November 6, 2019

Ms. Anne Sheehan
Chairman
Investor Advisory Committee
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

SENT VIA EMAIL (rules-comments@sec.gov)

Re: Securities and Exchange Commission's Investor Advisory Committee Meeting on November 7, 2019 (File No. 265-28)

Dear Ms. Sheehan:

Better Markets[1] appreciates the opportunity to submit this letter in advance of the Investor Advisory Committee's ("Committee") November 7, 2019 meeting in Washington, DC, during which the Committee will discuss the Securities and Exchange Commission's ("Commission") recent Concept Release on Harmonization of Securities Offering Exemptions ("Private Offering"). As the Committee recognizes full-well, securities regulation is at its core a disclosure regime. Its bedrock premise is that companies that want access to investors' hard-earned savings must disclose publicly and in a timely fashion all material information investors need to make informed decisions. Our securities laws and the rules by which they are administered have been built on that foundation.

As the Committee is aware, investors operate at a considerable informational disadvantage in the marketplace. The federal securities laws provide an important corrective to this dynamic by mandating corporate reporting, recognizing that companies have a natural inclination to withhold embarrassing and damaging information from investors. This is the fundamental dynamic underlying the Commission's disclosure regime: Investors generally want more information about companies, and these issuers want to disclose less information.

[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

The Committee has a critical voice in the debate regarding Private Offerings. After the Financial Crisis, Congress realized that investors' perspectives are often under-appreciated by the Commission, so it established in law and empowered Committee to advise and consult with the Commission on—

a. regulatory priorities of the Commission;
b. issues relating to the regulation of securities products, trading strategies, and fee structures, and the effectiveness of disclosure;
c. initiatives to protect investor interest; and
d. initiatives to promote investor confidence and the integrity of the securities marketplace.

The law also authorized the Committee "to submit to the Commission such findings and recommendations as the Committee determines are appropriate, including recommendations for proposed legislative changes."[2] Importantly, the law **required** that "the Commission shall— (1) review the findings and recommendations of the Committee; and (2) each time the Committee submits a finding or recommendation to the Commission, promptly issue a public statement" that would ''(A) assess[] the finding or recommendation of the Committee; and (B) disclose[] the action, if any, the Commission intends to take with respect to the finding or recommendation."

Given this explicit and powerful mandate, we urge the Committee to unequivocally and forcefully express its views on the Private Offering concept release in the interest of investors. It was created by Congress to do just that. Fewer policy matters under consideration by the Commission risk threatening the interest of investors more than some of the ideas articulated in the Private Offering concept release.

We appreciate both the Committee's and Commission's focus on the issue of the decreasing number of public companies. Public companies—with their robust financial controls, disclosure requirements, corporate governance structures and regulated public trading venues—provide investment opportunities for investors and all those who want to put aside a portion of their wages to be able to pay for their kids' education or retire in dignity. It is indeed a public policy failure that today investors have—compared to 1997, for example—almost half as few public companies to consider investing in. But the answer to this policy failure is not to breakdown the levies that protect retail and unsophisticated investors against highly risky, unregistered securities offering.

To aid your deliberation of the Private Offering concept release and your potential recommendation or report about it, we are enclosing our comment letter we submitted to the Commission in response to the concept release.

[2] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Sec. 911, *available* at https://www.govinfo.gov/content/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf.

Sincerely,

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BETTER MARKETS

September 24, 2019

Mrs. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Concept Release on Harmonization of Securities Offering Exemptions (Release Nos. 33–10649; 34–86129; IA– 5256; IC–33512; File No. S7–08–19)

Dear Secretary Countryman:

Better Markets[1] appreciates the opportunity to comment[2] on the above-captioned concept release ("Release") published for public comment by the Securities and Exchange Commission ("SEC" or "Commission"). In the Release,[3] the Commission describes the vast complex web of exemptions under the current securities laws and regulations that are available to companies that want to raise capital through the issuance of securities. The Release asks hundreds of questions about all aspects of the appropriateness of these exemptions, but the Commission does not propose any changes to the rules that created these exemptions. That, of course, is a glaring deficiency and precludes more informed responses, yet another reason for re-issuing the Release with additional information and data for public comment.

