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June 15, 2023

The Honorable Charles Schumer (D-NY)
Majority Leader
U.S. Senate
Washington, D.C. 20515

The Honorable Mitch McConnell (R-KY)
Minority Leader
U.S. Senate
Washington, D.C. 20515

The Honorable Richard Durbin (D-IL)
Majority Whip
U.S. Senate
Washington, D.C. 20515

The Honorable John Thune (R-SD)
Minority Whip
U.S. Senate
Washington, D.C. 20515

The Honorable Sherrod Brown (D-OH)
Chairman
U.S. Senate Committee on Banking, Housing, and Urban Affairs
Washington, D.C. 20515

The Honorable Tim Scott (R-SC)
Ranking Member
U.S. Senate Committee on Banking, Housing, and Urban Affairs
Washington, D.C. 20515

The Honorable Robert Menendez (D-NJ)
Chairman
Subcommittee on Securities, Insurance, and Investment of the U.S. Senate Committee on Banking, Housing, and Urban Affairs
Washington, D.C. 20515

The Honorable Mike Rounds (R-SD)
Ranking Member
Subcommittee on Securities, Insurance, and Investment of the U.S. Senate Committee on Banking, Housing, and Urban Affairs
Washington, D.C. 20515

Re: NASAA Urges Senate Leadership to Promote Trust in Our Public Capital Markets

Dear Majority Leader Schumer and Democratic and Republican leaders:

Maintaining robust public capital markets is critical to the financial futures of Americans and the global economy. The regulatory structures established in state and federal securities laws have resulted in the United States having the deepest and most liquid markets in the world. However, efforts are underway to enact legislation that would harm the public capital markets and preempt state investor protection laws to the detriment of entrepreneurs, small businesses, and individual investors. 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.

On behalf of the North American Securities Administrators Association ("NASAA"),[1] I write to urge you and your colleagues to only support and advance legislation that helps rather than harms entrepreneurs, small businesses, and individual investors. In support of your work, NASAA has reviewed the 18 bills passed by the U.S. House of Representatives (the "House") as of June 7, 2023 and referred to the U.S. Senate Committee on Banking, Housing, and Urban Affairs (the "Senate Banking Committee"). Below, we set forth and describe the seven (7) bills[2] we support and the six (6) bills[3] we respectfully do not support. At this time, we take no position on five (5) of the House-passed bills.[4]

As you will read, the reason we respectfully oppose several bills is that the weight of the evidence shows they would undermine our common goal of efficient capital formation for entrepreneuers and small businesses in the United States consistent with robust protection for the individual investors who often provide this capital. Investor protection is critical to fostering the trust that will fuel our capital markets for generations to come.

A. NASAA Urges Congress to Help Older Investors.

The House recently passed two (2) bills that specifically call on all of us to better protect older and sometimes vulnerable persons from financial fraud. NASAA supports both of them.

As background, state securities regulators have been at the forefront of crafting state and federal measures aimed at protecting older and vulnerable investors from financial exploitation. During the last decade, NASAA has urged Congress to (i) update and strengthen the authority of the U.S. Securities and Exchange Commission (the "SEC," "agency," or "Commission" as appropriate below) to impose civil penalties on securities law violators, particularly recidivists;[5] (ii) establish a federal senior investor taskforce within the SEC to consult with state securities regulators and law enforcement authorities;[6] (iii) direct the U.S. Government Accountability

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[1] Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA's membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, the U.S. Virgin Islands, and Guam. NASAA is the voice of securities agencies responsible for grassroots investor protection and responsible capital formation.

[2] NASAA supports H.R. 2593, the Senior Security Act of 2023; H.R. 500, the Financial Exploitation Prevention Act of 2023; H.R 2796, the Promoting Opportunities for Non-Traditional Capital Formation Act; H.R. 298, the Expanding Access to Capital for Rural Job Creators Act; H.R. 2792, the Small Entity Update Act; H.R. 2812, the Middle Market IPO Underwriting Cost Act; and H.R. 2795, the Enhancing Multi-Class Share Disclosures Act.

[3] NASAA opposes H.R. 835, the Fair Investment Opportunities for Professional Experts Act; H.R. 1579, the Accredited Investor Definition Review Act; H.R. 2797, the Equal Opportunity for All Investors Act of 2023; H.R. 2608, To amend the Federal securities laws to specify the periods for which financial statements are required to be provided by an emerging growth company, and for other purposes; H.R. 2610, 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; and H.R. 2793, the Encouraging Public Offerings Act of 2023.

[4] NASAA takes no position at this time on H.R. 388, Securities and Exchange Commission Real Estate Leasing Authority Revocation Act; H.R. 400, Investing in Main Street Act of 2023; H.R. 582, the Credit Union Modernization Act; H.R. 1076, Preventing the Financing of Illegal Synthetic Drugs Act; and H.R. 1156, China Financial Threat Mitigation Act of 2023.

