CENTER FOR CAPITAL MARKETS COMPETITIVENESS

TOM QUAADMAN
EXECUTIVE VICE PRESIDENT

1615 H STREET, NW
WASHINGTON, DC 20062-2000
[redacted]

December 20, 2018

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: List of Rules to be Reviewed Pursuant to the Regulatory Flexibility Act; Release Nos. 33-10576; 34-84640; 39-2523; IA-5067; IC-33298; File No. S7-25-18

Dear Mr. Fields:

The U.S. Chamber of Commerce (the "Chamber") welcomes the opportunity to comment on the notice issued by the Securities and Exchange Commission (the "SEC" or "Commission"), entitled List of Rules to be Reviewed Pursuant to the Regulatory Flexibility Act (the "Notice").

The Chamber again commends the Commission for continuing its initiative to review existing regulations that affect capital formation in the United States, particularly those that affect small businesses. This issue is especially important in light of the declining number of public companies—in the past twenty years, the number of US public companies has been cut in half. While no single rule change is likely to reverse this trend, we are confident that a careful reassessment of the SEC's approach to issues affecting the burdens on smaller private companies to go public and stay public will, over time and in the aggregate, make an impact.

The annual review under the Regulatory Flexibility Act of rules that have a significant economic impact on a substantial number of small entities is a valuable—though often underutilized—tool for the Commission. In years past, the SEC's efforts to seek and respond to public comment on ten-year-old rules have been relatively modest. We are encouraged that the Notice seeks input on 43 discrete sets of rules, and we are optimistic that public comment will lead to a thorough reassessment of the affected rules.

In this respect, the CCMC has long advocated that the Commission regularly conduct a regular look-back analysis of the agency's rules and regulations. Small businesses in particular often bear a disproportionate burden whenever regulation is imposed, and may benefit when regulations are reexamined over time. Accordingly, we believe a final regulation is the start of the rulemaking process, not its completion.

It is often difficult (if not impossible) for a regulator to know what will happen when a regulation is adopted. Capital markets are the reflection of large numbers of individuals making individual decisions. A regulator rarely has the capacity to predict with certainty how individuals or firms will respond to a new rule. If a regulator cannot predict the response, it is difficult to accurately quantify the cost of compliance or quantify the value of benefits before one knows how the industry will achieve compliance.

For this reason, we have long urged the Commission to consider an approach that combines a pre-adoption cost-benefit analysis with a post-adoption look-back requirement. Instead of assuming that rules are self-effectuating, we believe the Commission should adopt a more scientific approach: Consider rules as working hypotheses. Whether the anticipated reaction occurs, and at what cost, is the empirical question—one that must be reassessed again and again over time.[1]

Against this backdrop, we offer the following five recommendations on several of the rulemaking projects identified in the Notice. We discuss these five recommendations in depth in the rest of this Comment.

1. We urge the Commission to revisit its rules on executive compensation disclosure so that they produce narratives that are less verbose and easier to understand for investors and other market participants.

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[1] For additional thoughts on how to structure a comprehensive look-back process, see generally our report entitled *U.S. Securities and Exchange Commission: A Roadmap for Transformational Reform* at 83-93 (Dec. 2011), *available at* http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/16967_SECReport_FullReport_final.pdf?x48633.

2. We suggest that the Commission consider amending Rule 14a-16 to (1) eliminate the prohibition on providing a proxy card without a proxy statement so long as it is accompanied by the Notice of Internet Availability of Proxy Materials, and (2) extend application of the rule to business combination transactions.

3. We request that the Commission reconsider application of the Acquired Fund Fees and Expenses rule to business development companies.

4. We recommend that the Commission reduce the holding periods under Rule 144 to three months for reporting companies and six months for non-reporting companies, and that the Commission formally codify under Rule 144 the conditions of the "4(a)(1½)" quasi-exemption.

5. We encourage the Commission to seek public comment on ways in which the Form S-3 and F-3 instructions could be amended to expand the categories of eligible issuers so as to stimulate additional public capital formation.