At the outset, we note that the Commission has failed to discuss much less analyze its own past and ongoing actions that have induced and enabled expansion of private markets, to the detriment of the public markets, public investors and capital formation. While the SEC bemoans the size and vitality of the public markets, it continues to authorize if not incentivize the expansion of dark private markets, bleeding public investors of opportunities, transparency and

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

2 However, given the importance of the subjects of the release and their implications for investors and markets, a 60-day comment period is grossly insufficient. As discussed below, the Commission should gather additional information and re-issue an updated concept release with no less than 90 days for comment and, ideally 120 days so that the public, and not just the industry with its army of lobbyists and lawyers, can provide input.

3 *See* Concept Release on Harmonization of Securities Offering Exemptions, Release Nos. 33–10649; 34–86129; IA– 5256; IC–33512; File No. S7–08–19, 84 Fed. Reg. 30460 (June 26, 2019) *available* at https://www.federalregister.gov/documents/2019/06/26/2019-13255/concept-release-on-harmonization-of-securities-offering-exemptions.

accountability, and our economy of much-needed capital. Any such analysis would almost certainly demonstrate that many of these problems and challenges discussed in the Release are actually caused by the SEC's own actions. Given that, before taking any action on any of these matters, the SEC must undertake a comprehensive review of its own actions in creating the problems it now suggests "solutions" for, which, as discussed below, will actually make the problems worse.

It also noteworthy how much of the Release is based on conjecture and assumptions. The lack of robust data and actual concrete information is glaring and shocking. The Commission simply must undertake a serious data gathering process and then analyze that data before releasing it for public comment.

With those remarkable deficiencies as the overall frame for considering the Release, our comment letter will mainly focus on these seven general themes that thread through the entire Release:

1. Are retail investors asking for or need access to exempt offerings?

2. Are high-growth and/or promising companies having difficulties accessing funding?

3. Do high-growth and/or promising companies prefer funding from *retail* investors rather than institutional investors, venture funds, and others that are already amply available?

4. How do those who invest in exempt offerings fare? Will *retail* investors do better or worse compared to sophisticated investors investing in the same exempt offerings? Will retail investors fare better investing in exempt offerings versus public offerings?

5. What are the causes that contribute to companies' decision to remain private?

6. How could the SEC encourage more companies to become public issuers?

7. Are there appropriate ways to improve the definition of "accredited investor" without unduly exposing investors who cannot adequately protect themselves from harm?

SUMMARY

The Commission should be commended for highlighting the issue of the decreasing number of public companies. Public companies—with their robust financial controls, disclosure requirements, corporate governance structures and regulated public trading venues—provide investment opportunities for investors and all those who want to put aside a portion of their wages to be able to pay for their kids' education or retire in dignity. It is indeed a public policy failure that today investors have—compared to 1997, for example—almost half as few public companies to consider investing in.[4]

[4] 8,000 listed companies versus around 4,000. *See* "Where Have All the Public Companies Gone?" Bloomberg, April 9, 2018, *available* at https://www.bloomberg.com/opinion/articles/2018-04-09/where-have-all-the-u-s-public-companies-gone

While the SEC has identified a legitimate problem, the solutions it is contemplating in this Release—that of making it easier for private companies to remain private or public companies to go dark—are exactly the same measures that created this problem over the last three decades. Said differently, if the Commission enacts some of the ideas it is contemplating in this Concept Release, the US investors will have fewer public companies to invest in, the securities markets will have more companies with illiquid securities, and price discovery will suffer. The result is that more retail investors who cannot fend for themselves will be harmed and lose confidence in the markets and regulators, and withdraw further from such markets, which in turn would harm capital formation and economic vibrancy.

The Release suffers from a series of serious if not fatal shortcomings. Among those are:

- The Commission's own prior actions, rulemakings and exemptive orders have created many of the problems that have led to the shrinking number of public companies.

- The Commission offers insufficient evidence showing an actual need for financing. To the contrary, there is evidence that, in fact, there is glut of funding, and that too much money is chasing too few investment-worthy companies. The Commission assumes, without providing data, that deregulation will in fact spur capital formation, and ease viable and growing companies' access to financing.

- The Commission offers no evidence that retail investors who are not accredited investors actually demand or desire to invest in exempt offerings. The Commission also offers no evidence how investors (be they institutional or accredited) currently fare when investing in exempt offerings. Similarly, the Commission—despite its clear mandate of investor protection—fails to show how retail investors would fare if they invest in high-risk and illiquid exempt offerings. Similarly, the Commission fails to show whether any investor, who owns a properly diversified portfolio, would fare better when investing in exempt offerings versus public market-wide low-cost indexes.

