registering them.[116] Further, it would impose a broker-dealer-lite regulatory regime on private placement brokers. In other words, Congress would be placing additional blindfolds on state and federal regulators. We believe this legislation moves in the wrong direction, and we continue to encourage the SEC and FINRA to collaborate with us on possible changes to the existing regulatory requirements for finders.

B. Protecting Investors of All Ages and Backgrounds

To prevent investor harm in offerings that are by their nature high-risk, Congress should preserve the authority of the states to register and regulate small offerings, especially ones under

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[113] *See* S. 4857, Private Markets Transparency and Accountability Act, 117th Congress, 2nd Session. *See also* Written Testimony of Michael S. Pieciak, Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment (Sept. 11, 2019).

[114] In the case of FTX, there is no doubt that stronger disclosure and corporate governance requirements in the private securities markets would have made it easier to spot or prevent the alleged fraud and other misconduct earlier. By way of illustration, under existing law, FTX Trading Ltd. submitted Form D notices to the SEC after raising over $1.4 billion in capital from dozens of investors. Moreover, in these notices, the corporation only had to disclose basic information regarding it, the offering, the investors, and related fees. Had the law required more timely and fulsome disclosure, regulators and other market watchers may have identified the gaps and weaknesses in FTX's corporate governance earlier. *See* NASAA Letter to Congress (Nov. 30, 2022).

[115] *See* H.R. 7977, Promoting Opportunities for Non-Traditional Capital Formation Act, 117th Congress, 2nd Session.

[116] *See* H.R. ___, the Unlocking Capital for Small Businesses Act of 2023.

$250,000. As explained earlier, these offerings are not typically reviewed by federal authorities, yet the SEED Act, which was noticed in discussion draft form for a February 8, 2023, hearing of the HFSC Subcommittee on Capital Markets and introduced as H.R. 2609 on April 13, 2023, would take away existing state authority to protect investors and businesses.[117] The likely result is fundraising mistakes by well-meaning companies and fraud perpetrated against investors and entrepreneurs.

Similarly, Congress should prevent investor harm by preserving the authority of states to require notices to the states of certain securities transactions. The Restoring the Secondary Trading Market Act[118] and the Improving Crowdfunding Opportunities Act,[119] which were noticed in discussion draft form for a February 8, 2023, hearing of the HFSC Subcommittee on Capital Markets and introduced as H.R. 2506 and H.R. 2607, respectively, in the 118th Congress, would prohibit state governments from using an important tool – regulatory notices called notice filings – to keep track of capital-raising efforts in their states and prevent harm to investors. Further, the Restoring Secondary Trading Market Act would amend the Securities Act to exempt off-exchange secondary trading from state regulation where such trading is with respect to securities of an issuer that makes publicly available certain information required under federal securities laws. If these or similar types of bills were to become law, dozens of state governments would no longer have the choice of using certain tools for investor protection, including minimally burdensome notice filings.[120]

Furthermore, to protect investors from bad actors and bolster oversight and accountability of Wall Street, Congress should strengthen the SEC's ability to crack down on violations of the securities laws. Under existing law, in some cases involving fraud with substantial losses, the SEC can only penalize individual violators a maximum of $204,385 and institutions $987,860.[121] In other cases, the SEC may calculate penalties to equal the gross amount of ill-gotten gain but only if the matter goes to federal court, not when the SEC handles a case administratively. We urge Congress to update and enhance the SEC's civil penalties statute by increasing the statutory limits on civil monetary penalties, directly linking the size of these penalties to the scope of harm and associated investor losses, and substantially raising the financial stakes for repeat securities law violators. To assist state regulators in their efforts to protect investors, we urge Congress to require the federal financial regulators to establish a bad actors database and allow state and local governments to participate in it. The Tracking Bad Actors Act,[122] which was introduced in the 117th Congress, would require the establishment of such a database.

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[117] *See* H.R. ___, the SEED Act of 2023.

[118] *See* H.R. ___, preempt blue sky laws for off-exchange secondary trading in companies who make available current public information, including information required by Regulation A or Rule 15c2-11; H.R. 2506, the Restoring the Secondary Trading Market Act, 118th Congress, 1st Session.

[119] *See* H.R. ___, the Improving Crowdfunding Opportunities Act.

[120] *See* NASAA UFT Submission System - State Participation (as of July 18, 2022).