[5] *See* S. 837, Stronger Enforcement of Civil Penalties Act of 2023, 118th Congress, 1st Session.

[6] *See* H.R. 2593, Senior Security Act of 2023, 118th Congress, 1st Session.

Office ("GAO") to study the costs, causes, and barriers to reporting the financial exploitation of seniors;[7] (iv) amend the Victims of Crime Act of 1984 to establish eligibility for seniors victimized by financial exploitation to be reimbursed from state victim compensation programs;[8] and (v) enact the Empowering States to Protect Seniors from Bad Actors Act, which would fund a federal grant program that state securities regulators can access to protect senior investors through education, rulemaking, and enforcement.[9]

As presently written, NASAA supports H.R. 2593, the Senior Security Act of 2023, as amended ("H.R. 2593"), and H.R. 500, the Financial Exploitation Prevention Act of 2023, as amended ("H.R. 500"). They both enjoy bipartisan, bicameral support. On June 5, 2023, the House passed H.R. 2593 by voice vote. Representative Josh Gottheimer (D-NJ) introduced the legislation. Representatives Ann Wagner (R-MO) and Michael Lawler (R-NY) are cosponsors. On January 30, 2023, the House passed H.R. 500 by a vote of 419 to zero (0). Representative Ann Wagner (R-MO) introduced the legislation. Four (4) Democrats and nine (9) Republicans are cosponsors. Further, both bills have Senate companion bills with the same or similar text and bipartisan cosponsors. On March 23, 2023, Senator Kyrsten Sinema (I-AZ), joined by Senator Susan Collins (R-ME), introduced S. 955, the Senior Security Act of 2023. On May 9, 2023, Senator Bill Hagerty (R-TN) introduced S. 1481, the Financial Exploitation Prevention Act of 2023. Senators Jon Tester (D-MT) and Susan Collins (R-ME) are cosponsors.

Importantly, H.R. 2593 would solve two (2) longstanding problems—information gathering and sharing. Specifically, the bill would establish a "Senior Investor Taskforce" (the "Taskforce") at the SEC for 10 years. The Taskforce would "(A) identify challenges that senior investors encounter, including problems associated with financial exploitation and cognitive decline; (B) identify areas in which senior investors would benefit from changes in the regulations of the Commission or the rules of self-regulatory organizations; (C) coordinate, as appropriate with other offices within the Commission, other taskforces that may be established within the Commission, self-regulatory organizations, and the Elder Justice Coordinating Council; and (D) consult, as appropriate, with State securities and law enforcement authoritys, State insurance regulators, and other Federal agencies." Every two (2) years, the Taskforce would submit a report to Congress outlining trends and innovations that negatively affect this population. The bill would require the SEC to use existing funds to complete this work.

Moreover, H.R. 2593 would require the GAO to submit to Congress and the Taskforce the results of its study of financial exploitation of senior citizens. The study would cover (i) the economic costs of the financial exploitation of senior citizens; (ii) the frequency of senior financial exploitation and correlated or contributing factors; and (iii) policy responses and reporting of senior financial exploitation.

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[7] *See* H.R. 2593, Senior Security Act of 2023, 118th Congress, 1st Session.

[8] *See* S. 3487, Edith Shorougian Senior Victims of Fraud Compensation Act, 116th Congress, 2nd Session.

[9] *See* H.R. 5914, Empowering States to Protect Seniors from Bad Actors Act, 117th Congress, 2nd Session. Representative Josh Gottheimer (D-NJ) has committed to introducing the same or similar legislation during the 118th Congress. *See* Gottheimer Release: Gottheimer Announces New Steps for Seniro Security Strategy to Combat Financial Scams (Feb. 3, 2023).

Similarly, H.R. 500 would support information gathering and sharing, all to the end of better protection of older Americans. First, it would require registered open-end investment companies and the transfer agents who serve those companies, including mutual funds, to contact customers who hold non-institutional accounts directly with the company to request information for a trusted contact who can be notified if the company or transfer agent identifies possible financial exploitation.[10] Second, it would allow the company or transfer agent in limited circumstances to postpone the date of payment upon redemption of any redeemable security. Among other requirements, the company or transfer agent must reasonably believe the redemption was requested through the financial exploitation of a security holder. Also, the security holder must be (i) an individual age 65 or older or (ii) an adult who the company or agent reasonably believes cannot protect their own interests due to the adult's mental or physical impairment ("Specified Adults").[11] Third, H.R. 500 would require the SEC, in consultation with NASAA and other policymakers, to submit a report to Congress that includes recommendations regarding the regulatory and legislative changes necessary to address the financial exploitation of security holders who are Specified Adults.[12]

To be clear, NASAA sees opportunities for improvements in both bills. With respect to H.R. 2593, state securities regulators appreciate that it can be costly for regulators to organize taskforces and prepare reports to Congress. It may or may not be realistic for the SEC to undertake this additional work without additional funding. With respect to H.R. 500, NASAA strongly encourages Congress to clarify the relationship between this legislation and state law so that nothing in this legislation can be construed to preempt or limit any provisions of state law unless the legislation provides a greater level of protection to investors. Lawmakers should consider using the 'no preemption provision' in the 2018 Senior Safe Act as a model.[13] In addition, NASAA strongly encourages Congress to incorporate a requirement that, if a company or transfer agent reasonably believes that financial exploitation of a Specified Adult may have occurred, may have been attempted, or is being attempted, it must promptly notify the SEC, the relevant state securities regulator, and the relevant adult protective services agency. Lawmakers

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[10] Open-end investment companies offer securities in pooled investment vehicles such as mutual funds.