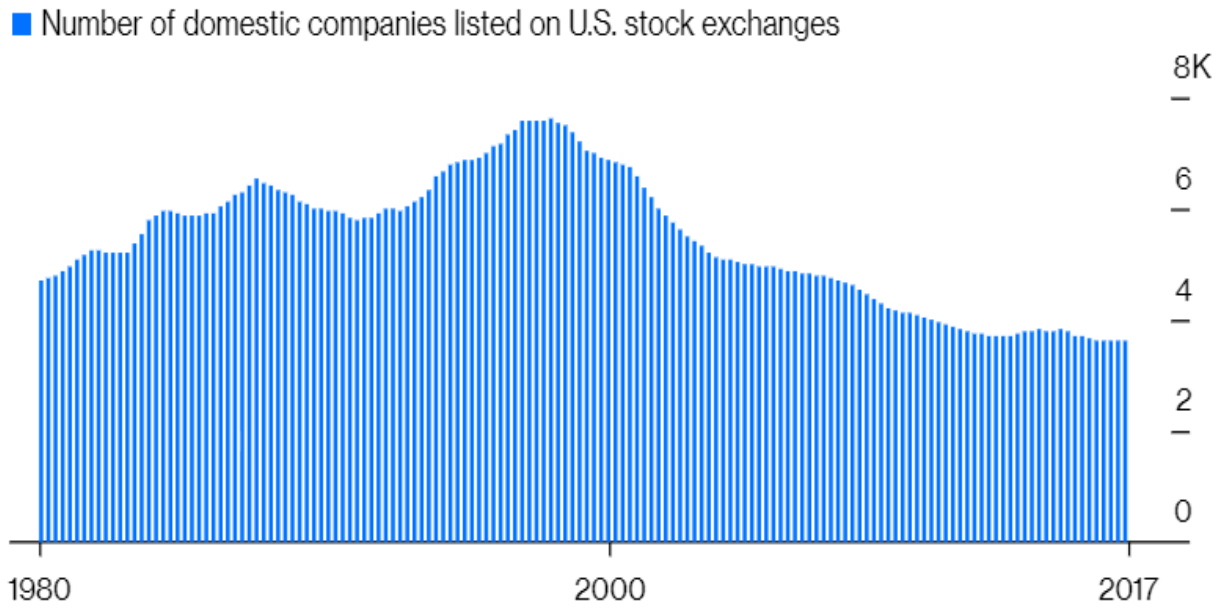
- Instead of blindly deregulating further, the Commission should review its own discretionary rules and actions, including many discussed in the Release, that has caused exempt offerings to balloon to the determent of retail investors and public markets.

- The construct of "Accredited Investor" is vital for the SEC to distinguish between those investors who could fend for themselves and do not depend on the government for protection and those investors who lack financial means or sophistications and look to the government for essential protection. The SEC must not weaken this clear demarcation that has guarded retail investors from being solicited unsuitable and harmful securities.

COMMENTS

The Shrinking Number of Public Companies is a Public Policy Challenge Created by Misguided Congressional and SEC Action.

Companies that stay private or public companies that go dark deprive investors of investment opportunities in liquid and transparent markets. Since the late 1990s, the number of US companies listed on public exchanges has decreased by more than 50%.



Source: Bloomberg.

Public companies have either de-listed (*i.e.*, "gone dark"),have merged or been acquired into another public of private company, or have gone out of business. An increasing share of new companies, rather than listing through an IPO, have decided to remain private. Experts agree that statutory and regulatory reforms have contributed to the shrinking of the public securities markets, and "have enabled the current trend toward prolonged delays in corporate IPOs."[5] This decline of public capital-raising is "due in large part to the dramatic deregulation of private capital under the securities laws over the last several decades" and therefore, "further deregulating the securities registration regime would only exacerbate the problem."[6]

Not only have the number of public companies shrunk in the past two decades, but the aggregate amount raised through exempt offerings is now double that of registered offerings, showing that those companies that go dark or remain private seem to have no difficulty in raising necessary funding. In 2018, companies raised about $1.4 trillion through registered, public offerings, whereas unregistered, exempt offerings were twice as much, amounting to $2.9.[7] This discrepancy is not new, but it is getting worse.