Targeted reforms to each of these regulations will benefit all issuers, including smaller businesses. In focusing on these discrete rules, however, we do not mean to suggest that we are agnostic about the other rules identified in the Notice. To the contrary, we urge the Commission to perform a thorough look-back analysis on all of them. We also support the Commission's exploration of reforms to the proxy voting system and capital raising process that Chairman Clayton outlined in his December 6 speech[2] and subsequent Senate testimony.[3] In addition, we appreciate the Commission's recent efforts to make its semi-annual "Reg Flex" agenda a less aspirational and more definitive document, which we agree enhances transparency and accountability of the agency.

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[2] *See* Chairman Jay Clayton, Speech, *SEC Rulemaking Over the Past Year, the Road Ahead and Challenges Posed by Brexit, LIBOR Transition and Cybersecurity Risks* (Dec. 6. 2018), *available at* https://www.sec.gov/news/speech/speech-clayton-120618/.

[3] *See* Chairman Jay Clayton, Testimony on "Oversight of the U.S. Securities and Exchange Commission" Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs (Dec. 11, 2018), *available at* https://www.banking.senate.gov/download/clayton-testimon-12-11-18.

DISCUSSION

1. Executive Compensation and Related Person Disclosure

According to the Notice, the Commission adopted amendments in August 2006 to the disclosure requirements for executive and director compensation, related person transactions, director independence and other corporate governance matters and security ownership of officers and directors. The centerpiece of the amendments is the "Compensation Disclosure and Analysis," or CD&A. These amendments were intended to make proxy and information statements, reports, and registration statements easier to understand. The Notice observes they were also intended to provide investors with a clearer and more complete picture of the compensation earned by a company's principal executive officer, principal financial officer and highest paid executive officers and members of its board of directors. In addition, they were intended to provide better information about key financial relationships among companies and their executive officers, directors, significant shareholders, and their respective immediate family members.

Nevertheless, as the Staff observed in its seminal 2013 *Report on Review of Disclosure Requirements in Regulation S-K*:

> Although the requirements for executive compensation disclosure have been amended more often than any of the other disclosure requirements in Regulation S-K, executive compensation disclosure is sometimes pointed to by companies and practitioners as an area with lengthy, technical disclosure. The executive compensation disclosure requirements should be evaluated in light of these concerns and reviewed to confirm that the required information is useful to investors. The review could also evaluate whether further scaling is appropriate.[4]

The complexity of the SEC's rules and interpretations, coupled with the technical nature of the broader subject of executive compensation, means that in-depth

[4] *Report on Review of Disclosure Requirements in Regulation S-K as Required by Section 108 of the Jumpstart Our Business Startups Act* at 101 (Dec. 2013), *available at* https://www.sec.gov/files/reg-sk-disclosure-requirements-review.pdf (internal citations omitted).

expertise is required to understand what CD&A requires a company to disclose. When in doubt about whether something needs to be disclosed, market practice seems to be to disclose it, even if the information is not useful to investors. As a result, CD&A disclosures are often highly technical and opaque.

Thus, although CD&A was intended to illuminate a company's executive compensation practices and philosophy, the discussion at most companies has instead resulted in a narrative that is dense and laden with technical jargon and immaterial information. CD&A can be impenetrable, even for sophisticated investors. The length of CD&A alone—a 20-page narrative is not uncommon and it has been known to run on for over 40 pages at some companies—can obscure what is material. To the extent investors struggle to comprehend CD&A, it can lead to misunderstandings in the marketplace and impair the ability of investors and other market participants to make informed decisions. For example, proxy advisory firms often misinterpret CD&A disclosures, and a common area of dispute between issuers and proxy advisory firms arises in the context of advisory firms' erroneous extrapolation of compensation data and trends.

CD&A has become the archetypal example of the "avalanche of information" that Justice Thurgood Marshall famously predicted and warned against over 40 years ago in the landmark *TSC Industries* case.[5] To be fair, issuers shoulder some responsibility for this situation, but it ultimately exists as a natural outgrowth of the Commission's rules, particularly under Item 402 of Regulation S-K. We share the Staff's view that executive compensation disclosure should be reassessed fundamentally "to confirm that the required information is useful to investors." In short, reforms are needed to ensure that CD&A disclosure is more straightforward and intuitive so that it provides the marketplace with material information but does not inundate users with information that is not useful for understanding and evaluating a company.[6]

[5] *See TSC Industries, Inc. v. Northway*, 426 U.S. 438, 448-49 (1976).