[11] These provisions in H.R. 500 are broadly consistent with the SEC staff's 2018 no-action letter and the 2016 NASAA Model Act to Protect Vulnerable Adults from Financial Exploitation, which is now the basis for law and regulation in at least 35 states. *See* Jennifer Palmer, Senior Counsel in the SEC's Division of Investment Management, Investment Company Act of 1940 – Section 22(e), Investment Company Institute No Action Letter (June 1, 2018); NASAA, NASAA Model Legislation or Regulation to Protect Vulnerable Adults from Financial Exploitation (adopted Jan. 22, 2016); NASAA's list of jurisdictions that have enacted legislation or regulations based on the NASAA Model Act to Protect Vulnerable Adults from Financial Exploitation (last updated May 2023). *See generally* FINRA, SEC Approves Rules Relating to Financial Exploitation of Seniors, Reg. Notice 17-11 (Mar. 30, 2017).

[12] This requirement recognizes the longstanding efforts of state and federal policymakers to provide Congress with recommendations and information regarding senior financial exploitation. *See, e.g.*, Stephen Deane, Engagement Adviser in the SEC's Office of the Investor Advocate, Elder Financial Exploitation: Why it is a concern, what regulators are doing about it, and looking ahead (June 2018).

[13] *See* 12 U.S.C. § 3423(c) ("Relationship to State law. Nothing in this section shall be construed to preempt or limit any provision of State law, except only to the extent that subsection (a) provides a greater level of protection against liability to an individual described in subsection (a)(2)(A) or to a covered financial institution described in subsection (a)(2)(B) than is provided under State law.").

may wish to use language from the NASAA Model Act to Protect Vulnerable Adults from Financial Exploitation to write an equivalent notification requirement for this legislation.[14]

In sum, we urge the Senate to act swiftly. We believe these bills even as presently written would go a long way to increasing protection for older investors.

B. NASAA Urges Congress to Expand Access to Capital for Entrepreneurs and Small Businesses in Rural Areas and Other Underserved Communities.

Also pending are two (2) House-passed bills that expressly call on all of us to better serve entrepreneuers and small businesses in rural areas and other underserved communities. NASAA is pleased to support both bills.

As background, state securities regulators regularly witness firsthand the value that comes from having entrepreneurs and small businesses engage directly with state regulators about capital raising generally and the securities offerings they will make or have made to investors in their states. This engagement helps issuers better understand their options for raising capital and avoid or mitigate compliance mistakes. It also deters fraud and other misconduct that can harm business owners and investors alike. For example, state securities regulators facilitate networking opportunities for businesses to raise capital, attend venture capital or entrepreneurs fairs (*e.g.*, the MIT Entrepreneur Forum), collaborate on outreach efforts with other regulators, and support the trainings conducted by nonprofit organizations (*e.g.*, venturecapital.org). The engagement similarly helps state securities regulators better understand the educational and compliance needs of the business community in their states, including rural and other hard-to-reach community members. State securities regulators use this information to enhance their education and outreach programming for entrepreneurs and small businesses.

As presently written, NASAA supports H.R. 2796, the Promoting Opportunities for Non-Traditional Capital Formation Act, as amended ("H.R. 2796"), and H.R. 298, the Expanding Access to Capital for Rural Job Creators Act, as amended ("H.R. 298"). On May 20, 2023, the House passed H.R. 2796 by a strong bipartisan vote of 309 to 67. Ranking Member Maxine Waters (D-CA) introduced the legislation. No Senator has introduced a companion bill for H.R. 2796. On January 30, 2023, the House passed H.R. 298 by voice vote. Representative Alexander Mooney (R-WV) introduced the legislation. Four (4) Democrats and eight (8) Republicans are cosponsors. H.R. 298 has a Senate companion bill, S. 294. On February 7, 2023, Senator John Kennedy (R-LA) introduced S. 294. Four (4) Democrats and one (1) Republican are cosponsors.