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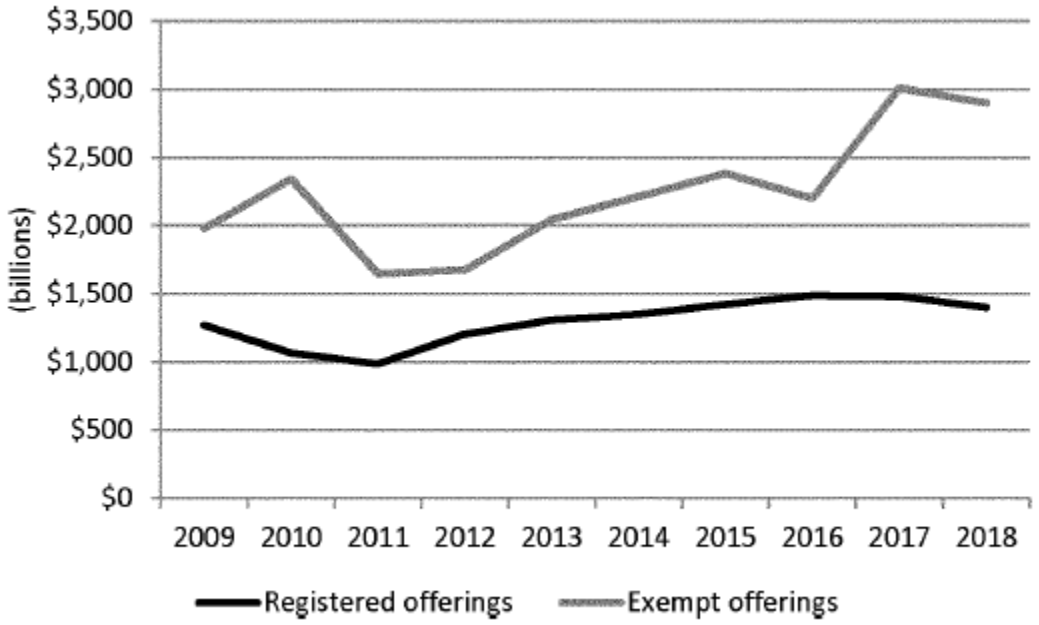
5 *See* Professor Renee Jones testimony ("Jones Testimony") before House Financial Services Committee, Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, "Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment," p.5, September 11, 2019.

6 *See* Elizabeth de Fontenay testimony ("de Fontenay Testimony") before House Financial Services Committee, Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, "Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment," p.2, September 11, 2019.

7 Release at 30,465.



Source: Release at 30465, Figure 1.

The rapid growth of private funding as shown above can be traced back to misguided Congressional action in the so-called JOBS Act of 2012. Until 2012, growing companies that needed a reliable source of funding had one viable path: that of going public through and IPO. A growing company with $10 million in assets would maintain its growth by increasing the number of shareholders. As this company's number of investors increased, Section 12(g) of the Securities Exchange Act of 1934 would be triggered, which would compel the company to disclose certain material information to its investors if their numbers reached 500 individuals. This disclosure would in turn cause the company to initiate and IPO. This is the path that Google, Microsoft and others took.

As companies prepared for an IPO, they "took steps to ensure they were well-positioned to face the public scrutiny a public offering entailed" and they hired "executives with experience working at publicly traded firms, recruit outside directors with strong reputations, and take steps to clean up conflicts of interest or other unorthodox transactions."[8] But in 2012, Congress raised the 500-individual threshold to 2,000, which, at the stroke of a pen, relieved over 87% of existing companies from the disclosure requirements and permitting them to remain private or go dark.[9]

As such, the "new Section 12(g) has essentially eliminated the prospect of mandatory registration."[10] The result has meant that today's startups and growing companies—especially those that raise their funds through venture capital or exempt offerings—could essentially remain

8 *See* Jones Testimony, p.2.
9 *See* Jones Testimony, pp.7-8.
10 *See* Jones Testimony, p.8.

private forever because investors from venture firms or those who are "accredited investors" do not count towards the 2,000-individual threshold.

Commission Assumes, Without Providing Data, that Deregulation Will in Fact Spur Further Capital Formation, and Ease Viable and Growing Companies' Access to Financing. Instead, Permitting Exempt Offerings to be Sold to Retail Investors May Expose Investors to the Worst of the Worst Companies.