[121] *See* SEC, Inflation Adjustments to the Civil Monetary Penalties Administered by the Securities and Exchange Commission (as of Jan. 15, 2023).

[122] S. 3716, Tracking Bad Actors Act of 2022, 117th Congress, 2nd Session.

C. Supporting Inclusion and Innovation in Our Capital Markets

The emergence of digital assets and related technology has brought further innovation to our ever-evolving capital markets. It also serves as a cautionary tale as we have witnessed the implosion of what were touted as safe and promising investment opportunities. This underscores the importance of preserving the securities regulatory framework as Congress considers legislation relating to digital assets, and we urge Congress to resist calls to shift oversight away from the SEC or otherwise weaken the fulsome protections that investors deserve. We also note that state securities regulators, as the local "cops on the beat" who are often the first to observe troubling patterns or behaviors, as was the case with BitConnect, should have a seat at the table in any digital asset working groups or other multi-agency efforts.[123]

To further enhance federal and state collaboration in our mutual goals of investor protection, Congress should modernize the Financial Literacy Education Commission ("FLEC").[124] Two decades after the creation of the FLEC, much has changed in the way people communicate, save, and invest, and Congress should consider ways to update and strengthen investor education. In conjunction with this effort, Congress should include a representative of state securities regulators as a member of FLEC. Current members include numerous federal government agencies and offices such as the SEC, the Federal Trade Commission, the Department of Education, and the Department of Defense, but there is no representation from state governments.

An important aspect of any agency's investor protection mission is to educate and inform investors. State regulators work hard to reach investors, devoting time and energy to speak at senior centers, teacher conferences, and other events. They also try to take advantage of social media to spread the word about current scams and other dangers. In this digital age though, it is challenging for state and federal regulators to compete with questionable "advice" offered through forums like WallStreetBets or the hype of the latest non-fungible token. We urge Congress to examine the resources that are devoted to investor education and pursue policies designed to bolster those efforts, including providing more resources to the SEC so that it can communicate its important message effectively.

As discussed above, the SEC's definition of an "accredited investor" is a critical component for protecting investors and restoring balance between our public and private markets. While we urge Congress to use its oversight rather than legislative tools at this time, if Congress were to do anything, it should be to pass legislation that reverses the deleterious impact of four decades of inflation on the existing net worth and income standards. To achieve this, Congress should raise the current income and net worth thresholds for natural persons and index those thresholds to inflation. Furthermore, just as a person's primary residence does not count

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[123] The work with BitConnect evolved into Operation Cryptosweep, which was a task force comprised of U.S. and Canadian NASAA members who produced significant enforcement results. *See, e.g.,* NASAA, Operation Cryptosweep Results as of 2018; Palash Ghosh, SEC Files Suit Against Promoters Of BitConnect Crypto Scheme, Forbes (May 28, 2021); Peter Feltman, States often first in crypto enforcement, leaving feds to follow, Roll Call (Mar. 22, 2022).
[124] 20 U.S.C. §§ 9701-9709.

towards the $1 million net asset threshold required for accredited investor status, Congress should add an exclusion for the value of any defined benefit or defined contribution retirement accounts, as well as the value of agricultural land and machinery held for production.

Finally, we urge Congress again to act on a swift, bipartisan basis to pass the following proposals: **(1)** The Empowering States to Protect Seniors from Bad Actors Act; **(2)** The Insider Trading Prohibition Act; **(3)** The 8-K Trading Gap Act; **(4)** Request a Study by the GAO Regarding Opportunities to Strengthen the Regulatory Framework Applicable to SDIRAs; **(5)** The Financial Exploitation Prevention Act; **(6)** SEC Whistleblower Reform Act; and **(7)** The FAIR Act.[125] As explained in our July 2022 testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, these proposals would empower all of us to better prevent harm to investors before it occurs, better detect harm to investors before it spreads, and better address violations of the law. Such improvements are integral to our collective efforts to ensure that Americans continue to want to invest in our regulated securities markets for generations to come.

XI. Conclusion

Thank you again for the opportunity to testify. I hope I have provided a helpful roadmap for our respectful opposition to the capital formation agenda under review, as well as an alternative path forward. I look forward to your questions.

[125] *See* Maryland Securities Division Commissioner Melanie Senter Lubin, Written Testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs Regarding Protecting Investors and Savers: Understanding Scams and Risks in Crypto and Securities Markets (July 28, 2022).