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[14] *See* NASAA Model Act to Protect Vulenable Adults from Financial Exploiation, Section 7 and its associated legislative commentary. The NASAA Model Act to Protect Vulenable Adults from Financial Exploiation provides broker-dealers and investment advisers with the authority to delay disbursing funds from an eligible adult's account for up to 15 business days if the broker-dealer or investment adviser reasonably believes that a disbursement would result in the financial exploitation of the eligible adult. If the broker-dealer or investment adviser delays a disbursement, it must notify people authorized to transact business on the account (unless these individuals are suspected of the financial exploitation), notify the state securities regulator and the adult protective services agency, and undertake an internal review of the suspected exploitation. The state securities regulator or adult protective services agency may request an extension of the delay for an additional 10 business days. Extensions beyond that could be ordered by a court.

Importantly, H.R. 2796 and H.R. 298 are complementary. To begin, H.R. 2796 would amend Section 4 of the Securities Exchange Act of 1934 ("Exchange Act") to require the SEC's Advocate for Small Business Capital Formation (the "Advocate") to provide educational resources and host events to promote capital raising options for traditionally underrepresented small businesses and businesses located in rural areas.[15] In addition, it would require the Advocate to meet at least annually with representatives of state securities commissions to discuss opportunities for collaboration and coordination with respect to these efforts.[16] In support of this coordinated education and outreach, H.R. 298 would amend Section 4 of the Exchange Act to require the Advocate to identify any unique challenges that "rural-area small businesses" have with securing access to capital and report annually to Congress on the most serious issues encountered by "rural-area small businesses" and their investors.

In sum, we urge the Senate to act without delay. Both bills would strengthen our common goal of tailoring governmental efforts to support hard-to-reach entrepreneurs and small businesses throughout the United States. As then-SEC Commissioner Michael Piwowar said in 2017, "For a capital formation agenda to succeed, it is essential that state and federal regulators work together to support the businesses that seek to engage in these offerings while also protecting investors."[17]

C. NASAA Urges Congress to Level the Playing Field.

This Congress, the House has passed two (2) bills that aspire to level the playing field for smaller participants in our capital markets. NASAA commends lawmakers for acting on longstanding competition concerns. We are pleased to support both bills.

The bills are H.R. 2792, the Small Entity Update Act, as amended ("H.R. 2792"), and H.R. 2812, the Middle Market IPO Underwriting Cost Act, as amended ("H.R. 2812"). On May 30, 2023, the House passed H.R. 2792 by a vote of 367 to eight (8). Representative Ann Wagner (R-MO) introduced the legislation. Four (4) Democrats, as well as one (1) Republican, are cosponsors. On June 5, 2023, the House passed H.R. 2812 by a vote of 390 to 10. Representative Jim Himes (D-CT), joined by Representative Michael Lawler (R-NY), introduced the legislation. No Senator has introduced a companion bill for either H.R. 2792 or H.R. 2812.

H.R. 2792 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 emerging growth company ("EGC") or a similarly large business. Specifically, the bill would direct the

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[15] As context, Section 19(d) of the Securities Act of 1933 ("Securities Act") requires the Commission to "conduct an annual conference as well as such other meetings as are deemed necessary, to which representatives from such securities associations, securities self-regulatory organizations, agencies, and private organizations involved in capital formation shall be invited to participate."

[16] While we appreciate the efforts of the prior Advocate to engage state regulators, we believe an annual meeting requirement would ensure such engagement occurs on a more regular basis.

[17] *See* SEC Commissioner Michael Piwowar, Opening Remarks at 2017 SEC/NASAA Annual Section 19(d) Conference (May 9, 2017).

SEC 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 recommendation, repeat the study in five (5) years, and adjust all dollar figures under the definition of small entity for inflation every five (5) years.

In a similar vein, H.R. 2812 would help to address a longstanding disadvantage faced by middle market businesses—specifically, in the United States, middle market businesses typically pay what effectively is a seven (7) percent tax before they can access our public capital markets. Meanwhile, larger businesses do not pay this tax.[18] In support of maintaining fair markets, which is an element of the SEC's present mission, this legislation would direct the Comptroller General of the United States, in consultation with the SEC and the Financial Industry Regulatory Authority ("FINRA"), to study the costs associated with underwriting initial public offerings ("IPOs") and Regulation A, Tier 2 offerings for small- and medium-sized companies. The bill also would direct the SEC to issue a report to Congress with findings and recommendations.

As stated, NASAA is pleased to support both bills. At the same time, we urge Congress to consider requiring the SEC to prepare a comprehensive study on private and public markets, including without limitation the SEC's latest data and research on the performance of offerings under Regulation A, Regulation D, and Regulation Crowdfunding, as well as the effect of recent changes to the SEC's "accredited investor" definition. It has been 60 years since the SEC led the preparation of a comprehensive report on the state of our capital markets.[19] Though Congress requests many studies from the SEC and the GAO, members of Congress rarely coordinate these requests. Among other benefits, a comprehensive study of the private and public capital markets would help regulators and legislators, as well as other stakeholders, better understand issues within their greater context for purposes of advancing helpful laws and rules. Moreover, we urge Congress to improve H.R. 2792 and H.R. 2812 by amending the legislation to direct the SEC to invite a representative of state securities commissions to consult on the SEC's research and reports to Congress.