Despite data showing that companies which are viable and investment-worthy have no significant challenge finding and raising necessary funding, the Commission, throughout the Release, seems to suggest that access to capital is still curtailed. The fatal flaw in such a suggestion is that the Commission fails to distinguish between investment-worthy companies and those that have little to no prospect of ever returning a profit for their shareholders. It is not unreasonable to assume that "in our current glut of capital, firms that still cannot attract capital from institutional or high-net-worth investors are likely the smallest firms with the very worst prospects, which are wholly unsuitable investments for retail investors."[11]

As discussed above, given the glut of funding[12] available to viable companies (including, historically low levels of interest rates which cause lenders and investors to compete to find viable borrowers/issuers), companies that have challenges finding investors, and therefore need to resort to soliciting retail investors, would need to have been denied by sophisticated investors and those who know the business or company's executives well. This means the company would need to be passed by their friends and family, local angel investor groups, local community banks or credit union, national banks, Regulation A+ (which permits companies to raise $50 million a year), venture capital funds, private equity funds, Business Development Companies, strategic acquirers, and other institutional investors. Put another way, all the "smart money" would need to decline such a company for it to make economic sense to undergo the expense of soliciting small-dollar retail investors.

But this also is the strongest signal sophisticated investors send to other market participants, that this company is unacceptably high-risk and investors should stay away.[13] This also means that, unlike in the public markets, where retail investors[14] and institutional investors operate on a relatively level playing field in making investment decisions,[15] in private markets, given the disparate share class structures, retail 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."[16]

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11 *See* de Fontenay Testimony, p.4.

12 *See* also Rick Fleming, Investor Advocate of the SEC, Comment Letter (Investor Advocate Letter), July 11, 2019, *available* at https://www.sec.gov/comments/s7-08-19/s70819-5800855-187067.pdf, p.5.

13 *See* Investor Advocate Letter, p.5.

14 Retail investors are also often aided by third-party analysts and information providers.

15 For example, by assessing a company's value using the market-clearing prices of its security, or having access to the same disclosure documents at the same time.

16 *See* Investor Advocate Letter, p.5; *see* also, de Fontenay Testimony, p.15, "expect retail investors to fall to the bottom of the heap in the private markets, behind the enormous amount of 'smart money.'"

The Commission Fails to Show Whether Retail Investors Could Afford or Want to Invest in Exempt Offerings or Would Fare Better When Investing in Exempt Offerings Versus Public Markets.

The Commission offers ***no evidence*** that retail investors who are not accredited investors could afford to invest in exempt offerings. As detailed in the SEC Investor Advocate's letter, "companies may not be able to raise a lot of money from retail investors who do not already meet the definition of accredited investor" since "the top 10% of U.S. households by net worth—a segment of the population that would include most accredited investors—hold 77.1 percent of the wealth in this country."[17] The Investor Advocate further documents that "when one looks beyond that top decile of households, the likelihood of stock ownership falls off dramatically. Even more remote is the likelihood that a household would have a portfolio of securities that is large enough for a financial professional to reasonably recommend the purchase of securities that are exempt from registration."[18]

Finally, given Federal Reserve's data that the bottom 50% of American households hold less than $10,000 in financial assets[19] and that median brokerage account balance of **all** U.S. investors is only $6,200,[20] it is reasonable to assume that retail investors—who are **not** ill-served by their investment professionals or defrauded to by struggling companies—would not prefer to invest their precious savings into illiquid and high-risk exempt offerings. They simply cannot afford to do it, and any broker who recommends such unsuitable investments would likely violate even the very weak new Regulation Best Interest rules.

There is also ***little evidence*** showing that retail investors actually want to invest in exempt offerings. The experience with Regulations A+ and Crowdfunding is the strongest signal that retail investors are sending that, in fact, they do not care for exempt offerings. As detailed in the Investor Advocate's letter, "both of these [Reg A and Reg Crowdfunding] exemptions were explicitly designed to allow companies to offer their securities to non-accredited investors…[O]f the completed offerings under Regulation Crowdfunding, the average amount raised was $208,300, well below the $577,385 maximum that was sought in the average offering."[21] Given that early-stage companies have much higher rates of failure, and the fact that retail investors (given the dearth of their investable funds) cannot adequately diversify among high-risk firms—like venture capital and private equity investors are able to do—it is only reasonable to expect that rational retail investors would not flock to exempt offerings.