[6] While smaller reporting companies and emerging growth companies moderately benefit from the scaled disclosure provisions of Item 402(*l*) under Regulation S-K, their disclosures can be complicated even under the disclosures in paragraphs (m) through (r) of Regulation S-K, and many see future reporting under paragraphs (a) through (k) as a disincentive to achieving accelerated filer status.

2. Internet Availability of Proxy Materials

In January 2007, the Commission adopted the "Notice and Access" amendments to the proxy rules under the Exchange Act that provide an alternative method for issuers and other persons to furnish proxy materials to shareholders by posting them online and providing shareholders with notice of the availability of the proxy materials. According to the Notice, issuers that rely on the "e-proxy" amendments may be able to significantly lower the costs of their proxy solicitations that ultimately are borne by shareholders, and the amendments also might reduce the costs of engaging in a proxy contest for soliciting persons other than the issuer.

Nevertheless, Rule 14a-16(f)(1) still prohibits an issuer from furnishing a proxy card with the Notice of Internet Availability of Proxy Materials under the e-proxy rules unless it is accompanied by a proxy statement. Thus, shareholders receiving the one-page proxy notice must still take the affirmative step of requesting a paper proxy card, or an issuer must wait ten days under Rule 14a-16(h) and incur the expense of a second mailing by forwarding the proxy card at that time. Insofar as reducing costs justified adoption of the e-proxy rules, this intended benefit is, for all practical purposes, lost.

We believe that whatever concerns animated this limitation at the time of Rule 14a-16's initial adoption and subsequent amendment in 2010 have abated due to the passage of time and investors' increased familiarity with this system. Moreover, smart phones, tablets and other personal computing devices have become ubiquitous, and investors are now much more accustomed to receiving information important electronically. Indeed, "access equals delivery" has been the Commission's mantra for many years now when it comes to the furnishing of a statutory prospectus under the Securities Act. It is high time that proxy statements under the Exchange Act receive the same treatment. We therefore recommend that the Commission consider amending Rule 14a-16 to eliminate the prohibition on providing a proxy card without a proxy statement so long as it is accompanied by the Notice of Internet Availability and issuers remain obliged to provide a paper proxy statement to any investor who requests one.

As the Notice further notes, the e-proxy amendments do not apply to business combination transactions. Likewise, whatever concerns warranted this limitation a decade ago no longer seem to have a modern justification. We therefore also respectfully request that the Commission give thought to extending the e-proxy rules to business combination transactions as well. Each of these recommendations would especially benefit smaller reporting companies for whom proxy printing and mailing costs can be disproportionately high.

3. Fund of Funds Investments

As the Notice explains, in June 2006 the Commission adopted three new rules under the Investment Company Act of 1940 that address the ability of an investment company to acquire shares of another fund. Those rules broadened the ability of a fund to invest in shares of another fund (a so-called "fund of funds") in a manner consistent with the public interest and the protection of investors. The amendments were intended to improve the transparency of the expenses of funds of funds by requiring that the expenses of the acquired funds be aggregated and shown as an additional expense in the fee table of the fund of funds under the caption "Acquired Fund Fees and Expenses," which is commonly referred to as the "AFFE" disclosure. Implementation of the AFFE disclosure requirement has negatively affected the market for business development companies ("BDC"), which is an unfortunate unintended consequence that we hope the Commission will address.

Congress established BDCs in 1980 to make capital available to small, developing and financially troubled companies that do not have ready access to the public capital markets or other forms of conventional financing. BDCs' primary role in the economy to date has been to provide debt financing to companies, primarily in the small and middle markets, that may find it difficult to obtain traditional bank financing. While there is a wide variation among BDCs in the size of their investments, the companies they invest in, and the industries in which they concentrate, they all share a common investment objective of making it easier for small and medium-sized companies to obtain access to capital. Small and medium-sized businesses are vital to promoting job formation and growth of the U.S. economy. This role has only increased in recent years as many banks have limited their middle-market lending activity in response to stricter post-financial crisis capital requirements.