D. NASAA Urges Congress to Strengthen the Ability of Individual Investors to Protect Themselves.

Last month, the House passed H.R. 2795, the Enhancing Multi-Class Share Disclosures Act, as amended ("H.R. 2795"), by a vote of 347 to 30. In short, NASAA supports the legislation as presently written because it would enhance transparency by requiring issuers with multi-class share structures to make certain disclosures regarding certain shareholders' voting power.

As background, a multi-class share structure occurs when a company issues two (2) or more classes of shares that have different voting rights. For example, a company may issue one (1) class of shares with no or few voting rights for the public and another class with more voting rights for company founders and executives.

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[18] *See* Robert Jackson, The Middle-Market IPO Tax (Apr. 25, 2018).

[19] *See* SEC, Report of Special Study of Securities Markets of the Securities and Exchange Commission (Apr. 3, 1963).

Multi-class share structures have existed in the United States since the late 1800s. The original intent of these structures was to allow companies, particularly family-run businesses, to maintain voting control without having to own the majority of equity in their company. Stated differently, insiders could control the company while owning a smaller number of shares than would be necessary in a traditional one-share, one-vote structure. For example, in 1925, the owners of the Dodge Brothers, an auto maker, had total voting control while holding only 1.7 percent of equity.[20]

In recent decades, the use of multi-class shares has risen in popularity. Since 1980, nearly 10 percent of all new initial public offerings ("IPOs") have used the structure. In addition, the percentage of IPOs using this structure has trended upward.[21]

As further background, in 2018, the SEC's Investor Advisory Committee ("IAC") and others determined that these structures may pose significant risks for investors, including limiting investors' abilities to influence management, direct strategy, and hold misaligned boards accountable. In their view, the current disclosure regime around such arrangements is simply inadequate given the significant risks associated with multi-class governance structures.[22]

In short, H.R. 2795 responds to this trend and associated concerns with a focus on closing well-documented disclosure gaps involving multi-class governance structures. Specifically, the bill would require issuers of securities with multi-class share structures to disclose certain information in any proxy solicitation or consent solicitation material for an annual meeting of the shareholders of the issuer or any other filing as the Commission determines appropriate. The disclosure would include (i) the number of shares of all classes of securities entitled to vote in the election of directors beneficially owned by specified persons and (ii) the amount of voting power held by specified persons. The specified persons would be each person who is a director, director nominee, or named executive officer of the issuer, or who is the beneficial owner of securities with five (5) percent or more of the total combined voting power of all classes of securities entitled to vote in the election of directors.

Introduced by Gregory Meeks (D-NY), this legislation presently has no cosponsors or a Senate companion bill. However, bipartisan support for this legislation is evident in the decision of the House Financial Services Committee ("HFSC") decision on May 24, 2023 to report the bill favorably by a vote of 48 to one (1). Further, the legislation received bipartisan support during prior Congresses.[23]

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[20] *See* House Report 115-879, Enhancing Multi-Class Share Disclosures Act, 115th Congress, 2nd Session. *See also* Congressional Research Service, Dual Class Stock: Background and Policy Debate (Dec. 8, 2021) (describing the public outcry that ensued after a stock issuance by the Dodge Brothers and the New York Stock Exchange's response thereto).

[21] *See* Jay Ritter, Initial Public Offerings: Dual Class Structure of IPOs Through 2022 (Apr. 24, 2023).

[22] See Recommendation of the SEC Investor Advisory Committee regarding Dual Class and Other Entrenching Governance Structures in Public Companies (approved Mar. 8, 2018).

[23] *See* H.R. 6322, Enhancing Multi-Class Share Disclosures Act, 115th Congress, 2nd Session. On July 11, 2018, H.R. 6322 was reported favorably out of the HFSC by a voice vote.

In conclusion, Congress should move quickly to enact this bill into law. This legislation would provide important disclosures for shareholders.

E. NASAA Urges Congress to Keep Investor Protection Top of Mind When Expanding the SEC's Definition of an "Accredited Investor."

Recently, the House passed three (3) measures intended to expand the number of investors qualified to purchase private securities by amending the SEC's definition of an "accredited investor." The proposals are H.R. 835, the Fair Investment Opportunities for Professional Experts Act, as amended ("H.R. 835"), H.R. 1579, the Accredited Investor Definition Review Act, as amended ("H.R. 1579"), and H.R. 2797, the Equal Opportunity for All Investors Act of 2023, as amended ("H.R. 2797").

As a threshold matter, NASAA supports well-designed 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.