The Commission also offers ***no evidence*** how investors (be they institutional or accredited) currently fare when investing in exempt offerings. In fact, given by their very nature of

17 *See* Investor Advocate Letter, p.2.
18 *See* Investor Advocate Letter, p.2.
19 See Board of Governors of the Federal Reserve System, 2016 SCF Chartbook, https://www.federalreserve.gov/econres/files/BulletinCharts.pdf, at 145.
20 *See* Brokerage Accounts in the United States, Advanced Analytical Consulting Group and Deloitte, November 30, 2015, available at https://www.dol.gov/sites/default/files/ebsa/researchers/analysis/retirement/brokerage-accountsin-the-us.pdf.
21 *See* Investor Advocate Letter, p.5.

unregistered offerings, ***the Commission admits that it lacks evidence*** about their performance.[22] The Commission makes the following startling ***admission regarding its total lack of evidence*** of investor harm:

> It is difficult to perform a comprehensive market-wide analysis of investor gains and losses in exempt offerings given the significant limitations on the availability of data about the performance of these investments. Where partial data is available for some types of investments in exempt offerings, it does not lend itself to a comprehensive estimate of investment performance and risks across the entire market of exempt offerings. A typical startup issuer may require a long period of time to experience a liquidity event or close its business, and we lack comprehensive data on such events and associated investor gains and losses. The lack of a secondary trading market for many securities issued in exempt offerings further limits our ability to examine investor gains and losses.[23]

Nothing else in the Release attempts to answer the fundamental question we posed at the outset of this letter: Given the SEC's mandate of investor protection, how will investors fare when they invest in exempt offerings? These offerings have scant information about the issuer and the securities themselves—to the extent they can even be traded—are very illiquid. Finally, retail investors would be at a disadvantage compared to deep-pocketed and sophisticated investors who have ability and leverage to gain more information. This informational asymmetry would mean that when a company issuing the exempt offering is in trouble, the sophisticated investors would be able to detect it (or know) sooner and liquidate sooner, leaving the retail investors further disadvantaged.

Throughout the Release, the Commission seems to be suggesting that supposedly retail investors are missing out on high-growth companies that only offer exempt securities. But as Professor de Fontenay has shown, these claims are based "more on faith than evidence," and that

> "available research suggest that retail investors would do materially worse on average in the private markets than in the public markets."[24]

At a bare minimum, the SEC must—before promulgating any rule that would expose retail, unaccredited investors to exempt offerings—definitively know that retail investors, given their financial and other limitations, would in fact do better when investing in exempt offerings versus what they could achieve, for example, by investing in the public markets or low-cost market index funds.

<u>Commission Should Repeal Exemptions and Cease Further Deregulation Which Has Harmed the Vibrancy of Public Markets and Reduced Number of Public Companies.</u>

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22 *See* Release at 30468.
23 *See* Release at 30468, fn. 53.
24 *See* de Fontenay Testimony, p.4.

Instead of deregulating further or contemplating policy revisions that would further expose retail investors with limited wherewithal to withstand financial loss to financial risk, the SEC should seek ways to encourage, and if necessary, compel companies with significant assets and growth-potential to go public. Increasing the number of listed companies is the only way to offer retail investors genuine investment opportunities in a manner that provides them with the minimal protections that an investor protection agency should demand. To do this, the SEC must **reduce** the number of exemptions available to companies, and not contemplate making it even easier for companies to remain private.

The Accredited Investor Construct Is One of the Commission's Most Important Retail Investor Protections and Should Not Be Diluted

For decades, the "accredited investor" construct has allowed the Commission to effectively draw a line between investors who have the financial means and financial knowledge to fend for themselves and those who lack such sophistication or wherewithal. This clear demarcation has helped the Commission to better protect those who need such protection, and has allowed market participants, including broker-dealers, underwriters and companies to more effectively target their solicitations and offerings. The SEC should not tamper with this time-tested and time-proven construct.

If anything, inflation has already caused hundreds of thousands of more investors to qualify as an "accredited investor" since the definition was set in law in 1982. This should give concern to the SEC as there may indeed now be tens of thousands of investors who have become qualified as "accredited investor" solely on the virtue of inflation of their asset prices but who otherwise lack necessary financial sophistication to carefully weigh the risks associated in investing in exempt offerings. These newly minted "accredited investors" are often seniors with diminishing mental abilities and other vulnerabilities, and the SEC should devote its regulatory attention to the protection of these investors, and not attempt ways to dangerously increase the number of "accredited investors" in its misguided effort to spur capital formation.

CONCLUSION

We hope our comments are helpful. We emphasize that retail investors are not clamoring for exempt offerings, that there is in fact a glut of funding available for high-growth and promising companies, and that those companies who are passed by various sophisticated investors and banks should not gain access to solicit unsophisticated investors. Moreover, the Commission's shocking lack of evidence or even information – separate and apart from assumptions and conjecture – dictates that it should not take any action regarding these matters until it and the public can conclude by clear evidence that retail investors will not be harmed by such actions.

Sincerely,

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