As a result of the application of the AFFE rule to BDCs, in 2014 several prominent index providers removed BDCs from their indices, causing a substantial reduction in institutional ownership. The removal of BDCs from these prominent indices has led to reduced BDC share liquidity, increased capital raising costs and reduced investor choice for BDC investment options. Access to the capital markets is especially important for BDCs because they are limited in their ability to retain capital in light of their requirement to distribute at least 90% of their taxable earnings annually. Because of the foregoing, BDCs are less able to satisfy their statutory mission of providing funding to small businesses and other companies that do not have ready access to more traditional sources of capital.

Moreover, according to a 2017 report issued by the House of Representatives Committee on Appropriations:

> As the law does not consider BDCs to be Funds of Funds, the SEC did not mention BDCs in the rule. Today the BDC industry has grown dramatically and the AFFE rule unnecessarily harms the industry. Retail investors benefit from having professional firms and indexes analyze BDC securities. However, retail investors are not being given adequate market protections because the AFFE rule prohibits BDC securities from inclusion in indexes, which results in fewer research analysts that cover the BDC industry.[7]

Various commentators and industry participants have recommended that the Commission modify or remove the AFFE disclosure requirement with respect to BDCs. BDCs are not passive investment companies but instead actively manage and operate a portfolio of assets that requires significant managerial expertise. In this respect, BDCs are similar to real estate investment trusts, which are not subject to AFFE disclosure. Additionally, the AFFE disclosure has a tendency to overstate expense ratios because an acquiring fund's indirect expenses required to be included in the calculation of AFFE can often be significantly higher than their direct expenses and, as such, the expense ratios of BDCs can be quite high. For all these reasons, we respectfully urge the Commission to reconsider application of the AFFE rule to BDCs.

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[7] H.R. Report No. 115-234, at 69 (2017)

4. Revisions to Rules 144 and 145

First adopted in 1972, Rule 144 under the Securities Act creates a safe harbor for the resale of securities under Section 4(a)(1) of the Securities Act. As the Notice observes, in December 2007 the Commission amended Rule 144 to shorten the holding period requirement for "restricted securities" of issuers that are subject to the reporting requirements of the Exchange Act to six months. Restricted securities of issuers that are not subject to the Exchange Act reporting requirements continue to be subject to a one-year holding period prior to any public resale. The amendments also substantially reduced the restrictions applicable to the resale of securities by non-affiliates.

Private placements of securities represent a critically important segment of capital market activity in the U.S. Investors in private placements give due consideration to the speed in which they can freely exit a position and otherwise maintain liquidity in privately placed shares. Throughout its history, Rule 144 has played an important role in providing liquidity to holders of restricted securities, and has become critical to facilitating capital formation in early stage and venture-capital-backed companies. Rule 144 also affects the financial position of countless investors by regulating how soon they can monetize their positions and reinvest those proceeds into other capital-generating opportunities. Conversely, if investors are unable to transfer restricted securities in an active secondary market, smaller issuers may be less attractive to investors for future offerings.

The Commission's steady progress to reduce holding periods since the rule's initial adoption in 1972 has provided enhanced investor liquidity and promoted further investment in early state businesses. Although other means of reselling restricted securities in compliance with the Securities Act exist, in our members' experience Rule 144 remains the most popular because it provides a clear safe harbor so long as the rule's conditions are satisfied. We would like to suggest a few modest revisions to Rule 144 that would benefit all issuers, including small businesses.

First, we recommend that the Commission reduce the holding periods under Rule 144 to three months for reporting companies and six months for non-reporting companies. Doing so would reduce the holding period from the current six and twelve month requirements, which the Commission itself shortened from one and two years in 2007. We believe such a change would be consistent with the expectations of modern investors who are accustomed to moving quickly in the markets and who are able to process information much more quickly than those of a generation ago due to technological advances in online and digital communication. Shortening the holding periods would also provide further incentives for investors to participate in the private placement markets, thereby stimulating capital formation. These amendments are in line with recent recommendations offered by the SEC's annual Government-Business Forum on Small Business Capital Formation.[8] Of course, the Commission's antifraud rules would remain available to protect investors in the secondary markets and discourage bad actors.