That said, implicit in these proposals is a notion that individual investors are clamoring to invest in private offerings, individual investors are locked out of participating in the most promising startups, and legitimate private companies with bona fide products or services are eager to sell securities to individual investors. The weight of the evidence supports none of these ideas.[24] On the contrary, the promising or successful private companies generally attract capital from a small number of wealthy backers such as venture capital funds. For these companies, this is the simplest, easiest, and cheapest way to raise money.[25]

A question must therefore be asked as to what sort of companies are eager to raise capital from a new population of individual accredited investors. Evidence suggests that it will be the private companies that first fail to attract interest from angel investors, venture capital firms, investment banks, or hedge funds.[26] For example, we already know that, even though the law already allows private companies using certain pathways to raise capital to accept investments from non-accredited investors, the vast majority of such offerings fail to seek capital from non-

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[24] *See* Letter from Rick A. Fleming, SEC Office of the Investor Advocate, to Vanessa Countryman, Re: Concept Release on Harmonization of Securities Offerings (July 11, 2019) (summarizing data from the U.S. Federal Reserve and private researchers to show that companies will be unlikely to want to seek out investments from individual investors who do not already qualify as accredited and that "small-dollar investors may be driven into investment structures in which they bear the downside risk of losing their entire principal while their potential for profits is severely restricted").

[25] *See* Dana Olsen, The State of U.S. Venture Capital in 15 Charts, Pitchbook.com (Oct. 29, 2018); Bain & Co., Global Private Equity Report 2020 (2020) at 11 (stating that private equity uncalled capital "has been rising since 2012" and "hit a record high of $2.5 trillion in December 2019 across all fund types").

[26] *See* SEC Division of Economic and Risk Analysis, Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009- 2017 (Aug. 2018) at 34 ("2018 DERA Report") (stating that "[t]he mean number of investors per offering (14) is significantly larger than the median (4), indicating the presence of a small number of a small number of offerings with a large number of investors. Offerings by pooled investment funds and REITs have the largest average number of investors (both accredited and non-accredited) per offering, while those by non-financial issuers have the smallest.").

accredited investors.[27] As succinctly explained by Professor Elisabeth de Fontenay, "[r]etail investors are not needed to provide capital to emerging companies, and promising companies do not appear to want them."[28] Furthermore, in the realm of the private markets, retail investors are pitted against well-heeled institutional investors who have the means and resources to extract the best deals from the most promising opportunities, thus leaving retail investors with the riskiest of the risky deals.

In addition, a separate but related question must be asked as to which individual investors actually have the types of financial resources that companies need. Consider the amount of financial assets—which include all bank accounts, certificates of deposit, cash value life insurance, stocks, bonds, and pooled investment funds (including retirement accounts)—held by American households. For the households in the bottom quartile of household net worth, the median value of financial assets held is a mere $1,380.72. For the next quartile of households (those between the 25th and 50th percentiles of net worth), the median value of financial assets held is $11,220. The next quartile up (between the 50th to 75th percentiles) is a bit better off, but the median value of financial assets held is still only $61,000. For three-fourths of American households, then, it is hard to imagine that there would be a significant demand for securities sold in the private markets. Indeed, their investments in high risk, illiquid, unregistered offerings are more likely to be the result of unscrupulous sales tactics rather than sound financial judgment.

Of course, the portion of the population lying just below the current accredited investor thresholds—which would likely include households between the 75th and 90th percentiles in terms of net worth—is more likely to have the financial wherewithal to invest in private offerings. For these households, the median value of financial assets held is $301,000. Consider, however, the investment portfolios of these households. For this segment of the population, the median value of retirement accounts is $192,000, which means that most of these households' financial assets are in retirement accounts. Moreover, barely one (1) in four (4) of these households hold stocks directly, and for those that do, the median value of the holdings is $30,000.[29]

Understanding this, Congress should appreciate that expanding the SEC's "accredited investor" definition as proposed probably would serve as a conduit, at best, for lackluster companies to waste the hard-earned savings of Americans. At worst, these proposals could become an engine for even more fraudulent exploitation of vulnerable investors.

Respectfully, we urge Congress to pause further consideration of H.R. 835, H.R. 1579, and H.R. 2797 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

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[27] *See* 2018 DERA Report at 34-35 (stating that between 2009-2017, only seven (7) percent of Rule 506(b) offerings had at least one non-accredited investor). It may be that private issuers do not exercise this option because of the enhanced disclosure obligations that must be met for sophisticated, but not non-accredited investors.

[28] *See* Elisabeth de Fontenay, Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment, Written Testimony Before the U.S. House Committee on Financial Services Subcommittee on Investor Protection, Entrepreneurship and Capital Markets (Sep. 11, 2019).

[29] *See* Board of Governors of the Federal Reserve System, Survey of Consumer Finances, 1989-2019.

investor."[30] We understand that, pursuant to the SEC's Unified Agenda of Regulatory and Deregulatory Actions (also commonly referred to as the "Reg Flex Agenda"), the SEC's Director of the Division of Corporation Finance is considering whether to recommend such changes to the Commission. The forthcoming proposed rulemaking may incorporate one (1) or more of the ideas set forth in these bills and have the benefit of the SEC staff's review of the effects of the changes the SEC made in 2020.

Should Congress disagree with our call for delay and oversight rather than premature legislation, NASAA offers the background and comments below regarding H.R. 835, H.R. 1579, and H.R. 2797. In addition, we highlight two (2) specific changes that we believe would have the greatest impacts on investor protection and ultimately the efficient allocation of capital.

To begin, H.R. 835 would amend the Securities Act to modify the definition of an "accredited investor" to codify the SEC's existing definition, incorporate new requirements to adjust net worth and income standards for inflation, and make it possible to qualify as an accredited investor based on education or job experience. The amended definition under H.R. 835 would include (i) 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; (ii) an individual whose income over the last two (2) 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; (iii) an individual who is licensed or registered with the appropriate authorities to serve as a broker or investment adviser; and (iv) 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 in H.R. 835.

H.R. 835 had limited bipartisan support in the House. Representative French Hill (R-AR) introduced the legislation. The bill has one (1) Democratic cosponsor and six (6) Republican cosponsors. On June 5, 2023, the House passed the legislation by voice vote. On April 26, 2023, the HFSC reported the bill favorably by voice vote. No Senator has introduced a companion bill.

In a similar vein, H.R. 1579 would amend the law 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 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 every five (5) years thereafter.[31]

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[30] 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).

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

H.R. 1579 had limited bipartisan support in the House. Representative Bill Huizenga (R-MI) introduced the legislation. Representative Michael Lawler (R-NY) is a cosponsor. On June 5, 2023, the House passed the legislation by voice vote. On April 26, 2023, the HFSC reported the bill favorably by a recorded vote of 41 yeas to two (2) nays. No Senator has introduced a companion bill.

Last, H.R. 2797 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. 2797 had bipartisan support in the House. Representative Mike Flood (R-NE) introduced the legislation. Two (2) Democrats and one (1) Republican are cosponsors. On May 31, 2023, the House passed the legislation by a vote of 383 to 18. On April 26, 2023, the HFSC reported the bill favorably by a recorded vote of 42 yeas to one (1) nay. No Senator has introduced a companion bill.

To begin with, these three bills 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.[32] In 2020, the SEC opted to permit qualification for a small set of professional certifications. The SEC considered but ultimately did not approve (i) qualification by additional professional certifications; (ii) qualification by education or job experience; or (iii) qualification by examination.[33] As a related aside, the SEC staff also considered these ideas when the agency issued a report in 2015 on the definition of an "accredited investor."[34]

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 (1) aspect in assessing an investor's financial sophistication. However, such standards should be coupled with demonstrable experience.[35] NASAA also generally agrees

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[32] When the SEC took up these ideas through rulemaking in 2020, only three (3) of the five (5) Commissioners voted to approve the final rule. *See* SEC, Final Commission Votes for Agency Proceedings, Calendar Year 2020 (last updated Aug. 18, 2021).

[33] *See*, *e.g.*, SEC Final Rule, Accredited Investor Definition, Rel. No. 33-10824 (Aug. 26, 2020)("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.").

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

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

that rigorous examinations, coupled with continuing education or retesting requirements, can be one (1) aspect in assessing an investor's financial sophistication.

At this time, NASAA can support two (2) specific changes to the SEC's "accredited investor" definition. First, we believe the SEC's definition should exclude assets accumulated or held in retirement accounts from inclusion in natural person accredited investor net worth calculations. Around the same time the natural person accredited investor thresholds were established in 1982, 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. It should be a priority for Congress and the Commission to guard these assets from exposure to the riskiest offerings in our markets. The retirement accounts with the largest balances are generally held by older investors who are especially vulnerable to losses that they cannot recoup over time. Further, this population can ill-afford to invest in the types of illiquid securities offered in many private deals. Like a primary residence, which Congress excluded in 2010 from the SEC's accredited investor net worth calculations, these are assets that as a class and given their defining purpose are not appropriate for speculative private investing.

Second, we believe the SEC should adjust the income and net worth thresholds to account for inflation since 1982 and then index those thresholds going forward. The natural person accredited investor thresholds—specifically, $1 million in net worth, an individual annual income of $200,000, or a combined income of $300,000—have not changed since 1982, except for the exclusion of primary residences from net worth calculations. In 1982, these thresholds applied to 1.6 percent of American households. Although a poor proxy for sophistication and the ability to bear losses, the number of qualifying households in 1982 kept the risks of private market investing within a rung of investors most likely to be able to bear speculative losses. That is no longer true; today, these thresholds qualify approximately 13 percent of American households to engage in private market investments.

Any adjustment to the income and net worth thresholds must take into account the role inflation has played in eroding their protective aims. The Commission previously acknowledged that in failing to adjust the "dollar-amount thresholds upward for inflation, we've effectively lowered the thresholds in term of real purchasing power."[36] Without adjustment, the protective barrier that these thresholds are meant to represent will become further eroded, exposing more vulnerable investors to unnecessary risks.

In sum, we urge Congress to delay further action until the SEC staff have concluded their inquiry of possible changes to the SEC's definition. We further urge Congress to keep the protection of investors top of mind when making any changes to the SEC's definition. NASAA remains open to discussions with Congress, the SEC, and other stakeholders about additional reforms to the SEC's definition that take into account the ability of investors to bear losses.

[36] *See* SEC Proposed Rules, Revisions to Limited Offering Exemption in Regulation D, Rel. No. 33-8828 at 42 (Aug. 3, 2007).

F. NASAA Urges Congress to Reject Proposals That Would Relax Obligations for EGC Issuers and Extend EGC Privileges to All Issuers.

The remaining three (3) bills passed by the House are intended to reduce disclosure requirements for issuers, particularly EGCs, to increase IPOs and improve the quality of public offerings. These proposals are H.R. 2608, To amend the Federal securities laws to specify the periods for which financial statements are required to be provided by an emerging growth company, and for other purposes, as amended ("H.R. 2608"); H.R. 2610, 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, as amended ("H.R. 2610"); and H.R. 2793, the Encouraging Public Offerings Act of 2023 ("H.R. 2793").

NASAA appreciates efforts by lawmakers to increase IPOs, add useful clarity to the securities regulatory framework, and improve the quality of public offerings. We agree that our public markets have deteriorated over the last several decades and that reforms are needed to reinvigorate them. However, these proposals are premised on deregulatory approaches that degrade the quality and quantity of publicly information about issuers, an approach that we know does not work.

To begin, H.R. 2608 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.

H.R. 2608 had bipartisan support in the House. Representative Patrick McHenry (R-NC) introduced the legislation. The bill has no cosponsors. On June 5, 2023, the House passed the legislation by voice vote. On April 26, 2023, the HFSC reported the bill favorably on a 41 to zero (0) vote. No Senator has introduced a companion bill.

NASAA opposes H.R. 2608, as presently written, 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 (2) 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.

In a similar vein, H.R. 2610 would make clear that the registration statement of the EGCs need not include profit and loss statements for more than the preceding two (2) years rather than the three (3) 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. The SEC presently accepts

voluntary draft registration statement submissions from all issuers for nonpublic review provided certain procedures are followed.[37]

H.R. 2610 had bipartisan support in the House. Representative Patrick McHenry (R-NC) introduced the legislation. The bill has no cosponsors. On June 5, 2023, the House passed the legislation by voice vote. On April 26, 2023, the HFSC reported the bill favorably on a 42 to zero (0) vote. No Senator has introduced a companion bill.

NASAA opposes H.R. 2610 as presently 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 Jumpstart Our Business Startups Act ("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.

Last, H.R. 2793 would extend certain EGC privileges to all issuers and require the SEC to submit a report to Congress before it conducts a rulemaking. Specifically, H.R. 2793 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.[38] 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 testing-the-waters accommodation to non-EGCs.[39] 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.[40] In addition, H.R. 2793 would extend the confidential review of draft registration statements to all 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

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

[38] *See* JOBS Act 1.0 at § 105.

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

[40] *See* 17 CFR § 230.163(b).

the basis of the rulemaking, the legislation would permit 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.

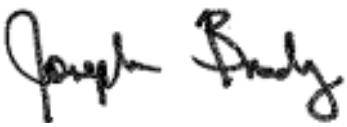
H.R. 2793 had bipartisan support in the House. Representative Ann Wagner (R-MO) introduced the legislation. The bill has three (3) Democratic and one (1) Republican cosponsors. On June 5, 2023, the House passed the legislation on a 384 to 13 vote. On April 26, 2023, the HFSC reported the bill favorably on a 38 to one (1) vote. No Senator has introduced a companion bill.

NASAA opposes H.R. 2793 as presently written. Respectfully, this legislation would reinforce the sort of deregulatory creep that NASAA 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. In addition to our concerns regarding confidential reviews of registration materials outlined above, 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 issues proposals 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.

In sum, we urge Congress to reject these bills. Rather than passing legislation that would only make our markets more opaque, we should focus on pro-investor measures like the ones outlined earlier in this letter and previous NASAA communications to Congress, including our 2023 Report and Recommendations on Reinvigorating Our Capital Markets.[41]

Thank you for your time and consideration. Should you have any questions or wish to seek NASAA's technical feedback on any legislative proposals, please do not hesitate to contact me or Kristen Hutchens, NASAA's Director of Policy and Government Affairs, and Policy Counsel, at khutchens@nasaa.org.

Sincerely,



Joseph Brady
NASAA Executive Director

[41] Please visit NASAA's Policy Center at nasaa.org to find our recent letters to Congress and testimony, as well as our Federal Policy Agenda.