Second, we recommend that the Commission formally codify under Rule 144 the quasi-exemption referred to by securities practitioners as the "4(a)(1½)" exemption. Though not officially reflected in the Commission's regulations, this quasi-exemption blends elements of the Section 4(a)(1) and Section 4(a)(2) exemptions for certain block trades and other private resales of securities without general solicitation involving large accredited investors, and is regularly relied upon by market participants trading certain illiquid positions in the secondary markets. The Fixing America's Surface Transportation Act, or FAST Act, in 2015 sought to codify "4(a)(1½)" into Section 4(a)(7) of the Securities Act, but added a number of new conditions unfamiliar to market participants and, as a result, the statutory exemption's use has been somewhat limited in practice since its enactment.

The Commission and its Staff have tacitly approved of the "4(a)(1½)" exemption in various contexts for many years, and formally codifying its parameters into Rule 144 would bring this important provision out of the shadows once and for all. Indeed, the SEC's own Advisory Committee on Small and Emerging Companies has made the same request.[9]

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[8] *See, e.g.,* Final Report of 2016 SEC Government-Business Forum on Small Business Capital Formation at 18 (March 2017),*available at* https://www.sec.gov/info/smallbus/gbfor35.pdf ("Reduce the Rule 144 holding period to 3 months for reporting companies."); *see also* Final Report of 2014 SEC Government-Business Forum on Small Business Capital Formation at 30 (May 2015), *available at* https://www.sec.gov/info/smallbus/gbfor33.pdf ("Reduce the holding periods under Rule 144(d)(1)(i) from six months to three months and under Rule 144(d)(1)(ii) from one year to six months.").

[9] *See* Recommendation Regarding the "4(1½) Exemption" (June 11, 2015), *available at* https://www.sec.gov/info/smallbus/acsec/acsesc-4a-one-and-a-half-recommendation.pdf.

5. Revisions to the Eligibility Requirements for Primary Securities Offerings on Forms S-3 and F-3

The Notice states that the Commission in December 2007 adopted amendments to the eligibility requirements of Form S-3 and Form F-3 to allow more companies to benefit from the greater flexibility and efficiency in accessing the public securities markets afforded by Form S-3 and Form F-3 without compromising investor protection. With these guiding principles in mind, we urge the Commission to again consider whether further amendments to the eligibility criteria of Forms S-3 and F-3 are prudent due to the passage of time and other developments in the capital markets.

We believe such amendments are particularly timely in light of the Commission's recent rulemaking efforts to increase the eligibility thresholds for smaller reporting companies.[10] Congress has also considered a variety of different measures to expand eligibility of issuers to use Form S-3 by amending the Securities Act over the past several years, and the Financial Choice Act would have accomplished this objective by lowering the minimum public float requirements to more closely align them with the new smaller reporting company thresholds. But the Commission already has the authority to amend its rules on this matter without action by Congress.

As we have previously noted, there is widespread availability of information in the modern digital age, which we believes contributes to broader and more rapid seasoning of reporting companies. Accordingly, we encourage the Commission to seek public comment on ways in which the Form S-3 and F-3 rules could be amended in a way to further stimulate public capital formation.

[10] *See generally* Release No. 33-10513, Amendments to Smaller Reporting Company Definition (June 28, 2018), *available at* https://www.sec.gov/rules/final/2018/33-10513.pdf (amending the definition of "smaller reporting company" to include registrants with a public float of less than $250 million, as well as registrants with annual revenues of less than $100 million for the previous year and either no public float or a public float of less than $700 million).

CONCLUSION

In sum, we believe a regular look-back review is an integral component of the SEC's rulemaking agenda. We again applaud the Commission for seeking comment on the many rules identified in the Notice, and believe targeted reforms to them will benefit not just small businesses but all issuers. Thank you for your consideration of these comments, and we are available to discuss them further with the Commissioners or Staff at your convenience.

Sincerely,

Tom Quaadman

cc: The Honorable Jay Clayton
The Honorable Kara M. Stein
The Honorable Robert J. Jackson, Jr.
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman