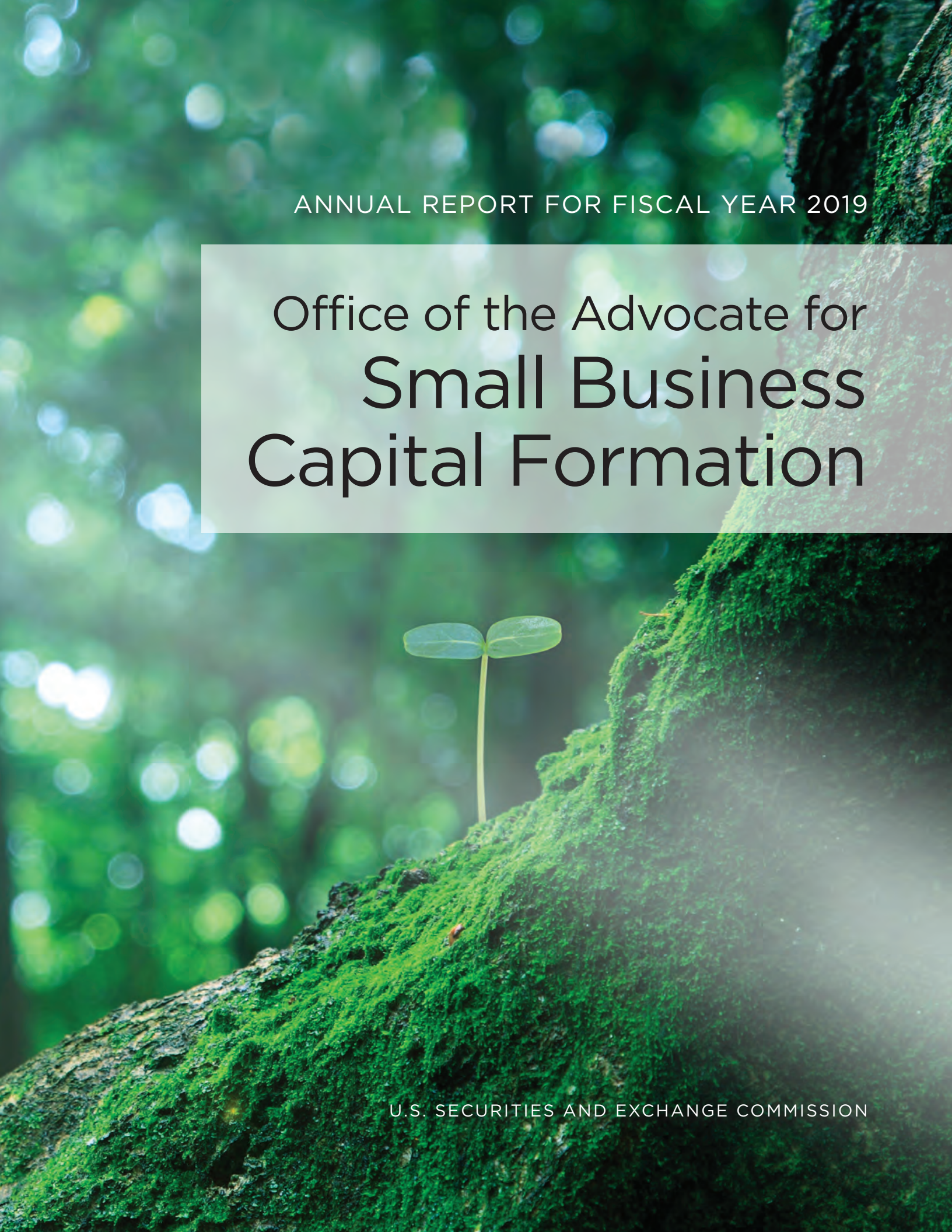


ANNUAL REPORT FOR FISCAL YEAR 2019

Office of the Advocate for Small Business Capital Formation

U.S. SECURITIES AND EXCHANGE COMMISSION

ABOUT THIS REPORT + ACKNOWLEDGEMENTS

This annual report of the Office of the Advocate for Small Business Capital Formation for Fiscal Year 2019 is being delivered to the Committee on Banking, Housing, and Urban Affairs of the U.S. Senate and the Committee on Financial Services of the U.S. House of Representatives in accordance with Section 4(j) of the Securities Exchange Act of 1934 (the Exchange Act), as amended by the SEC Small Business Advocate Act of 2016, 15 U.S.C. § 78d(j)(6).

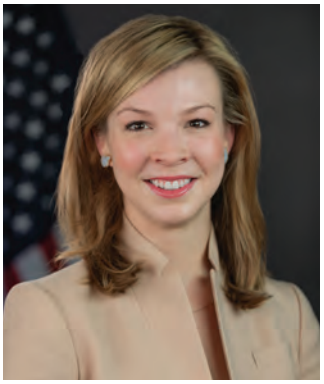
Pursuant to Section 4(j)(6)(D) of the Exchange Act, this Report is provided directly to the committees of Congress without any prior review or comment from the Commission, any Commissioner, any other officer or employee of the Commission, or the Office of Management and Budget. It does not necessarily reflect the views of the Commission, the Commissioners, or staff of the Commission.

The work of the Office is possible only through the support of a talented and passionate team. While the Office has been supported by many colleagues across the agency during its first year in operation, we recognize the following team members who worked in the Office during FY2019:

Emerald Greywoode Boston-Mammah
Colin A. Caleb
Julie Zelman Davis
Jessica W. McKinney
Jennifer Riegel
Malika Sullivan

Special thanks to our colleagues within the SEC for providing resources for this Report, including the Division of Economic and Risk Analysis for providing SEC data to quantify the state of small business capital formation and contextualize issues, and the Office of Public Affairs for making our written product for this report visually engaging. We particularly thank the following individuals: Daniel Bresler, Vlad Ivanov, Andy Kim, Anzhela Knyazeva, Wei Liu, Chris Onrubia, Narahari Phatak, Zehra Sikandar, and John Zheng.

Message from the Advocate



"Small businesses are the backbone of our economy" is a statement so often repeated that it has become a standard line used almost ubiquitously by leaders, both political and apolitical.[1] Rightly so, given the role smaller companies play in our economy—from being the primary job creators over the past two decades, to the innovators of new technologies that change lives, to the generators of wealth for many investors. Yet small businesses are often underrepresented here in Washington, DC, where laws and rules impacting their operations are made.

I have the opportunity of a lifetime to serve as the U.S. Securities and Exchange Commission's (SEC) first Advocate for Small Business Capital Formation after being appointed in December 2018 and beginning to build the SEC's newest office starting in January 2019.[2] During our formative first year of operation, I approached building our Office with the only frame of reference I had coming from the private sector: like a start-up. We crafted a business plan[3] to communicate with the public our mission, vision, and approach for supporting small businesses' capital formation needs, just like many start-ups do before pitching to investors. Knowing that we needed to scale pragmatically and efficiently, we defined our minimum viable product (or MVP) and documented the steps we would take to achieve full scale programming, along with a timeline to provide visibility of what you could expect from us and when.

At almost every event we host, we simultaneously engage with businesses and their investors, recognizing that the success of businesses is interwoven with the success of their investors. In speaking with new audiences, I often analogize our Office to a megaphone, explaining that we take the ecosystem's voices and make them louder within the SEC and the broader regulatory landscape to positively impact policy. It is my hope that this inaugural report will do just that: take the many voices that we hear, distill them into a concise summary, and communicate in a compelling manner what small businesses and their investors tell us that they need from our capital markets.

Looking back at FY2019 and our first nine months, I am proud of what we have accomplished to date, and I look forward to working collaboratively with the Commission, Congress, and our agency partners to deliver meaningful solutions to support the backbone of our economy: small businesses. We are proud to be, as many a small business storefront sign says, "Open for Business."

MARTHA LEGG MILLER
Advocate for Small Business Capital Formation

Breaking Down Our Long Title

An independent office housed within the U.S. Securities and Exchange Commission, created by Congress via special legislation

One called to use your voice for others, derived from Medieval Latin

Office of the Advocate for Small Business Capital Formation

From start-ups to small cap, “small” is relative for the SEC’s newest Office, which supports emerging, privately-held companies up to small public companies

The deployment of productive capital by informed investors to create economic growth

Contents

ABOUT THE OFFICE 1

INAUGURAL YEAR OF THE OFFICE IN REVIEW 4

STATE OF SMALL BUSINESS CAPITAL FORMATION 11
Small, Emerging Businesses 16
Mature and Later-Stage Businesses 21
Small Public Companies 24
Founder Demographics & Capital Formation 26
Natural Disasters & Capital Formation 34
Rural Communities & Capital Formation 36

POLICY RECOMMENDATIONS 39
Modernize, Clarify, and Harmonize Exempt Offering Framework 40
Investor Participation in Private Offerings 41
Engaging Investors via Finders 44
Crowdfunding 46
Scaled Obligations for Smaller, Less Complex Reporting Companies 48

SMALL BUSINESS CAPITAL FORMATION ADVISORY COMMITTEE 51

About the Office

Congress created the Office to provide a dedicated champion to smaller companies accessing critical capital to build, grow, and thrive. The Office operates pursuant to sections 4(j) and 40 of the Securities Exchange Act of 1934 (15 U.S.C. §§ 78d and 78qq), as added by the SEC Small Business Advocate Act of 2016 (P.L. 114-284) and amended by the Small Business Access to Capital after a Natural Disaster Act (title IX of division S of Public Law 115-141) (collectively, the Small Business Advocate Act).

Director Martha Miller describes the role of her office at the SEC to small business owners and entrepreneurs in Kansas City, MO.

The Office officially commenced operations in January 2019. As an independent office reporting directly to the Commission, the Office is statutorily charged with the following functions:

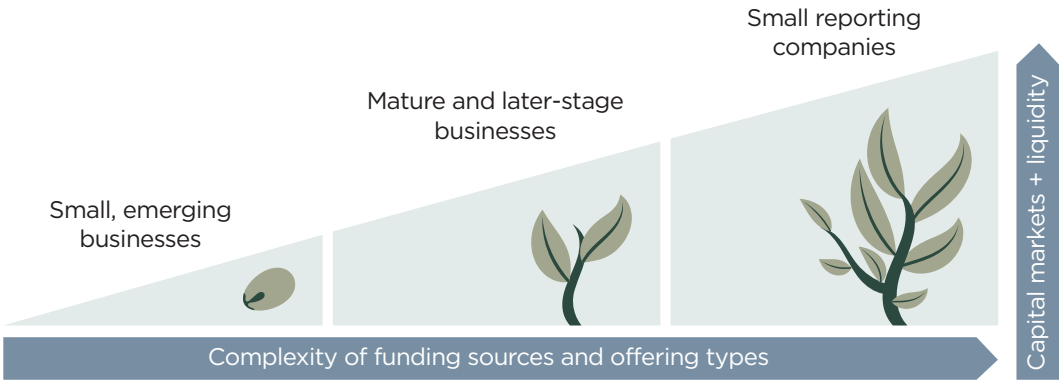
- Assisting small businesses and their investors in resolving significant problems they may have with the SEC or with self-regulatory organizations (SRO);
- Identifying areas in which small businesses and their investors would benefit from changes in SEC regulations or SRO rules;
- Identifying problems that small businesses have with securing access to capital;
- Analyzing the potential impact on small businesses and their investors of proposed SEC regulations and SRO rules;
- Conducting outreach to small businesses and their investors to solicit views on capital formation issues;
- Proposing appropriate regulatory and legislative changes to the SEC and Congress to mitigate problems identified with small business capital formation and to promote the interests of small businesses and their investors; and
- Consulting with the Investor Advocate on such regulatory and legislative changes and other small business issues.

The Office also proactively works to identify any unique challenges faced by minority-owned small businesses, women-owned small businesses, and small businesses affected by natural disasters.

The Office hosted a round table in Little Rock, AR at the Venture Center, a nonprofit fintech accelerator focused on solutions for community banks.

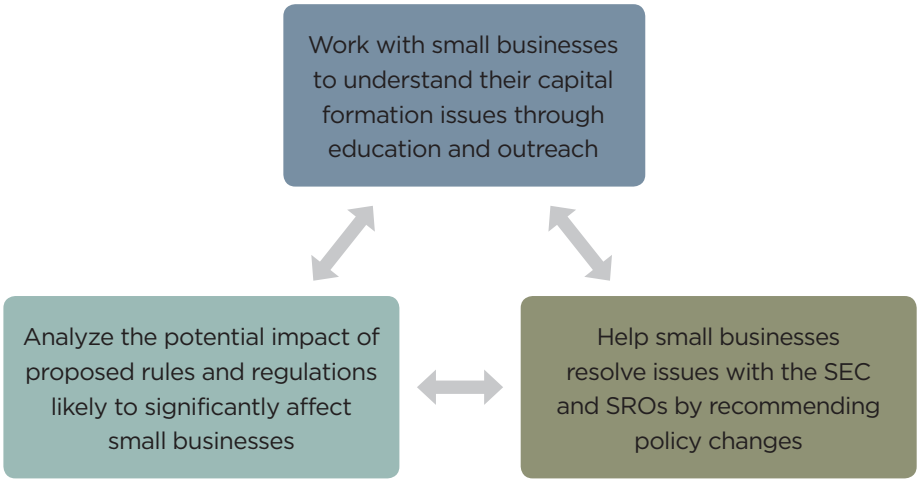
Scope of Small Businesses

The Office supports a spectrum of small businesses and their investors, from emerging, privately-held businesses to publicly traded companies with less than $250 million in public market capitalization.[4] Based upon commonalities in sources of capital and issues faced, the Office has segmented its target market into three categories of businesses and their corresponding investors:



Our Mission

The Office's mission is to advocate for small businesses and their investors to foster better access to capital markets, strengthening the voice of small business within the SEC and the broader regulatory landscape.



Core Tenets

The Office adheres to the following core tenets in approaching its delivery of services and solutions to small businesses and their investors:

- Small businesses are job creators, generators of economic opportunity, and fundamental to the growth of the country.
- One size does not fit all for small businesses.
- Good work has been done by the SEC, but we are not done and should continue to evolve as the market demands.
- Small business policy should facilitate trust and confidence in capital markets to encourage efficient allocation of investment dollars.
- We serve as a collaborator with, and contributor to, other SEC divisions and offices and SROs, not as an auditor.

Values

The Office is guided by four core values:

- ACCESSIBILITY — We engage with both small businesses and their investors, as well as with the SEC, SROs, Congress, and other agencies on a regular basis through a variety of channels.
- TRANSPARENCY — We are visible and open in our approach to supporting small businesses and their investors.
- PRAGMATISM — We approach problems with a solution-oriented mindset by making practical, market-driven recommendations.
- EFFICIENCY — We operate like a lean start-up, maximizing resources and focusing activities where the Office can have a measurable impact.

Inaugural Year of the Office in Review

LAUNCH OF THE SEC'S NEWEST OFFICE

JANUARY 31

Martha Legg Miller was sworn in as the first Advocate for Small Business Capital Formation, with initial team members joining shortly thereafter.

MARCH 18-20

Office hosts first external engagement events with entrepreneurs and investors in Kansas City, MO and KS.

APRIL 8

Publication of Foundational Business Plan[5] and roll out of plans for 2019 activities at SEC Speaks.

MAY 6-10

National Small Business Week, including Small Business Roundtable with Commissioners, inaugural meeting of the Small Business Capital Formation Advisory Committee, and celebration of the 100th day of the Office.

JULY 22

Office launches explanatory videos on how to comment, highlighting small business-related rulemakings in plain English.

AUGUST 13

Advisory Committee hosts first out of DC meeting in Omaha, NE, making recommendations on open rulemakings.

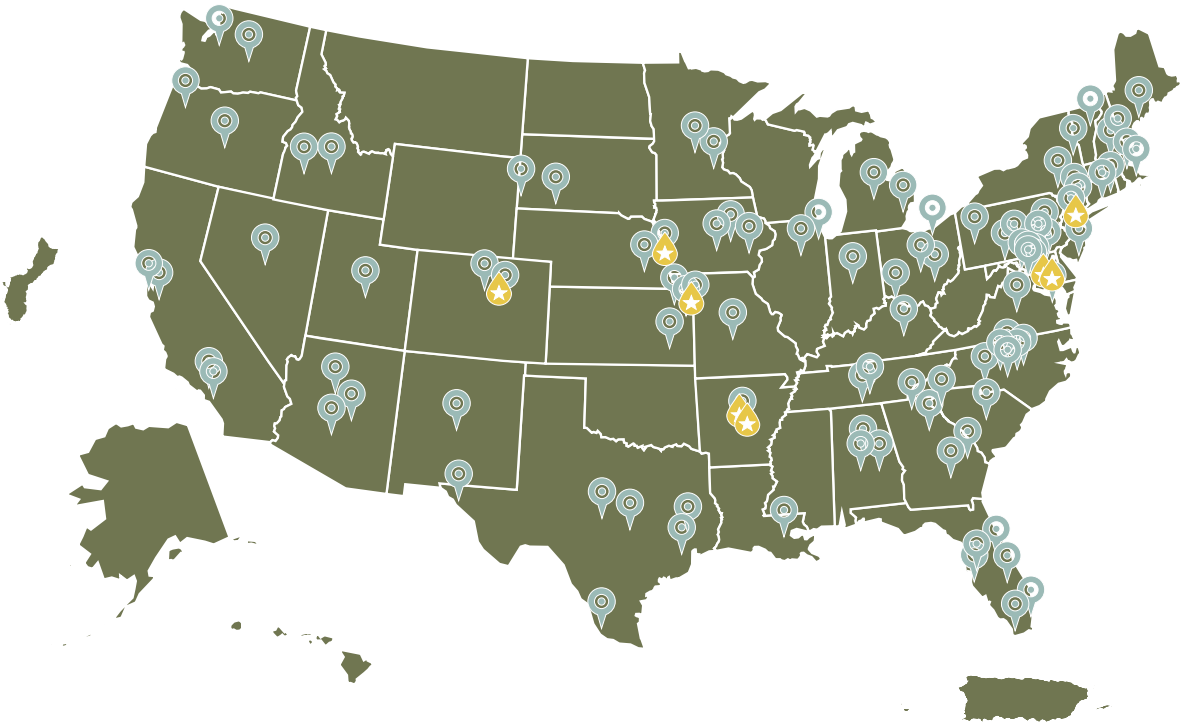
AUGUST 14

Office hosts the 38th Annual Government-Business Forum on Small Business Capital Formation in Omaha, NE at Creighton University.

Business Plan

Throughout the first year of our Office, we have often referred to ourselves as a "start-up within the government," challenged with operationalizing and delivering solutions to our "customers"—small businesses and their investors—starting from a blank slate. We began building out the Office by engaging in the same work that thousands of startups across the United States engage in each year: developing a business plan.[6] Starting with our enabling legislation as guideposts, we crafted a statement of our Office's mission to guide each decision we would make, keeping small businesses' and their investors' needs first of mind. Just as businesses do, we followed that by defining our target market and began identifying the capital formation needs of different small business market segments. With the mission and target market established, we outlined the products, programs, and services our Office would deliver, established projected launch dates, and began identifying critical components of each deliverable to ensure that we scale in a lean and efficient manner, again adopting a business-oriented mindset to solutions tailored to our target market. We created the business plan as a compass to guide decisions internally, as a pacesetter to keep us on track, and as a roadmap to guide expectations externally. Because of the premium we place on transparency, we put the business plan on our website to be open about our thought process and plan of action.

Outreach Activities



EVENTS/SPEAKING ENGAGEMENTS POINTS OF CONNECTION

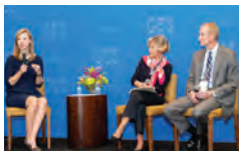
Highlighted Engagements in Fiscal Year 2019

In addition to hundreds of meetings, phone calls, emails, and cups of coffee shared with individuals across the small business ecosystem, we have sought out opportunities to engage with diverse groups of small business thought leaders—our Office's customers—through events, speaking engagements, and networks of potential beneficiaries of our Office's products, programs and services. Some of the events in which we have engaged this year include:

Road to Global Entrepreneurship Summit[7]

March 19, 2019
Overland Park, KS

Panel discussion alongside individuals from the public and private sector, hosted by the U.S. Department of State.



SEC Speaks 2019[9]

April 8, 2019
Washington, DC

Launch of the Office's Foundational Business Plan[10] and plans for inaugural year of the Office.

Investment Company Institute's Small Funds Committee

April 30, 2019
Washington, DC

Solicitation of investor input from smaller funds and investment companies.

Roundtable with Colorado Small Businesses and Investors

May 3, 2019
Denver, CO

Roundtable discussion with small business owners and investors on pressing capital formation issues.

Town Hall Meeting at the 1 Million Cups[8]

March 20, 2019
Kansas City, MO

Town hall meeting with small business owners, investors, and aspiring entrepreneurs.

International Institute for Securities Market Growth and Development[11]

April 9, 2019
Washington, DC

Discussion of the creation of the Office and role at the SEC with international securities regulators.

Rocky Mountain Securities Conference[12]

May 3, 2019
Denver, CO

Discussion of legal issues in small business capital formation in the Rockies.

National Small Business Week Roundtable on "Capital Formation Between the Coasts"[13]

May 6, 2019
Washington, DC

Roundtable focused on experiences of businesses and investors raising capital and investing outside of coastal "hot spots."

National Association of Women Business Owners' Advocacy Day[14]

June 4, 2019
Washington, DC

Collaboration with female entrepreneurs on their national advocacy day.

38th Government-Business Forum on Small Business Capital Formation[15]

August 14, 2019
Omaha, NE

Hosted forum, gathering members of the public and private sectors to craft suggestions for securities policy.

U.S. Black Chambers 10th National Conference[17]

August 20, 2019
National Harbor, MD

Panel discussion on the art of capital raising and deal activity.

Rural RISE 2019 Summit[19]

Sept. 18, 2019
Pine Bluff, AR

Panel discussion highlighting government resources to empower rural communities to foster entrepreneurship.

National Small Business Association

June 10, 2019
Washington, DC

Discussion with NSBA's Leadership Council on their top issues.

Maha Discovery Festival[16]

August 15, 2019
Omaha, NE

Pitched the Office like an entrepreneur at the largest Midwestern entrepreneurship conference.

The Venture Center Roundtable[18]

Sept. 17, 2019
Little Rock, AR

Roundtable discussion with the Little Rock startup and fintech community.

NYSE American Emerging Companies Summit

Sept. 19, 2019
New York City, NY

Fireside chat discussing issues faced by small reporting companies and their investors, and *Inside the IceHouse* podcast episode recording.[20]

Launch of Video Content

Small business owners and their investors often do not engage with the SEC (or other federal government agencies) for many reasons, including lack of time and resources. In an effort to increase engagement in the regulatory process, the Office piloted four videos in FY2019 that, in 3-5 minutes, provide a high-level, plain English overview of a rulemaking topic, how it affects small business interests, and how the viewer can engage and provide feedback. These videos are a reflection of growing trends in information consumption, with 80% of all internet traffic in 2020 projected to be video.[21]

The FY2019 videos included:[22]

- How to Comment: Engage in the Rulemaking Process
- Harmonization of the Exempt Offering Framework
- Accelerated Filer Proposed Amendments
- Simplifying the M&A Accounting Rules

The videos reflect the changing nature of how people are consuming information and prioritizing visual content. External audiences have been far more willing to stream a short video about a securities law topic that they see on social media than to dig into a lengthy PDF on SEC.gov to find out it if is relevant to them. Going forward, the Office will continue exploring video and other forms of media to better engage with and inform small businesses and investors.

Small Business Forum

The Office hosted the SEC's 38th annual Government-Business Forum on Small Business Capital Formation on August 14, 2019 in Omaha, Nebraska at the Heider College of Business at Creighton University, continuing the SEC's three-year tradition of taking the Forum outside of Washington, DC. The Forum is a unique event where members of the private and public sectors converge to identify and highlight issues they experience in accessing capital and investing in small businesses and then formulate solutions on which the government can take action. The Office assumed responsibility for the Forum beginning in FY2019 under the Small Business Advocate Act. A separate report has been delivered to Congress summarizing the proceedings and recommendations of the participants.[23]

[Top] "Capital Formation Success Stories from the Silicon Prairie" panelists and SEC Commissioners engage in a thoughtful dialogue about capital raising.

[Center] SEC Commissioners and "Harmonization: What a Concept!" panelists.

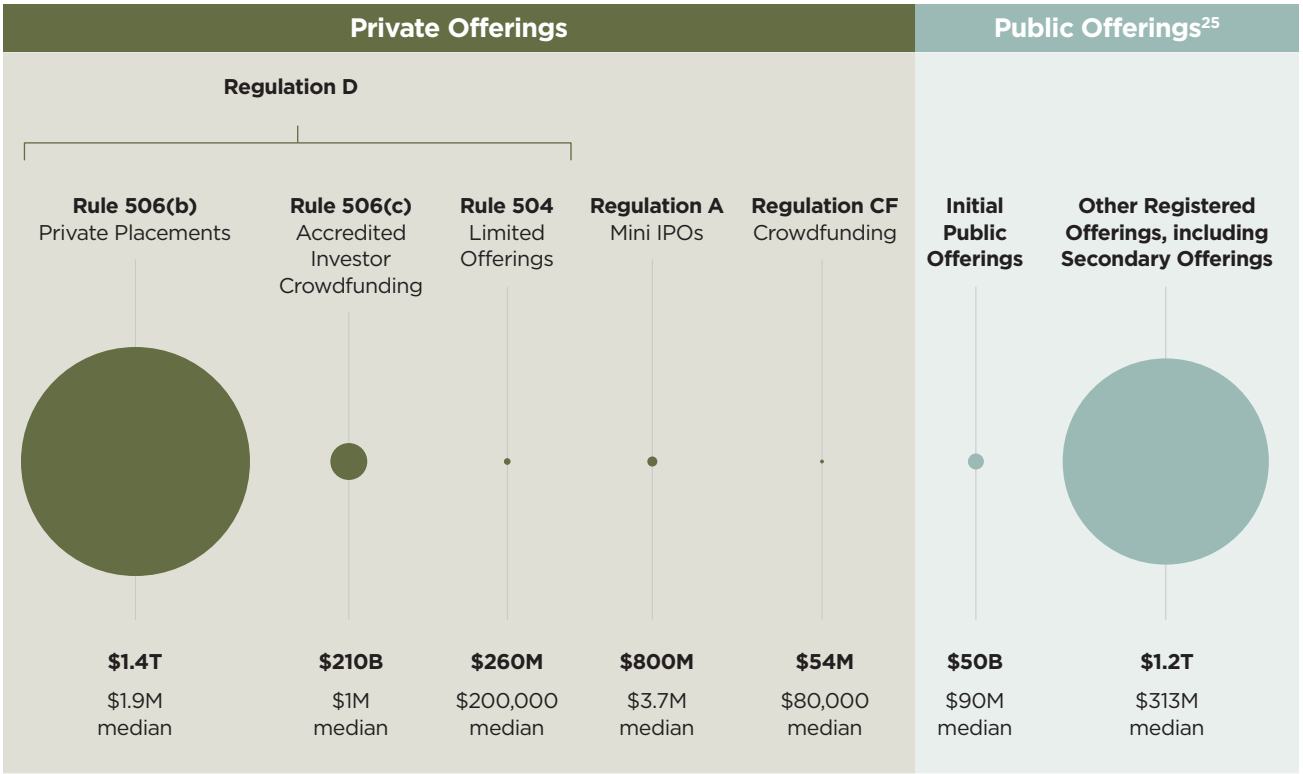
[Bottom left] Commissioner Rob Jackson visits with business owners and investors.

[Bottom right] Commissioner Allison Herren Lee talks with panelists and participants.

State of Small Business Capital Formation

The data provided in this Report is derived from a combination of public filings with the SEC, as analyzed by the SEC's Division of Economic Research and Analysis (DERA), and is supplemented with figures and findings from third parties. In doing so, we hope to provide a snapshot view of the state of U.S. small business capital formation, amalgamating many important pieces of the capital formation story into one resource to aid in evaluating the current flow of investment capital between small businesses and investors. The data supplements anecdotal evidence and helps quantify the successes and challenges in small business capital formation nationwide. Using data, we can better identify what tools, strategies, and approaches would be most helpful in crafting policy solutions. Unless otherwise indicated, the data period utilized for DERA data is July 1, 2018 to June 30, 2019.

What regulatory pathways are companies using to raise capital?[24]



What are the primary types of offerings and what companies are using them?

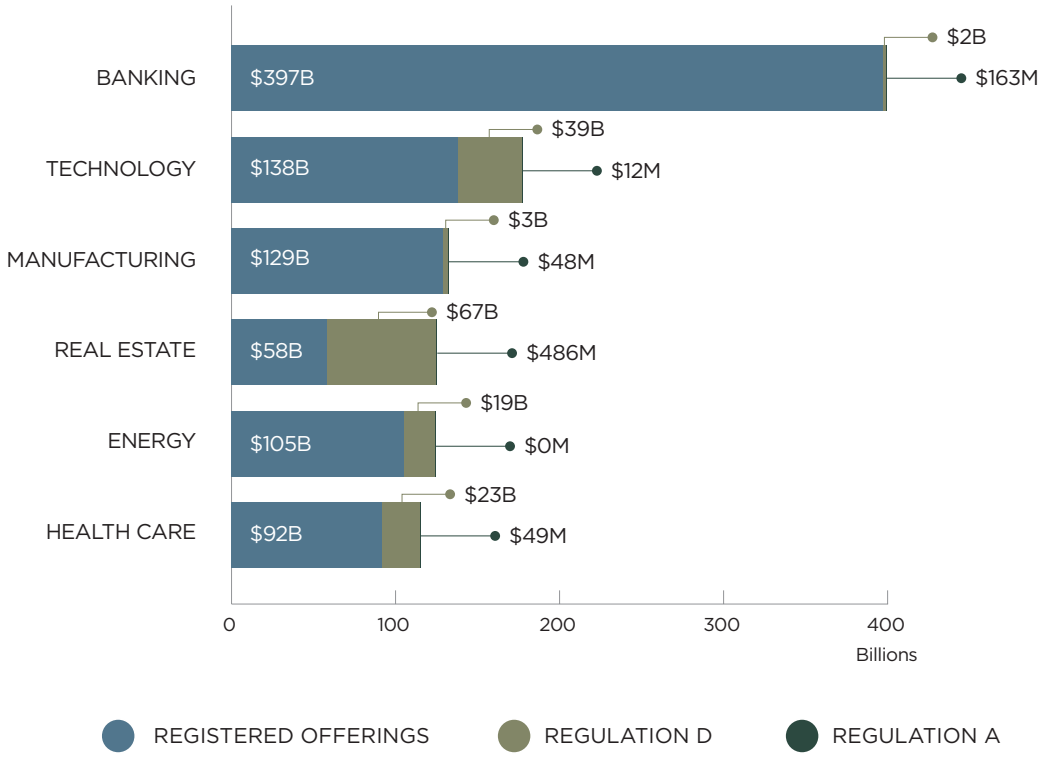
OFFERING TYPE	IN A NUTSHELL	TYPICAL CO. PROFILE
Equity Crowdfunding *Regulation Crowdfunding*[26]	Raising up to $1.07 million from many investors online.	
Limited Offerings *Rule 504 of Reg D*[27]	Raising up to $5 million from investors, often with whom the company has a relationship.	
Intrastate Offerings *Section 3(a)(11) and Rules 147 and 147A*[28]	Raising capital locally according to state law exemptions, which generally cap the offering at between $1 million to $5 million, depending on the state.	
Private Placements *Rule 506(b) of Reg D or Section 4(a)(2)*[29]	Raising unlimited capital from higher net worth investors with whom the company has a relationship.	
Accredited Investor Crowdfunding *Rule 506(c) of Reg D*[30]	Raising unlimited capital from higher net worth investors, often online, using general solicitation.	
Mini Public Offering *Regulation A*[31]	Raising up to $50 million from many investors online.	
Registered Offerings (including Initial Public Offerings) *Securities Act of 1933*[32]	Raising large amounts of capital through "IPOs" or secondary offerings through a registration statement filed with the SEC.	

SMALL, EMERGING BUSINESSES

MATURE AND LATER-STAGE BUSINESSES

SMALL PUBLIC COMPANIES

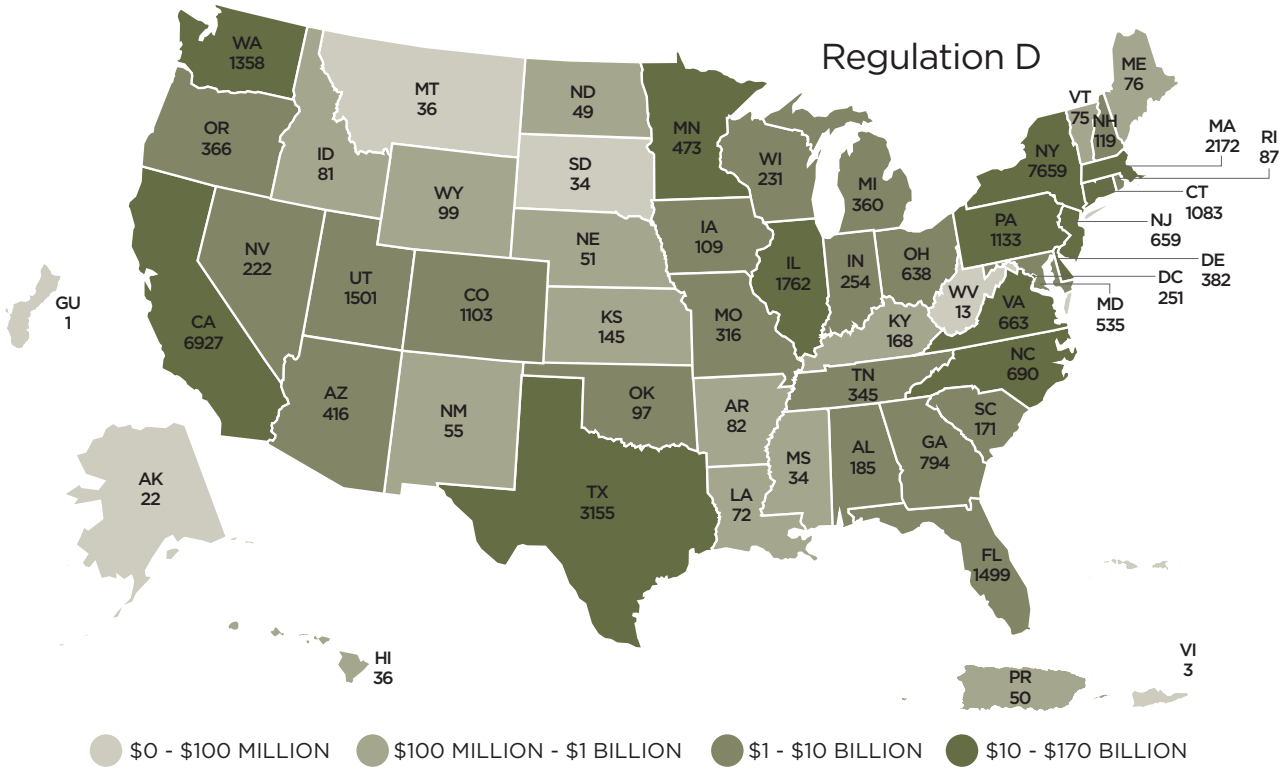
How are companies using the offering types in the industries that raise the most capital (excluding pooled funds)?[33]

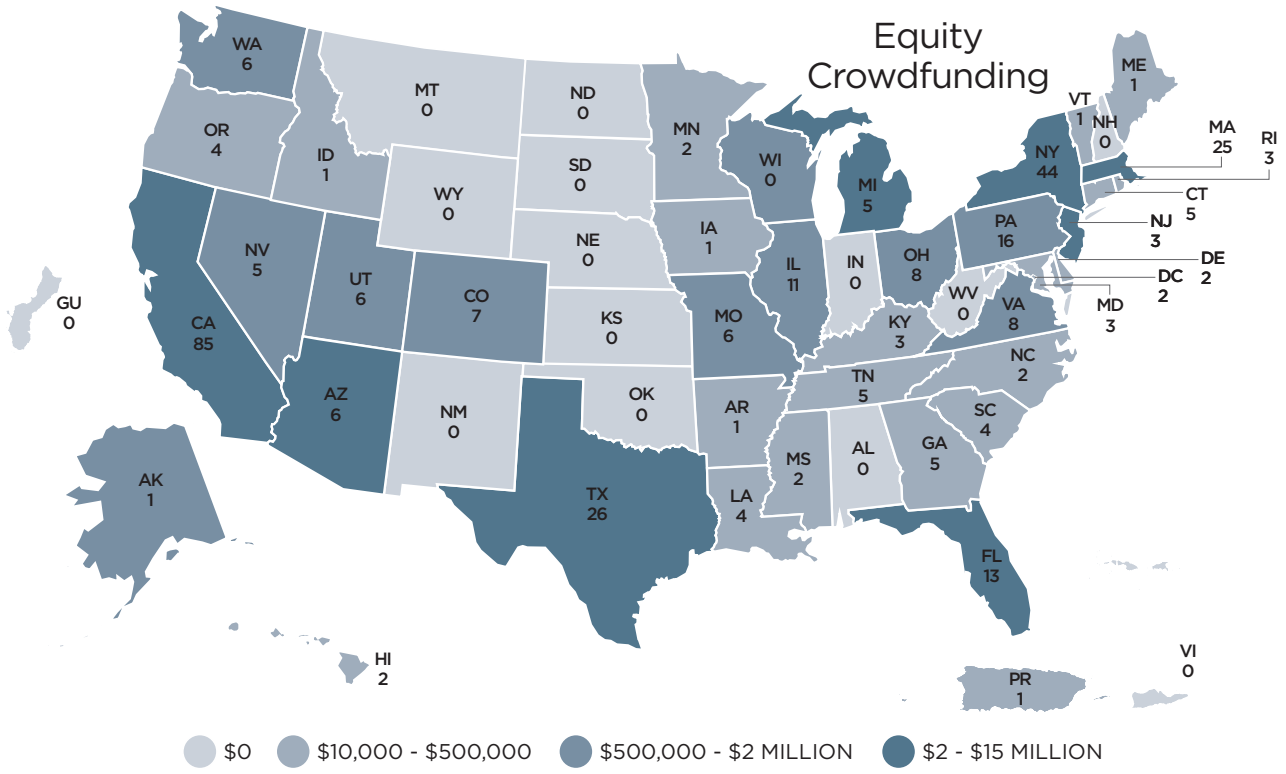


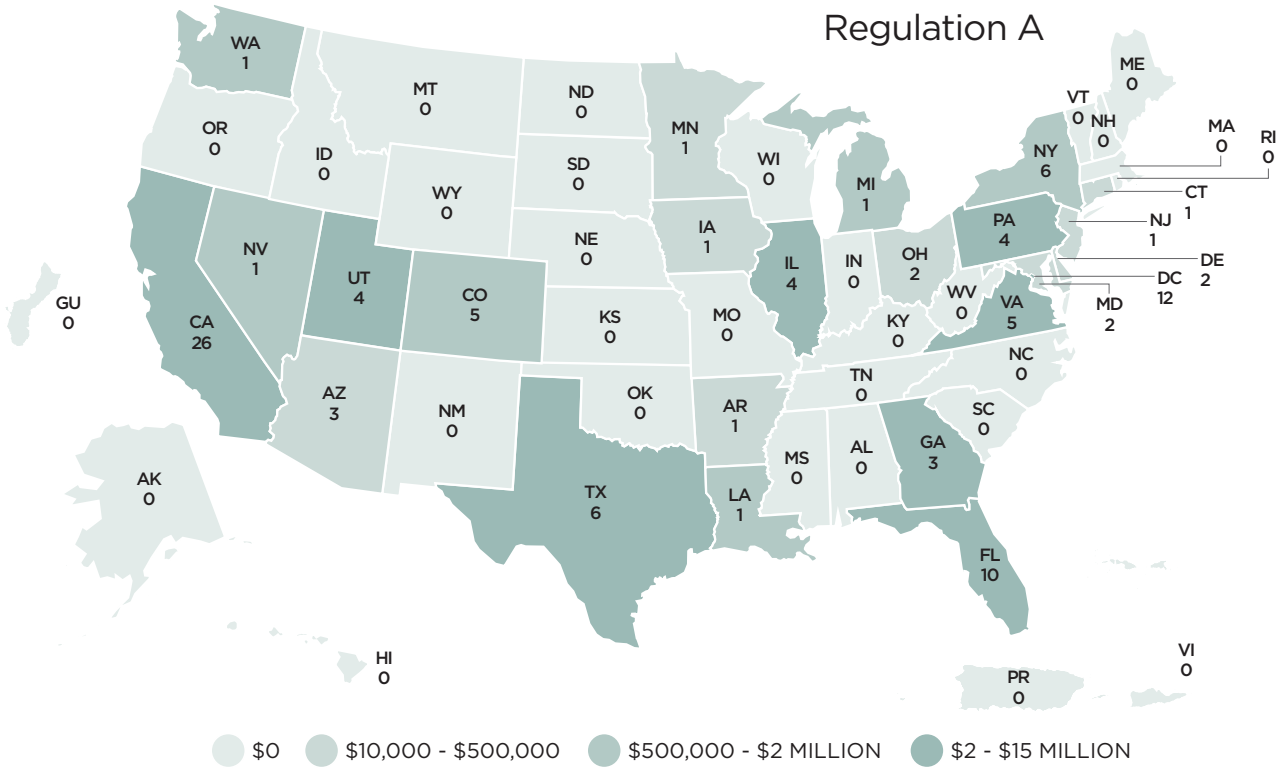
The Office joined over 300 rural capacity builders in Pine Bluff, Arkansas at Rural RISE, highlighting government resources to empower rural communities fostering entrepreneurship.

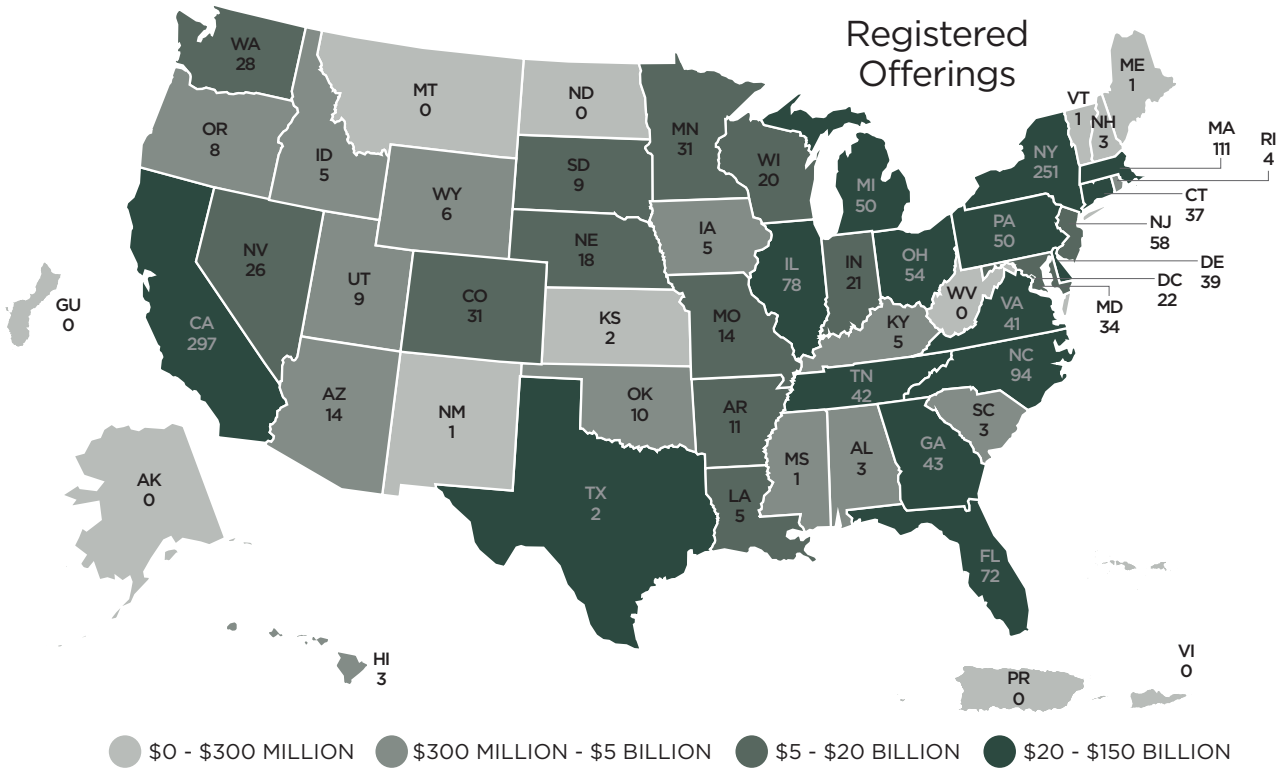
Where are companies raising capital?[34]

The maps included in this section illustrate the concentration of estimated total capital raised under various different offering types by issuers that report a primary location in the U.S., with the number of offerings conducted indicated on each state.





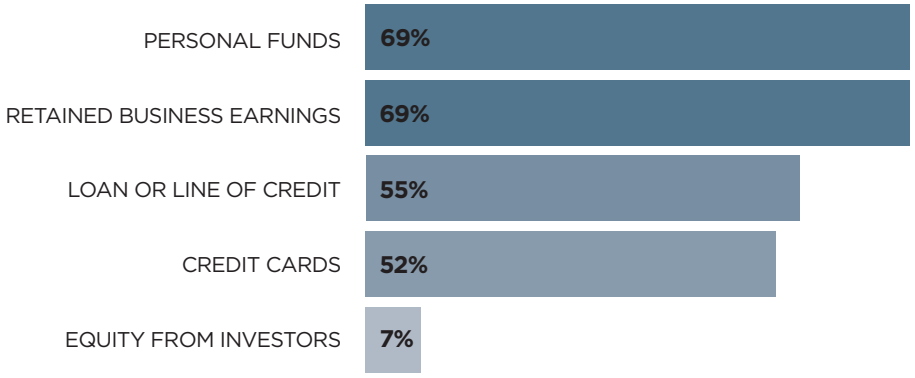

Regulation A
WA 1
OR 0
CA 26
ID 0
NV 1
MT 0
WY 0
UT 4
AZ 3
CO 5
NM 0
ND 0
SD 0
NE 0
KS 0
OK 0
TX 6
MN 1
IA 1
MO 0
AR 1
LA 1
WI 0
IL 4
MS 0
MI 1
IN 0
KY 0
TN 0
AL 0
OH 2
GA 3
FL 10
SC 0
NC 0
VA 5
WV 0
PA 4
NY 6
VT 0
NH 0
ME 0
MA 0
RI 0
CT 1
NJ 1
DE 2
MD 2
DC 12
GU 0
AK 0
HI 0
PR 0
VI 0
$0
$10,000 - $500,000
$500,000 - $2 MILLION
$2 - $15 MILLION


Registered Offerings
WA 28
OR 8
CA 297
ID 5
NV 26
MT 0
WY 6
UT 9
AZ 14
CO 31
NM 1
ND 0
SD 9
NE 18
KS 2
OK 10
TX 2
MN 31
IA 5
MO 14
AR 11
LA 5
WI 20
IL 78
MS 1
MI 50
IN 21
KY 5
TN 42
AL 3
OH 54
GA 43
FL 72
SC 3
NC 94
VA 41
WV 0
PA 50
NY 251
VT 1
NH 3
ME 1
MA 111
RI 4
CT 37
NJ 58
DE 39
MD 34
DC 22
GU 0
AK 0
HI 3
PR 0
VI 0
$0 - $300 MILLION
$300 MILLION - $5 BILLION
$5 - $20 BILLION
$20 - $150 BILLION

Companies within this segment of the market generally raise capital through some combination of bootstrapping, self-financing, bank debt, friends and family, crowdfunding, angel investors, and seed rounds. This funding is commonly used to get companies off the ground and through early prototypes.

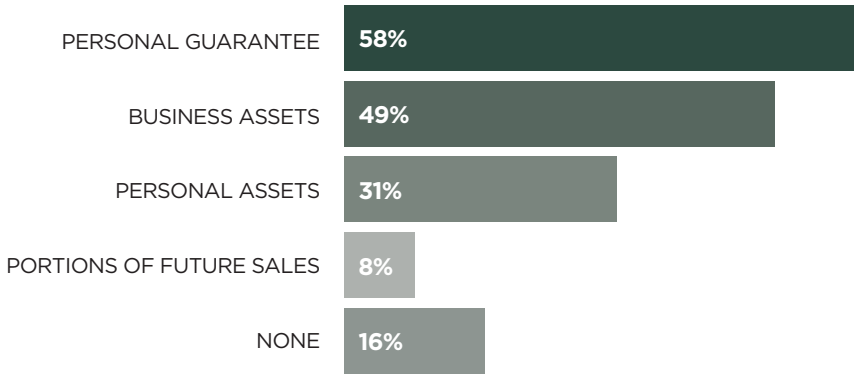
How are early stage small businesses accessing capital?

Small businesses often bootstrap and self-finance to overcome access to capital challenges, including using the following overlapping resources:[35]



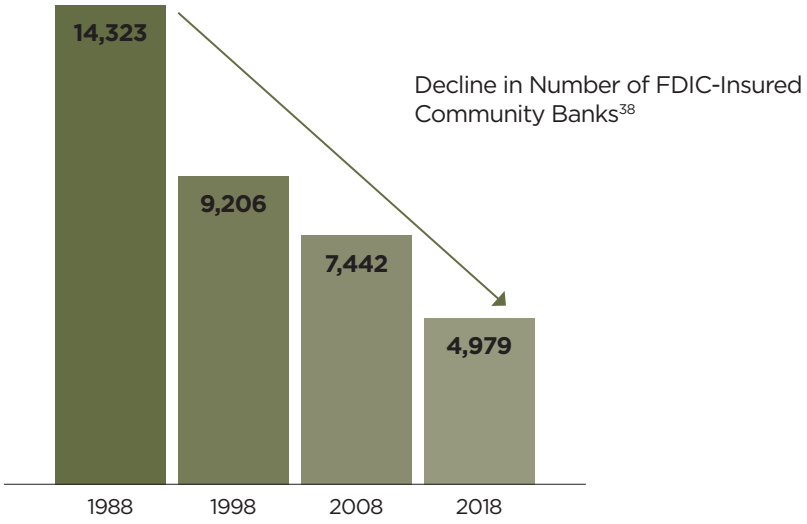
Notably, funding operations using retained business earnings is generally an option only available to established companies.

How are small business loans and lines of credit typically collateralized?[36]



> Young small businesses are more likely to tap into informal sources of credit such as funding from owners or family and friends, while older firms are more likely to receive funding from more traditional sources.
>
> BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM[37]

How have community banking trends impacted emerging businesses?



Banks are moving away from smaller-dollar loans, which are less profitable at scale. The following figures illustrate that pain point for smaller companies:[39]

Some banks have reportedly reduced or eliminated loans below a certain threshold, typically

<$100,000

Many banks will reportedly not lend to businesses with annual revenues

<$2 million

Neither term loans based upon cash flow or commercial revolving lines of credit are available for companies that are not yet revenue-producing or that are temporarily choosing to accelerate growth at the expense of profitability.[40]

> Capital is the lifeblood of small businesses, who depend on credit to start, operate, and grow. Historically, small businesses relied on banks to access capital. But during the 2008 financial crisis, credit markets froze, and banks temporarily stopped lending even to businesses with good credit. This crisis hit small businesses hard and credit conditions have been slow to recover.
>
> KAREN G. MILLS, FORMER SBA ADMINISTRATOR[41]

What is the role of angel investors?

"Angel investors" are generally high net worth individuals who provide financial backing for early-stage businesses, often coming from among an entrepreneur's friends and family.[42] They typically invest their own funds directly in a business located in close proximity,[43] often using convertible debt.[44]

What is the scale of angel investing in early-stage companies in 2018?[45]

334,565
active angel investors

$23.1 billion
in total angel investments

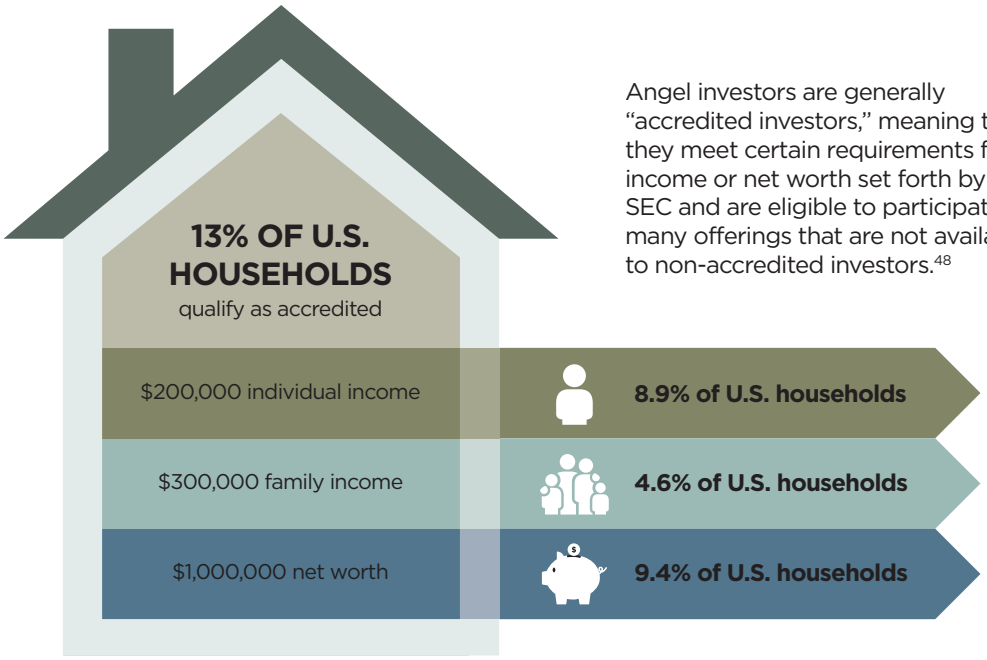
66,110
entrepreneurial ventures received angel funding

$349,620
average angel funding round

The average angel's individual investment is between:[46]

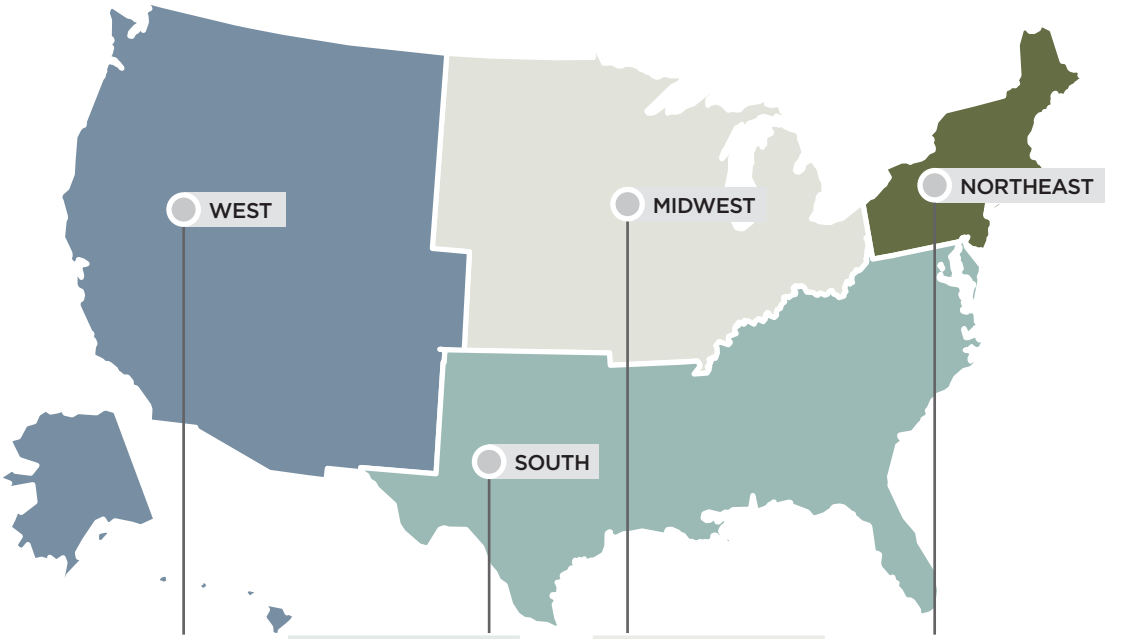
$5,000 and **$100,000**

What does the pool of accredited investors look like?[47]



Angel investors are generally "accredited investors," meaning that they meet certain requirements for income or net worth set forth by the SEC and are eligible to participate in many offerings that are not available to non-accredited investors.[48]

How does household income and net worth vary by region of the U.S.?[49]



WEST

Mean household income **$108,500**

Median household income **$57,500**

Mean household net worth **$873,700**

Median household net worth **$114,300**

SOUTH

Mean household income **$100,000**

Median household income **$51,500**

Mean household net worth **$636,900**

Median household net worth **$87,000**

MIDWEST

Mean household income **$102,000**

Median household income **$54,700**

Mean household net worth **$658,800**

Median household net worth **$103,200**

NORTHEAST

Mean household income **$136,500**

Median household income **$64,400**

Mean household net worth **$851,300**

Median household net worth **$154,500**

What role do non-accredited investors play?

While there are pathways for non-accredited investors to participate in exempt offerings, the vast majority of small businesses are still limiting their offerings to accredited investors.[50] From 2015-2018, non-accredited investors participated in only:[51]

6% of Rule 506(b) transactions

2-3% of total capital raised in transactions under Rule 506(b)

> [S]o much of entrepreneurship happens at the local level. Entrepreneurs raise money from local investors, hire from the local market, and found companies with the people who live in the same area.
>
> EWING MARION KAUFFMAN FOUNDATION[52]

How costly is it for early-stage companies to navigate compliance with securities laws?

Companies spend significant money on legal fees in raising early-stage capital, in some cases amounting to the cost of an additional employee's salary. One 2019 start-up guide quotes the costs as:[53]

$5,000 TO $20,000

for very early stage

$20,000 TO $40,000

for a venture capital raise

The age at which companies raise capital has matured:

While in 2014 a 3-year old company was commonly raising Series A, in 2019 that same age company is raising angel and seed-financing.[54]

> [T]he nature of startups receiving financing is fundamentally changing as investors continue to concentrate capital in fewer yet larger deals. At the seed stage, startups historically have been pre-product, but today's investors tend to prefer a more mature company at this stage, which typically means the startup should at least have a minimum viable product.
>
> PITCHBOOK[55]

Mature and Later-Stage Businesses

Companies within this segment of the market are generally growing and looking for larger amounts of capital that can fund operations of scale, ventures into new verticals, and preparation for public markets. Most often these investors are institutional in nature, whether syndicate groups, venture capital, private equity, or even public funds.

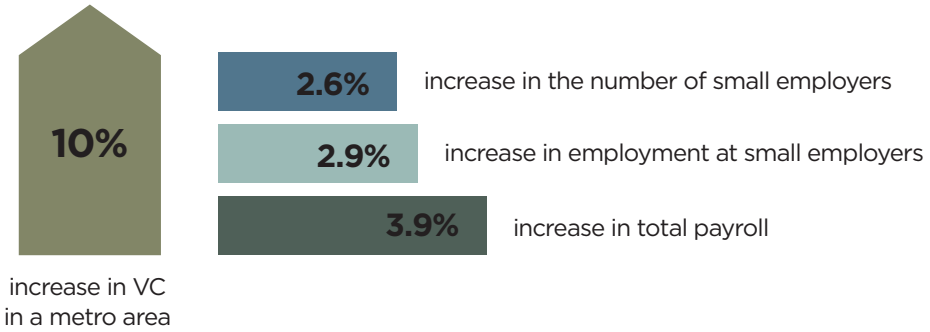
What is the role of venture capital (VC) in funding mature and later-stage businesses?

VC funds a small portion of the overall number of small businesses (approximately 0.5%), but those businesses tend to have outsized growth trajectories.[56] VCs tend to fund companies with significant return on investment multiples, realizing profit at the company's initial public offering or sale. A few statistics illustrate VC's scale and impact on small business capital formation:

18,228
VC deals in 2018,
up from 6,876 in 2009[57]

1,087
VC-backed IPOs
from 2009-2018[58]

Increases in the availability of VC funding in metro areas have been correlated with job growth:[59]



What is the role of private equity (PE) in funding mature and later-stage businesses?

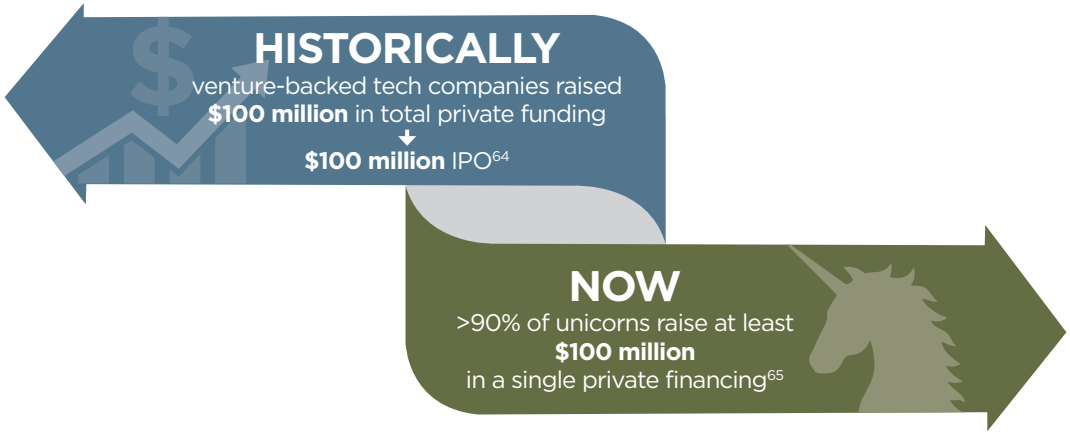
PE funds tend to back companies with return prospects following restructuring, realized through dividends and/or sale of the target company, often funded by a combination of investor equity and debt. A few statistics illustrate PE's scale and impact on small business capital formation:

10,000
average PE yearly deal count for the past 5 years[60]

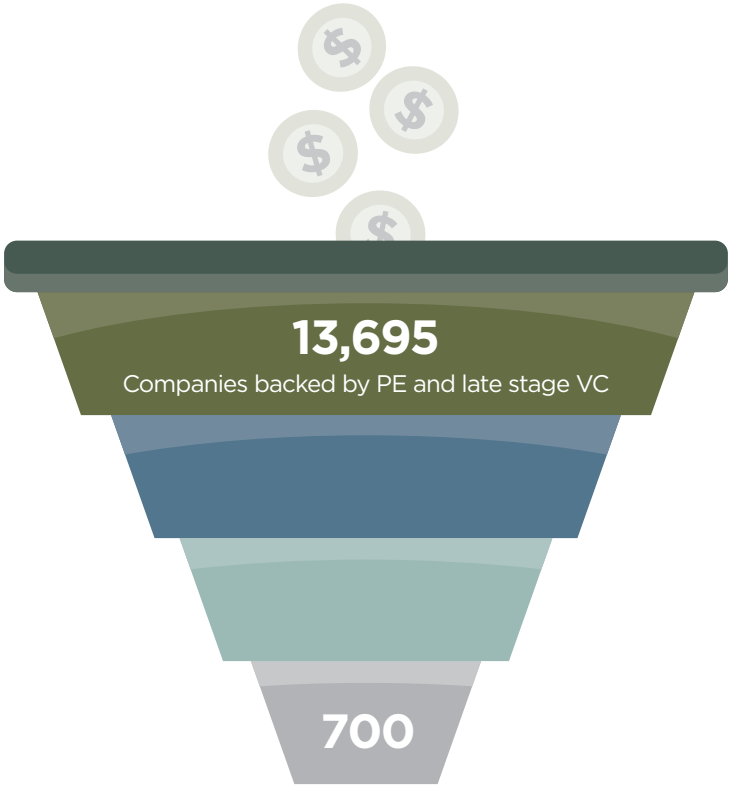
1,043
PE-backed IPOs from 2009-2018[61]

Some studies have found that PE returns have recently outperformed the public market (12% for PE vs. 8% for the S&P),[62] while others have noted a greater return dispersion from private equity than from the public market, and mutual funds in particular.[63]

When do mature and later-stage businesses enter the public markets following VC and PE investments?



In what ways do VC-and PE-backed companies enter the public markets?



of which are estimated to become the next immediate generation of public companies[66]

44.8%

of companies currently listed on the NASDAQ were formerly backed by PE or VC[67]

From 2009 to 2018, public companies acquired

11,000+

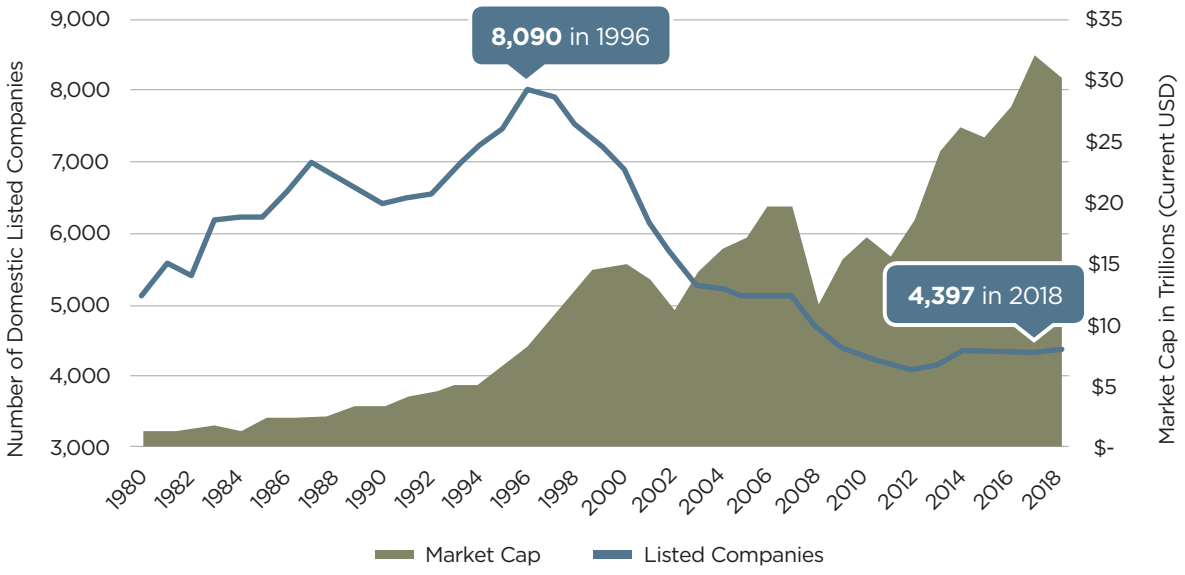
PE and VC-backed companies for over $3 trillion

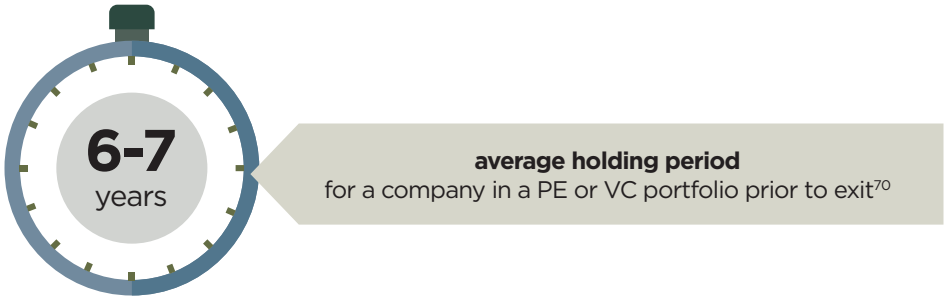
to serve various growth, intellectual property, talent and strategic needs[68]

Small Public Companies

Companies can access broad pools of investors when they conduct public offerings, allowing companies to raise large amounts of capital to fund activities such as research and development, capital expenditures, or debt service. Public offerings also provide liquidity to early-stage investors and publicity for the company's products and services.

How has the prevalence of publicly traded companies changed over time?[69]





Companies are increasingly going public at a later stage in their lifecycle after raising more capital from the private markets, providing for less growth following their IPO. In other words, companies are generally choosing to enter the public markets after maturing beyond the smaller reporting company thresholds.[71]

All IPOs from July 1, 2018 through June 30, 2019:[72]

204
IPOs

$243 Million
Average Proceeds

IPOs and other registered offerings by small public companies[73] from July 1, 2018 through June 30, 2019:

294
Offerings

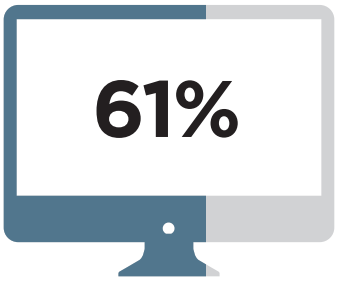
$47 Million
Average Proceeds

The Fortune 500 has changed dramatically since 1955:[74]

only **12%** remain on the list in 2014

the other **88%** have gone out of existence, merged, or fallen off the list

Small companies struggle for attention:

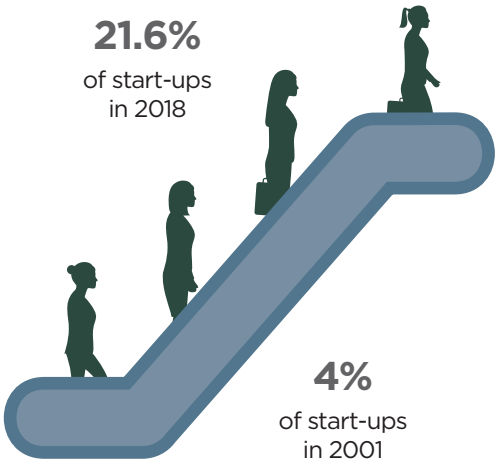


of exchange-traded companies with <$100 million market capitalization have **no research coverage**[75]

> The old pattern was that small companies raised small amounts of speculative capital from venture capitalists at speculative valuations, and then the ones that worked out went public at much higher valuations. The new pattern is that large companies raise large amounts of not-particularly-speculative growth capital from mutual funds at mature-company valuations, and then eventually they sort of quietly slip into being public.
>
> MATT LEVINE, BLOOMBERG[76]

Women-Owned Businesses

Women are founding more start-ups:[77]



Capital used at start-up varies by gender:[78]

$54,375
for women

$80,285
for men

Women are **less likely to apply** for bank loans, despite research finding no differences in approval rates.[79]

Women constituted

25.9%

of entrepreneurs seeking capital in 2018...

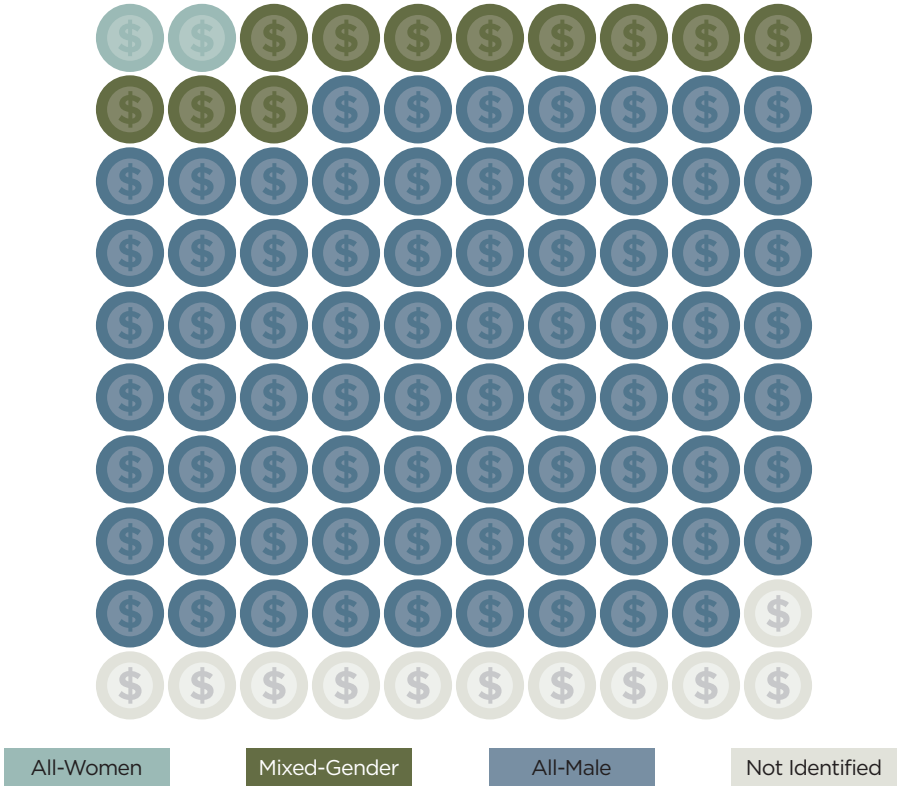
and had an investment yield rate of

17.5%

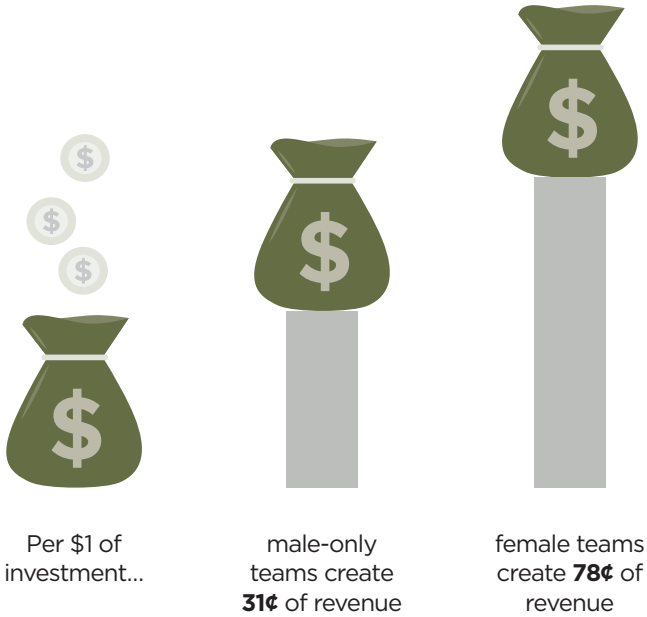
compared to a baseline rate of

23.2%[80]

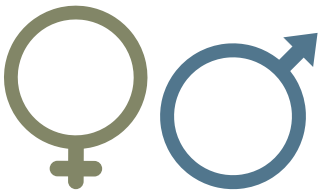
In 2018, women founding teams received **less VC funding** than their male peers of the approximately $130 billion reportedly invested:[81]



One study found that companies founded or co-founded by women **generate more revenue:**[82]



What effect does sexual orientation have on access to capital?

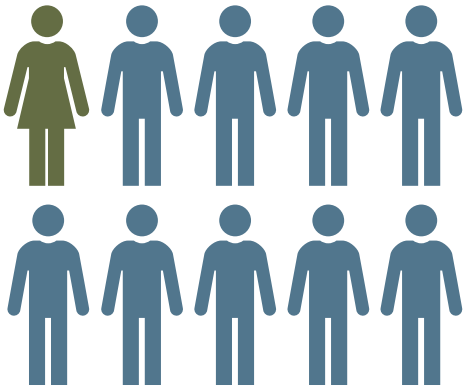


Research by StartOut found that gender had a far greater effect on startup funding levels than sexual orientation of the founders.[83]

Women Investors in Small Businesses

29.5%

of angel investors are women[84]



only

11%

of VCs across the industry are women[85]

71%

of VC firms have no female partners[86]

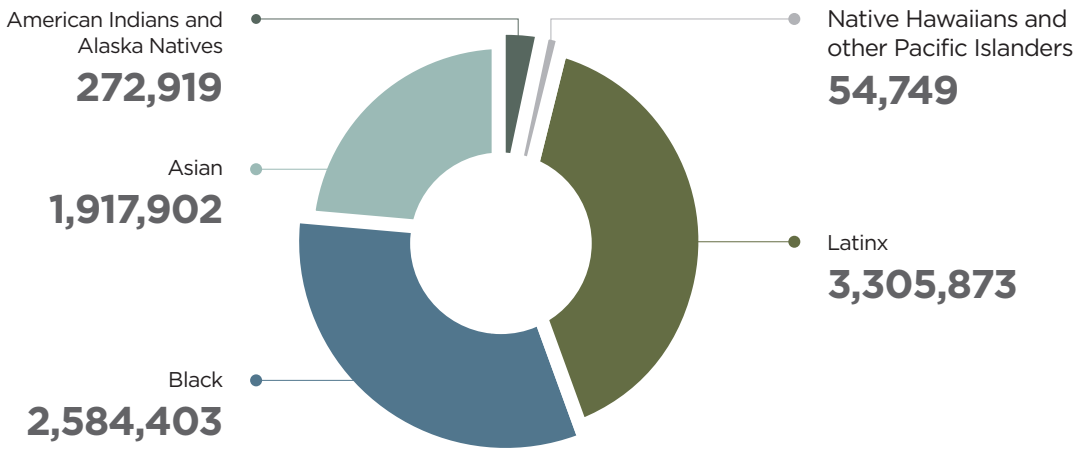
Minority-Owned Businesses

The most recent estimates show that 8 million businesses are minority owned, or 29.3% of U.S. firms.[87]

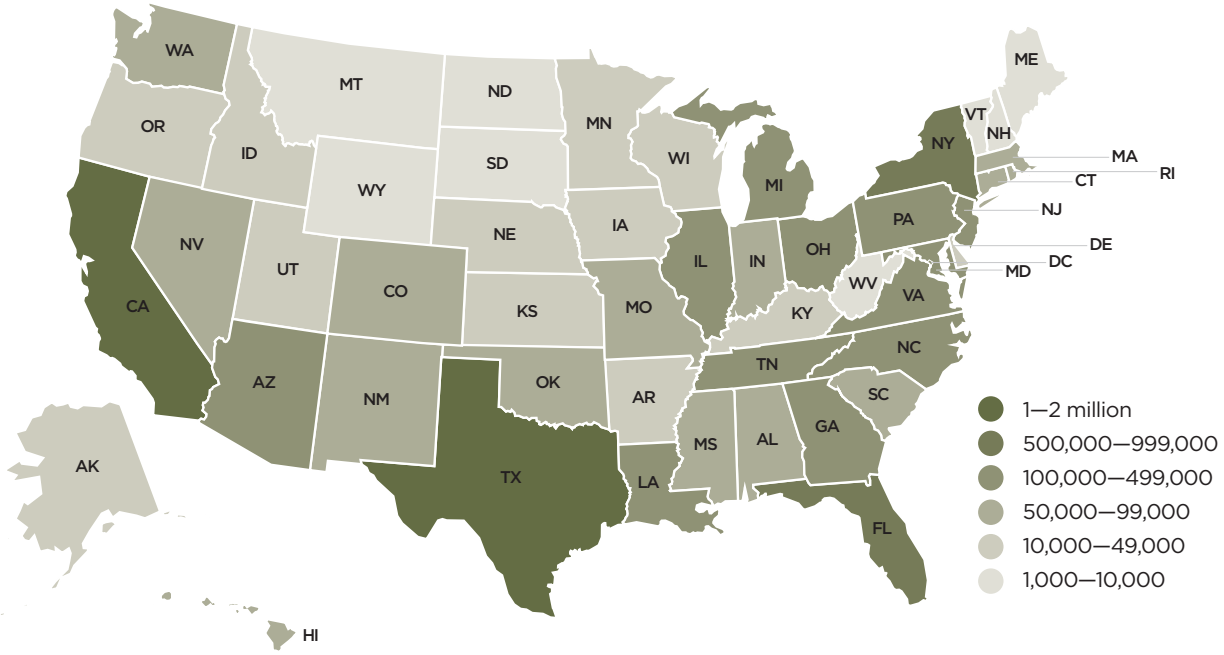
Since 2007, there has been a

38% increase in the number of minority-owned businesses[88]

Numbers of Minority-Owned Businesses[89]



Number of Minority-Owned Businesses by State[90]



What challenges do minority-owned businesses face in accessing capital?

Minority-owned businesses face challenges in accessing loans from banks, including:[91]

3X

more likely to be denied loans

7.8%

average interest rate
(vs. 6.4% for non-minority)

new black-owned businesses start with almost three times less in terms of overall capital

$35,205

compared with new white-owned businesses

$106,720[92]

Minorities constitute

10.7%

of entrepreneurs seeking capital in 2018

and had an investment yield rate of

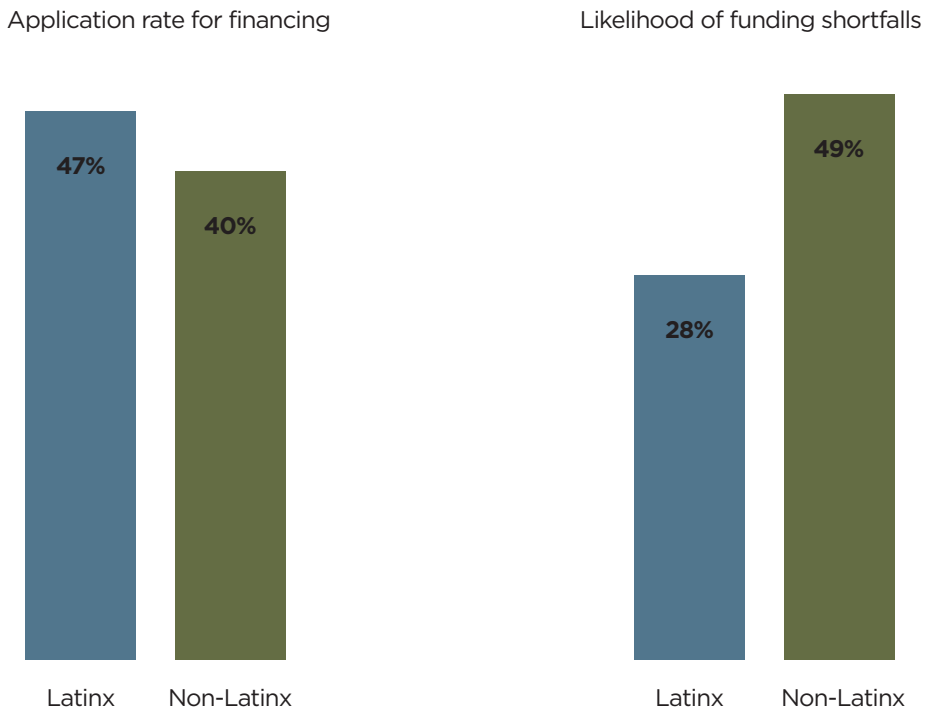
22%

compared to a baseline rate of

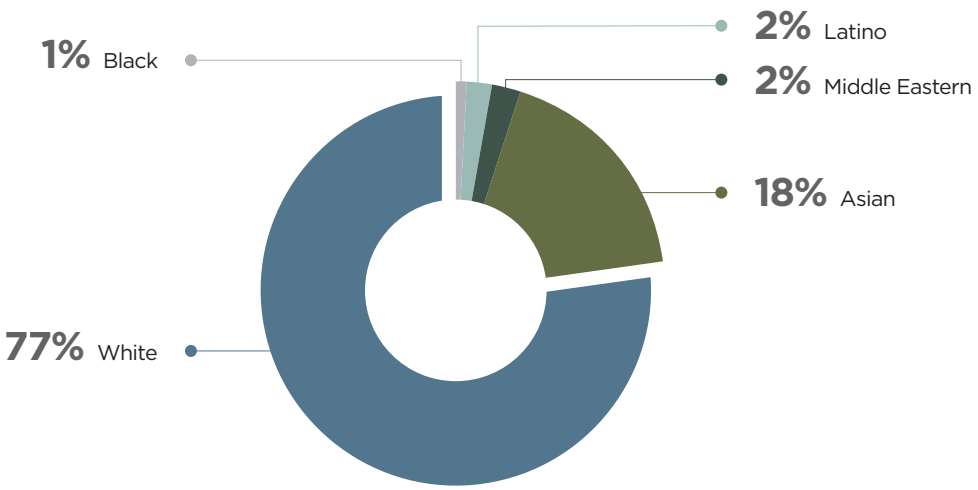
23.2%[93]

Minority entrepreneurs report profitability is disproportionately impacted by lack of access to capital:[94]

What challenges do Latinx business owners report in accessing debt financing?[95]



Founder Diversity in VC-backed Businesses:[96]



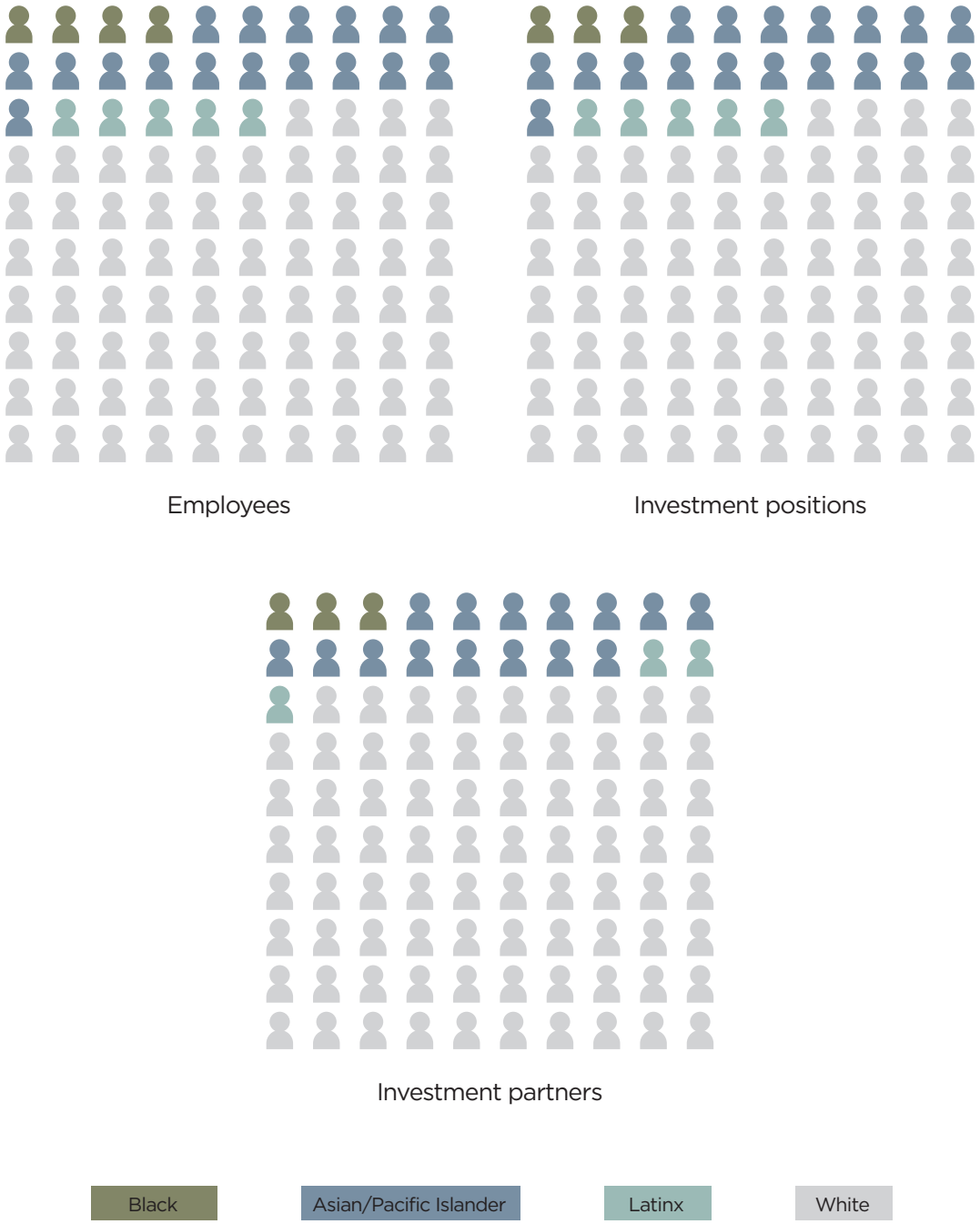
Minority Investors in Small Businesses

Only

5.3%

of angel investors are minorities[97]

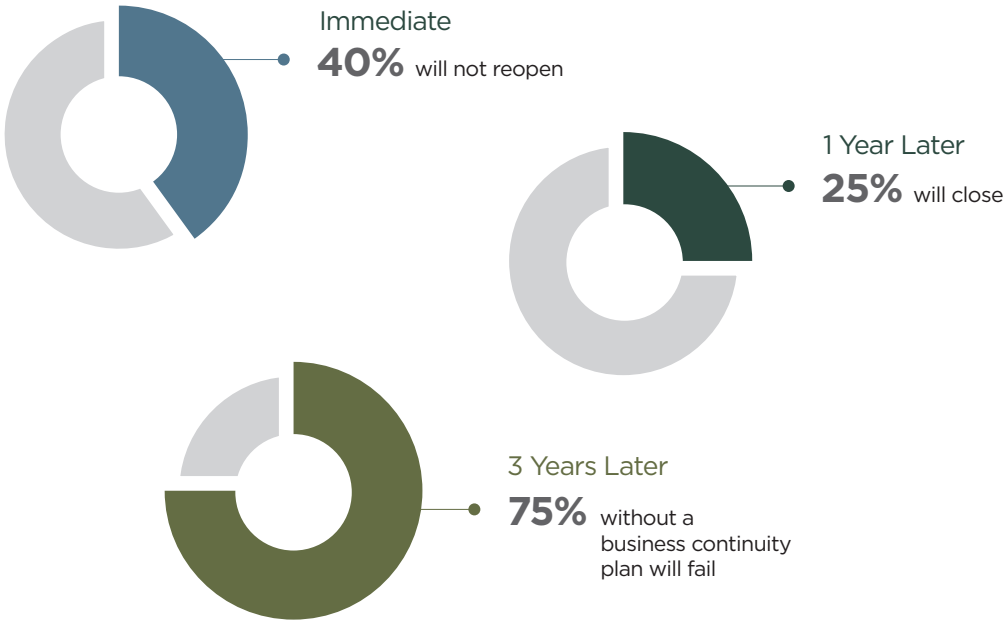
VC Workforce Representation[98]



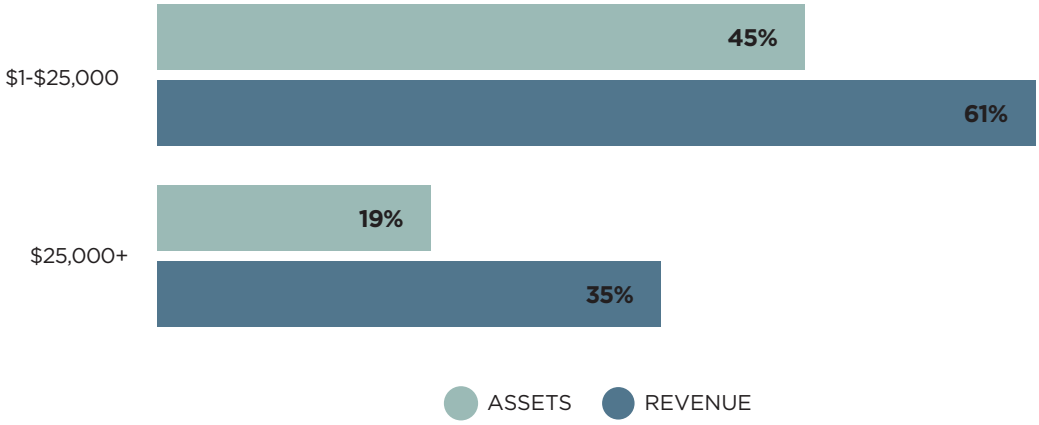
Natural Disasters & Capital Formation

When natural disasters strike communities, they often impact the survival prospects for small business, who may have fewer resources to weather the challenges to rebuild the business and reinvigorate its customer base.

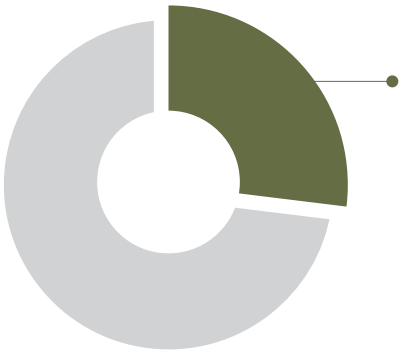
Impact of Natural Disasters on Small Businesses[99]



Reported Small Businesses Losses Following Natural Disasters[100]



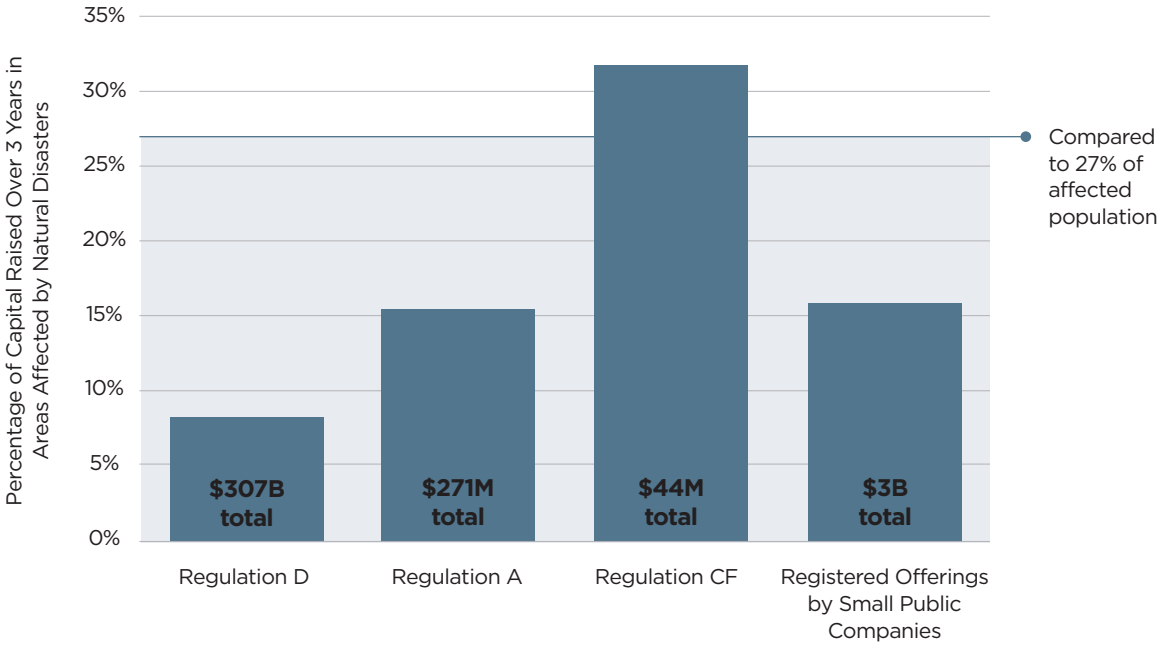
How does the percentage of the population affected by natural disasters compare to the amount of capital being raised?



27%

of the US population[101] lives in an area that was affected by a natural disaster[102] over three years ending June 30, 2019

However, businesses in areas affected by natural disasters over that three year time period are generally raising less capital relative to the affected population:[103]



> Counties hit by severe disasters experienced greater out-migration, lower home prices and higher poverty rates.
>
> NATIONAL BUREAU OF ECONOMIC RESEARCH[104]

Rural Communities & Capital Formation

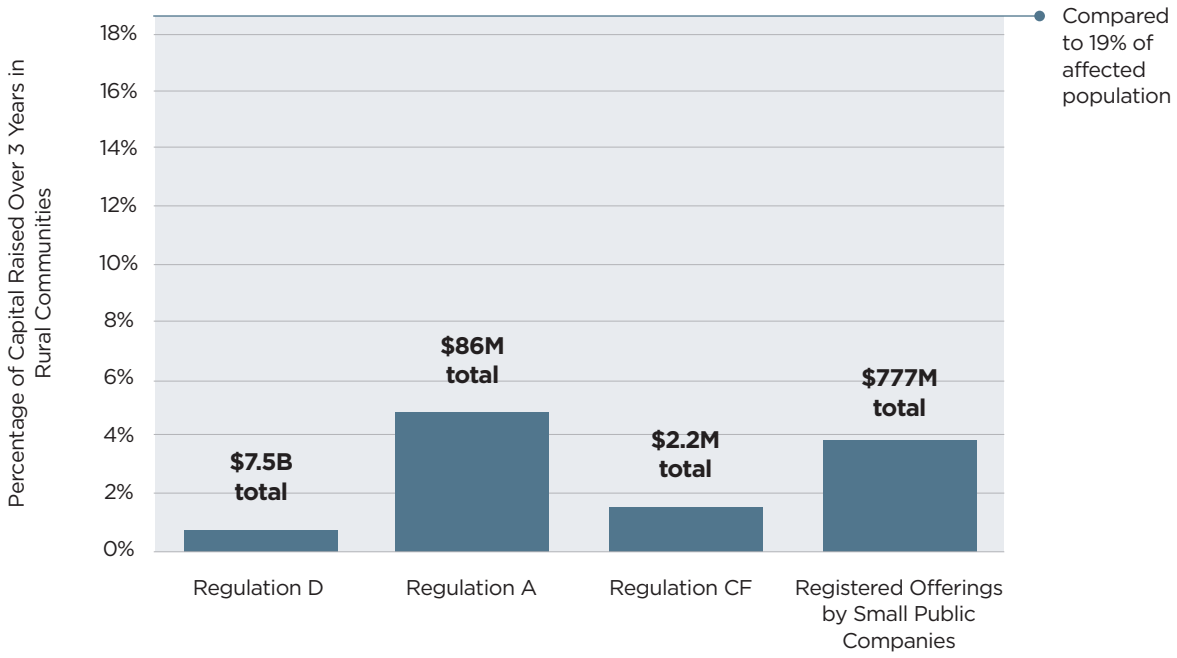
Much of entrepreneurship happens at a local level, particularly in early stages of company formation and growth. The importance of local ecosystems can exacerbate company challenges in rural communities facing population declines, impacting access to potential angel investors, talent, and customers.

How does the rural population compare to the amount of capital being raised?

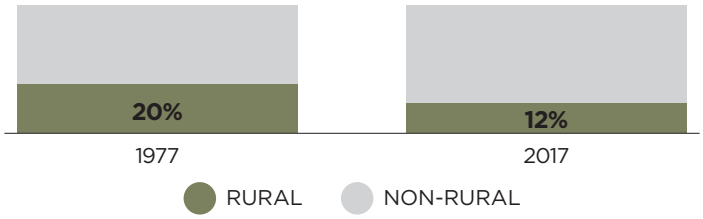
19% of the U.S. population lived in rural areas[105]

17% of small employer firms are located in rural areas[106]

However, businesses in rural areas[107] are raising less capital over three years ending June 30, 2019 relative to affected population:



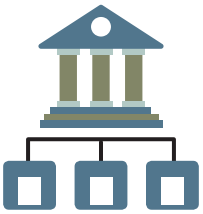
In recent decades, startup activity has declined in rural areas:[108]



The decline in community banks in rural areas is crippling access to early-stage debt for small businesses.[109] As of 2017 in the U.S.'s 1,980 rural counties:[110]

115

have just one community bank branch



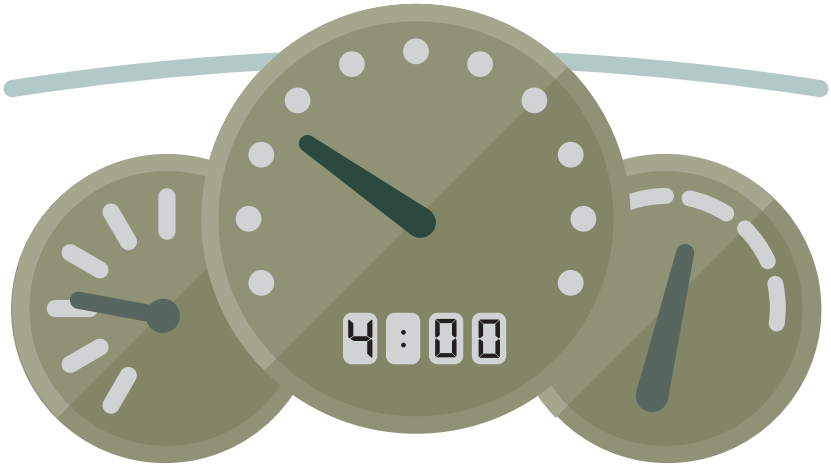
625

do not have a locally-owned community bank

35

have no bank

Many angel groups are working to find investment opportunities outside of the "four hour drive radius" rule of thumb, such as through state-wide networks.[111]



> For venture capital, the data indicate that while the average deal size and concentration of deals (inputs) in rural geographies may be less than that of urban regions, there is little difference in the performance of a rural investment in terms of multipliers, jobs, or exit types (outcomes).
>
> PATRICIA SCRUGGS, WAYNE EMBREE AND ROB WILTBANK[112]

Policy Recommendations

Over the course of the first year in operation, the Office has received feedback on various issues encountered by small businesses and their investors from start-up to small cap, from coast to coast, and across industries. The recommendations set forth in this report are proposed as pragmatic and principles-based solutions to the most serious issues raised with the Office. Our general experience has shown that where an issue affects a broad segment of the market, the magnitude of the issue's impact is often greater for minority-owned and women-owned small businesses and investors, as well as on small businesses and investors in areas affected by natural disasters or in rural areas.

Our Office is generally supportive of the current initiatives and rulemakings underway at the SEC as they relate to small business capital formation.[113] We present these recommendations as an opportunity to distill specific marketplace calls for action that are either not a part of the current regulatory or congressional agenda or that are complimentary to ongoing efforts. These recommendations provide a focused set of five critical challenges expressed by the market, with corresponding background discussion, summary of issues raised, and proposed solutions.

The Office, Commissioners, and SEC staff tour an opportunity zone construction site in Omaha, NE.

Background

Access to capital markets is critical for much of small business financing, with investor capital playing separate and complimentary roles to financing from the banking sector.[114] In meeting with businesses and their investors across the country about capital formation, one of the most consistent critiques expressed has been that the current exempt offering framework is complex and confusing. While the current rules contain a relatively broad "menu" of tools to raise capital, the requirements for each differ and in some cases conflict.[115] This challenging regulatory puzzle is understandably difficult to navigate, with each puzzle piece originating at different times and in response to different policy demands, with origins all the way back to 1933 with the Securities Act's passage. A complex path to capital to grow, scale, and mature makes it all the more challenging for companies to fulfill our collective expectation of new entrants joining the public markets to supplant the past two decades' approximate 50% drop in listed companies.[116] It is imperative that companies and investors have navigable and functional tools for the exchange of capital in early, pre-IPO stages to build the pillars of tomorrow's public markets.

Issues Raised

To understand securities law compliance, marketplace participants tend to need either a law degree or access to sophisticated counsel who can help them navigate the rules, both of which carry a significant price tag and can be a barrier to entry. This issue is exacerbated for those without broad networks or without excess funds to hire counsel in the midst of raising capital (which naturally tends to occur when capital is at its scarcest). While the "menu" of exemptions contains many options, regulatory uncertainty or confusion often incents companies and their investors to avoid using certain exemptions in favor of the most common and well understood pathways.[117] For example, the integration doctrine is used to determine when more than one transaction should be "integrated" and considered a single offering, and it entails a facts and circumstances analysis dating back to 1933.[118] Although it has been modernized and clarified over the years, companies and investors, as well as their counsel, struggle when trying to raise money using different offering exemptions that do not all allow general solicitation.[119] When the rules confuse not only the actors who are directly impacted by the rules—namely, businesses and investors—but also counsel on whom they rely for expert advice, capital formation is negatively affected.

A small business owner in Pine Bluff, Arkansas shares her perspectives with the Office over coffee.

Proposed Solution: Harmonization

The SEC's recent Harmonization Concept Release[120] sought unprecedented feedback on the areas in which the exempt offering framework works effectively, as well as where it can be improved to support efficient flow of capital while maintaining appropriate investor protections. Many ideas have been proposed to modernize, clarify, and streamline the regulations on the offer and sale of securities, and we have overwhelmingly heard support from marketplace participants for implementing many of the ideas suggested. In doing so, we would prioritize the following guiding principles:

- The rules, as well as how we at the SEC communicate compliance obligations, should be accessible to both companies and their investors, regardless of legal acumen.[121]
- The rules should allow companies to progressively and efficiently raise capital at each stage of the company life cycle as they grow, scale, and mature.
- The internet and technology have revolutionized communication since the Securities Act of 1933, including how businesses reach customers and operate. Any changes to the rules should incorporate an understanding of current communication practices, while also providing flexibility for the inevitable evolution of tomorrow's tools.
- To the extent that dollar amount caps are incorporated,[122] they should be tied to expressed marketplace needs for capital and provide flexibility for future review and adjustment. Caps should also take into consideration the varying demands for capital depending upon industry, geography, and life cycle stage.
- In evaluating the capital formation tools and investor protective measures, Congress and the Commission should reexamine the principles underlying regulation of capital raising transactions in light of the changing needs of the market.[123]

See also: Small Business Capital Formation Advisory Committee Recommendation.[124]

Investor Participation in Private Offerings

Background

Much attention has been paid recently to investors' access to opportunities in the private markets, where much of today's companies' "J-curve" growth is occurring prior to their IPOs, which are increasingly used as a liquidity rather than capital raising event. Many of the offering exemptions used in the private markets, whether under Rules 506(b) or 506(c) of Regulation D or under Regulation A, limit participation to accredited investors or contain restrictions on participation by non-accredited investors, including complete participation restrictions or investment limitations. The definition of "accredited investor" is "intended to encompass those persons whose financial sophistication and ability to sustain the risk of loss of investment or ability to fend for themselves render the protections of the Securities Act's registration process unnecessary."[125] The Senate Committee on Banking, Housing, and Urban Affairs noted that the addition of the accredited investor definition in the Small Business Investment Incentive Act of 1980[126] was intended to "give small businesses greater access to … sophisticated investors without the costs associated with the registration requirements."[127]

The SEC's current rules[128] define a natural person as an accredited investor if that investor either:

- earned income that exceeded $200,000 (or $300,000 together with a spouse) in each of the prior two years, and reasonably expects the same for the current year; or
- has a net worth over $1 million, either alone or together with a spouse (excluding the value of the person's primary residence).

The definition also qualifies many types of entities as accredited investors if they have assets exceeding $5 million. However, the definition's enumerated list omits certain types of entities, such as American Indian tribal corporations, which has the practical effect of excluding otherwise sophisticated investors from participating in investment opportunities.

The Office participated in a panel discussion on the art of capital raising and deal activity at the U.S. Black Chambers' 10th National Conference.

For retail investors (i.e., individuals buying securities for their own account), there are few opportunities to participate in the growth of the private markets via diversified portfolio holdings, whether through pooled investment vehicles (i.e., mutual funds or exchange-traded funds) or otherwise. Private funds, such as venture capital funds and private equity funds, generally operate under exemptions from registration, which limit their accessibility to most retail investors.[129] Current liquidity and valuation requirements on open-end funds, the most popular fund type for retail investors,[130] present challenges to significant holdings in private companies.[131] Closed-end funds, such as interval funds and tender offer funds, issue shares that are not freely redeemable and thus not subject to the liquidity risk management rules of open-ended funds, making them better suited to hold interests in private companies.[132] However, they often trade at a discount to net asset value, contributing to their relative lack of popularity with investors.[133] Business development companies (BDCs)[134] and small business investment companies (SBICs)[135] are other types of funds that invest in private companies, but they may be more difficult for retail investors to gain exposure to in practice.[136]

Issues Raised

Any changes to the definition of "accredited investor" or to retail access to private markets will have dual impacts on investors' access to investment opportunities as well as the supply of capital to the exempt markets. Throughout our conversations in FY2019 on raising earlier stage capital from individual investors, whether from angels or friends and family, both businesses and investors have acknowledged the benefit of guardrails for retail investors, while also highlighting the imbalance of a single test based solely on income, net worth, or total assets. Women, minorities, and rural communities have expressed disproportionate challenges with the standard, which often draws a line between the investors' network and qualification for the most attractive offering exemptions.[137] The current standard arguably prioritizes an investor's ability to sustain the risk of loss without sufficient consideration of an investor's financial sophistication. Many have recommended creating avenues for sophisticated investors to participate in exempt offerings by adding alternative criteria for qualification.

In addition, investors—both accredited and non-accredited alike—have criticized their lack of access to high-growth potential companies in the private markets, who often trade on the public markets only after achieving most of their growth potential. Some have expressed frustration with the idea that "you have to be rich to get rich" under the current rules. For some accredited investors, they lack the time and resources to personally source, vet, and invest in a diversified portfolio of private companies that balances return potential with inevitable risk of failure of many early-stage businesses.

> "To the extent that companies decide not to go public due to anticipated regulatory burdens, regulatory policy may be unintentionally exacerbating wealth inequality in the United States by restricting certain investment opportunities to high income and high net worth investors.
>
> 2017 U.S. TREASURY REPORT[138]

Proposed Solution: Accredited Investor Refinement

Adding alternative measures for evaluating investor sophistication would further Congress's and the Commission's stated goals of facilitating capital formation while providing appropriate protections for investors. Additional qualifying pathways to individuals being accredited based upon sophistication in making investment decisions could include:

- financial professionals licensed by or registered with the SEC, state securities regulators, or appropriate self-regulatory organizations (e.g., FINRA); and
- attainment of designated financial industry examinations or licenses.

Any additional means of qualifying should provide companies, investors, and their advisors with simplicity and certainty in ascertaining qualification to avoid inadvertent increases in transaction costs and thereby costs of capital. Based upon the differential access to investors, varying costs of living, and corresponding income and net worth levels by geography, we note that increasing the base income and net worth thresholds would have a disproportionate impact in more rural and emerging entrepreneurial ecosystems, as well as on under-represented business owners and investors.

When updating the definition of accredited investor, it would further add simplicity and clarity to eliminate the list of enumerated entities that may qualify if such entity has over $5 million in assets[139] and instead make clear that any entity that has more than the asset threshold would qualify regardless of corporate form.

See also: Small Business Capital Formation Advisory Committee Recommendation,[140] former Advisory Committee on Small Business Capital Formation (ACSEC) Recommendation,[141] Harmonization Concept Release, 2019 Small Business Forum Report and historical reports,[142] 2017 Treasury Report.[143]

Proposed Solution: Retail Investor Access to Pooled Vehicles

Current fund rules allow investment companies to deploy limited strategies to invest in less liquid assets, such as private funds, as well as direct holdings in private companies. However, as the above-referenced data indicates, the current tool set is not well-utilized. Attention should be given to whether that underutilization is a byproduct of market preferences or whether the fund rules make those vehicles less attractive for fund formation, management and investment, with corresponding changes to the rules suggested. While the structure of public funds investing in private funds may be critiqued for a double-layer of management fees, reasonable fees may be justified where they afford investors asset management by professionals with experience in private markets, deal terms on parity with other sophisticated institutional investors, and an otherwise inaccessible diversified portfolio of private market holdings. Efficient fee structures should be prioritized in developing pooled vehicle solutions.

In addition, continued focus on retail investors' access to smaller funds—including those that invest primarily in smaller cap public companies, those with diversified positions including private holdings, as well as those focused on private market holdings—will further support competition and small business capital formation.[144]

See also: Small Business Capital Formation Advisory Committee Recommendation,[145] Committee on Capital Markets Regulation 2018 Report.[146]

Engaging Investors via Finders

Background

One of the biggest challenges that small businesses face when they seek to raise capital is identifying and connecting with potential investors who are a good fit from market/industry experience, risk tolerance, and investment capability perspectives. Sometimes companies, particularly those raising

The Office collaborates with female business owners on their national advocacy day in Washington, DC, answering questions about their challenges finding investors.

large amounts of capital pre-IPO, engage registered broker-dealers to line up a book of investors in exchange for a success or other fee. However, broker-dealers are increasingly concentrating their activity upstream in the market where they can offer a package of services, leaving companies seeking more routine introductions or relatively smaller amounts of capital (e.g., as one source noted, under $5 million[147]) without a connection to capital sources. Finders often bridge the gap between entrepreneurs who need funding and potential investors interested in supporting emerging companies by making introductions, often for a fee.[148] Finders may also provide businesses with support services, such as consulting on market deal terms or commentary on pitch materials, generally engaging in activities short of what many suggest should require registration as a broker-dealer.[149] Over the course of many decades and through a series of SEC no-action letters and case law, a nebulous distinction between finders and broker-dealers has emerged.[150] Many proposals have been put forward to provide clarity on where the line should be drawn between exempt finders, on the one hand, and full registration as a broker-dealer, on the other.[151]

Issues Raised

Locating the right investors is challenging no matter where a company is located, but that pain point is felt more acutely for entrepreneurs located far from the "hotspots" of VC and other funding sources where their network may not extend. Some demographic groups—namely women and minority business owners—have expressed that they face higher hurdles to connecting with funders based upon their network of potential investors who may not be accredited, often needing the support of finders to locate investors with the right investment capacity and risk tolerance. In short, the lack of clarity on the role for finders in matchmaking between companies and investors disproportionately impacts smaller companies, companies in geographic areas or segments of the market not served by registered broker-dealers, and companies with under-represented founders.

Proposed Solution: Clear Finders Framework

Small businesses and their investors need clarity on what role finders can play in providing services that fall short of requiring registration as a broker-dealer. Over the years, many potential solutions have been offered, from bright line exemptions to carve-outs for de minimus activity to "light" registration requirements.[152] In implementing a framework for finders to support emerging businesses' capital needs and provide clarity to investors participating in the market, it is critical that the rules be clear for marketplace participants to reduce confusion, defining in plain English the activities that do not trigger registration and delineating when the scope of activities rises to the level that registration is appropriate. The framework should make clear what offering exemptions are eligible, whether the introduced investors must be accredited, the nature of compensation the finder may receive, the types of other incidental activities that the finder may engage in on behalf of the business, and the respective roles of federal and state regulators. Providing a clear framework should bring welcomed transparency to an otherwise opaque area of the market.[153]

See also: 2019 Small Business Forum Report and historical reports,[154] ABA Report on Private Placement Broker-Dealers, ACSEC Finders Recommendation, 2017 Treasury Report.

Crowdfunding

Background

Crowdfunding—or the practice of raising capital in relatively small amounts from a large number of investors, typically over the internet—is one of the newest offering exemptions, with rules finalized by the SEC in 2015 following the Jumpstart Our Business Startups (JOBS) Act of 2012.[155] This mode of capital raising originated overseas[156] in the wake of the 2008 financial crisis because of the difficulty entrepreneurs and small businesses faced in raising funds.[157] In a nutshell: with traditional banks providing fewer loans to earlier stage companies, entrepreneurs began looking elsewhere for capital.[158] While some states had an intrastate crowdfunding framework prior to the JOBS Act, the equity crowdfunding industry did not take off until after the 2012 legislation and SEC rules that followed. Many online portals support companies raising capital through two different regulatory pathways that originated in the JOBS Act: (1) Regulation Crowdfunding under Title III (or Reg CF), which caps the offering at $1.07 million per year and includes other limitations on individual investments, and (2) Rule 506(c) general solicitation offerings to verified accredited investors, sometimes referred to as "accredited investor crowdfunding."[159] This section focuses on the Reg CF path for crowdfunding.

Further to the origins of the equity crowdfunding funding model, these offerings provide an alternative source of capital where community bank presence has waned. Some studies, as well as anecdotal evidence, have indicated that crowdfunding is boosting success in raising capital for certain demographics of entrepreneurs disproportionately to the rest of the entrepreneurial population, including women-owned, minority-owned, and rural businesses, as well as younger entrepreneurs.[160] These are populations of business owners who are notoriously underserved by traditional capital raising, such as through private placements to accredited investors.[161] In other words, crowdfunding may be bridging the gap between entrepreneurs without broad networks of high wealth investors and interested backers of their companies. Feedback to our Office indicates that the primary beneficiaries of crowdfunding investments are twofold:

1. businesses in communities where smaller or community banks are less accessible;[162] and
2. businesses with meaningful growth potential but who lack "venture returns" of 10x+, such as lifestyle, services, or retail businesses.

For businesses in the first group, they are often raising capital below the current $1.07 million Reg CF offering cap, many times from a loyal customer base. This may be reflected by the $25,000 median target amount sought by companies in Reg CF offerings,[163] where crowdfunding is filling the gap left by banks for small dollar loans. However, for businesses in the second group, the current offering cap has been described as a deterrent or hindrance to utilization of crowdfunding in the first place, with those companies needing significantly more capital than the $1.07 million cap permits.

The SEC published its three-year lookback report in May 2019[164] examining utilization of the nascent Reg CF exemption, showing modest adoption rates, which may be in part driven by some of the limitations flagged by companies, portals, and investors.

The Office hosts "Capital Formation Between the Coasts" roundtable focused on experiences of businesses and investors raising capital, including through crowdfunding, and investing outside of coastal "hot spots" to kick off National Small Business Week.

Issues Raised

Users of crowdfunding have flagged various issues with the framework as designed by both statute and regulation. The current constructs may unduly limit investor interest in participation. Company appetite for compliance costs relative to the available proceeds may point them towards offering types with lower compliance costs. Contrasted with their foreign counterparts, companies are raising more capital overseas using crowdfunding in an arguably more efficient manner.[165] Portals, many of which are small businesses themselves that have raised capital to fund initial operations, have flagged the challenges they face with profitability of their business model given the limitations on equity compensation[166] and the high costs of compliance, which may push portals to redirect their focus to other vibrant overseas crowdfunding markets or to other more profitable segments of the domestic market.

Proposed Solutions: Crowdfunding Updates

Changes to the current structure and requirements for Reg CF would enable companies and investors to use equity crowdfunding to its fullest potential. Potential solutions include:

- Increase the total amount that companies can raise in a 12-month period from the current $1.07 million to better align with early-stage companies' evolving capital needs,[167] as well as international practices.[168] Trends are showing that Series A is "the new" seed funding, as companies seek increased capital to fund early-stage operations (e.g., in 2018 the average seed funding was $5.7 million and average Series A round was $15.7 million, compared with 2010 averages of $1.3 million for seed and $5.1 million for Series A[169]). An increased cap would allow companies to raise meaningful early-stage capital using crowdfunding rather than limiting companies' options to a narrower set of exemptions.

- Remove the investment cap for accredited investors, which would harmonize the crowdfunding rules with Regulations A and D, neither of which limit investment amounts by accredited investors.
- Reevaluate the thresholds for the various disclosure obligations, such as reviewed and audited financials, to appropriately tier to the capital raised and the costs incurred by companies at investors' expense. For example, reporting requirements could be simplified for companies raising under $250,000.
- Enable the use of special purpose vehicles (or SPVs), which would have the potential benefits of cleaning up the cap tables for companies, making them more attractive to follow-on investors and mitigating Rule 12(g) threshold concerns, and streamlining management of investor rights, potentially providing a more impactful voice for investors and providing companies with a more engaged investor for strategic support.
- Reevaluate the compliance requirements for portals as well as permissible types of compensation, such as increasing flexibility for equity compensation.

See also: Small Business Capital Formation Advisory Committee Recommendation,[170] Association of Online Investment Platforms Policy Paper,[171] 2017 Treasury Report, 2019 Small Business Forum Report and historical reports.[172]

Scaled Obligations for Smaller, Less Complex Reporting Companies

Background

The U.S. securities laws allow companies to access the public markets in exchange for disclosures to investors about relevant financial and operating information. Over the years, the disclosure obligations of public companies have evolved and substantially increased in breadth. In addition to the costs of *going* public, which cost most companies over $1 million, companies incur significant ongoing compliance costs for *being* public.[173] In one survey, two-thirds of CFOs estimated spending $1 million to $1.9 million annually for ongoing compliance costs, allocated among auditing fees (32%), financial reporting (18%), legal costs (16%), regulatory compliance (12%), public and investor relations (9%), and various other expenses.[174] These costs are separate from the staffing needs of companies to implement compliance. Put simply, the reporting compliance costs—

The Office engages in a fireside chat discussion about the issues faced by small reporting companies and their investors at the New York Stock Exchange.

in addition to the increased costs of potential shareholder litigation—are costs unique to public companies that are not borne by private companies on a comparable scale.

Issues Raised

In discussing the decision to remain private or to embark upon an IPO, many investors and companies—particularly those who are smaller—have pointed towards balancing allocation of resources to compliance obligations versus funding innovation at scale.[175] When weighing the potential costs of public company compliance, the impact of those obligations often has a relatively greater resource-constraining effect on smaller entities, many of whom lack the complexity both organizationally and financially that many of the compliance rules were drafted to address. This debate among marketplace participants on striking the right balance has occurred concurrently with concerns over the waning entrance of smaller public companies in recent years.[176]

> "Well-intentioned regulations aimed at protecting the public from the misrepresentations of a small number of large companies have unintentionally placed significant burdens on the large number of smaller companies. As a result, fewer high-growth entrepreneurial companies are going public and more are opting to provide liquidity and an exit for investors by selling out to larger companies. This hurts job creation, as the data clearly shows that job growth accelerates when companies go public, but often decelerates when companies are acquired.
>
> PRESIDENT OBAMA'S COUNCIL ON JOBS AND COMPETITIVENESS (OCT. 2011)[177]

Proposed Solution: Continued Scaling Obligations

Congress and the Commission have recently taken actions to streamline the pathways for growing companies to access the public markets without unnecessary compliance burdens swaying companies' and their investors' decision to remain private.[178] Recently, the SEC has embarked upon a series of rulemakings aimed at improving disclosures for investors while simplifying compliance for companies, with many of the changes aimed at improving the readability of disclosure documents and reducing repetition or disclosure of information that is not material.[179] Many recent amendments to the rules emphasize a principles-based approach, reflecting the evolution of businesses and the philosophy that a one-size-fits-all approach can be both under and over-inclusive. The Office encourages Congress and the Commission to continue to tailor the disclosure and reporting framework to scale the obligations of reporting companies to the complexity and scale of operations in furtherance of capital formation and appropriate investor protection.

See also: 2017 Treasury Report, 2019 Small Business Forum Report and historical reports.[180]

Small Business Capital Formation Advisory Committee FY 2019 Summary

The Small Business Advocate Act also established the SEC's new Small Business Capital Formation Advisory Committee,[181] which replaced the SEC's former Advisory Committee on Small and Emerging Companies. The new Advisory Committee is designed to provide a formal mechanism for the Commission to received advice and recommendations on Commission rules, regulations, and policy matters related to emerging, privately held small businesses to publicly traded companies with less than $250 million in public market capitalization; trading in securities of such companies; and public reporting and corporate governance of such companies. The Office provides administrative support for the Advisory Committee, which otherwise functions independently.

In April 2019, the Commission appointed the inaugural members of the Advisory Committee.[182] The membership includes companies and investors from across a diverse set of experiences, industries, geographies, and company life cycle stages.

CARLA GARRETT, *Chair*
Corporate Partner, Potomac Law Group PLLC
Washington, DC

JEFFREY M. SOLOMON, *Vice Chair*
Chief Executive Officer, Cowen, Inc.
New York, NY

GREGORY YADLEY, *Secretary*
Partner, Shumaker, Loop & Kendrick, LLP
Tampa, FL

YOUNGRO LEE, *Assistant Secretary*
CEO and Co-Founder, NextSeed
Houston, TX

GREG DEAN*
Senior Vice President of the Office of Government Affairs, FINRA
Washington, DC

ROBERT FOX
National Managing Partner, Professional Standards Group, Grant Thornton LLP
Chicago, IL

STEPHEN GRAHAM
Co-Chair, Fenwick & West LLP's Life Sciences Practice
Seattle, WA

SARA HANKS
CEO and Co-Founder, CrowdCheck, Inc.
Alexandria, VA

BRIAN LEVEY
Chief Business Affairs and Legal Officer, Upwork Inc.
Santa Clara, CA

TERRY MCNEW
President and CEO, MasterCraft Boat Holdings
Vonore, TN

SAPNA MEHTA
General Counsel & Chief Compliance Officer, Rise of the Rest Seed Fund; Associate General Counsel, Revolution
Washington, DC

MARTHA LEGG MILLER*
Director, Office of the Advocate for Small Business Capital Formation, U.S. Securities & Exchange Commission
Washington, DC

KAREN G. MILLS
President, MMP Group, Inc.
Boston, MA

CATHERINE MOTT
Founder and CEO of BlueTree Capital Group, BlueTree Allied Angels, and BlueTree Venture Fund
Pittsburgh, PA

POORVI PATODIA
CEO and Founder, Biena Snacks
Allston, MA

MICHAEL S. PIECIAK*
Commissioner of the Vermont Department of Financial Regulation
Montpelier, VT

JASON SEATS
Chief Investment Officer, Techstars
Austin, TX

MARC OORLOFF SHARMA*
Chief Counsel of the Office of the Investor Advocate, U.S. Securities & Exchange Commission
Washington, DC

JOSEPH SHEPHERD*
Associate Administrator, U.S. Small Business Administration
Washington, DC

HANK TORBERT
President, AltaMax, LLC
New Orleans, LA

*Advisory Committee members include the SEC's Advocate for Small Business Capital Formation and three non-voting members appointed by each of the SEC's Investor Advocate, the North American Securities Administrators Association (NASAA), and the Small Business Administration, as well as an observer appointed by the Financial Industry Regulatory Authority (FINRA).

The Advisory Committee held its inaugural meeting on May 6, 2019 during National Small Business Week and its second meeting on August 13, 2019 in Omaha, Nebraska. During the fiscal year, the Advisory Committee put forward two recommendations[183] to the Commission.

RECOMMENDATION RE: COMMISSION'S PROPOSAL TO AMEND FINANCIAL DISCLOSURE REQUIREMENTS RELATING TO ACQUISITIONS AND DISPOSITIONS OF BUSINESSES

August 23, 2019

The Committee supports the Commission's proposal to amend the financial reporting requirements for the acquisitions and dispositions of businesses including Rules 3-05, 3-14, and Article 11 of Regulation S-X, subject to following recommendations:

- That the Commission continue to look at Regulation A companies and whether they warrant different treatment under these rules; and
- That the Commission further look at the proposed amendments to the pro forma financial information requirements with respect to whether the proposed addition of Management's Adjustments, which are intended to reflect reasonably estimable synergies and transaction effects, should be optional or not required at all.

Specifically,

- The Committee supports the proposed amendments to the Significance Tests under these rules by:
  - Revising the Income Test to include the addition of a revenue component, such that the registrant must exceed both the revenue and net income components; and
  - Revising the Investment Test to change the denominator of the Investment Test from the registrant's total assets to the registrant's fair market value.
- The Committee supports the proposed amendment that would require financial statements of the acquired business to cover up to the two most recent fiscal years rather than up to the three most recent fiscal years.

COMMISSION RESPONSE

As indicated on the Fall 2019 Unified Agenda of Federal Regulatory and Deregulatory Long-term Actions (Fall 2019 Unified Agenda),[184] the Division of Corporation Finance is considering recommending that the Commission adopt amendments to Regulation S-X (Rule 3-05) that affect the disclosure of financial information of acquired businesses. Staff in the Division of Corporation Finance will consider this Advisory Committee recommendation in connection with this initiative.

[Top left] Members of the SEC's Small Business Capital Formation Advisory Committee discuss capital formation initiatives at the Committee's inaugural meeting on May 6, 2019.

[Top right] Members Catherine Mott and Jason Seats discuss recent Commission rulemakings.

[Center left] Chair Carla Garrett and Vice-Chair Jeff Solomon lead the Committee in the development of recommendations at the Committee's meeting.

[Center right] Members Youngro Lee and Bert Fox engage in discussion with other Committee members.

[Right top] Member Hank Torbert weighs in on recommendations with experience from his business operations.

[Right bottom] Members of the Advisory Committee met at Creighton University in Omaha, NE on August 13, 2019.

RECOMMENDATION RE: COMMISSION'S PROPOSAL TO AMEND THE ACCELERATED AND LARGE ACCELERATED FILER DEFINITIONS

August 23, 2019

The Committee supports the proposal to amend the "accelerated filer" and "large accelerated filer" definitions such that an issuer that is eligible to be a Smaller Reporting Company and has less than $100 million in revenue in the most recent fiscal year shall be a non-accelerated filer.

However, the Committee would welcome the Commission to explore additional further amendments to the definitions of "accelerated filer" and "large accelerated filer" such that more companies could be non-accelerated filers. The Committee's recommendations include:

- Exploring raising the revenue threshold to be a non-accelerated filer, so that issuers that are eligible to be a Smaller Reporting Company and have more than $100 million in revenues could be a non-accelerated filer.
- Instead of basing revenues for the non-accelerated filer test on the amount of revenues in the most recent fiscal year, base the revenues for the non-accelerated filer test on the three-year rolling average of the amount of the company's revenues.
- Looking at whether all Smaller Reporting Companies should be non-accelerated filers.

The Commission should also consider input from institutional investors regarding whether or not the auditor attestation of SOX 404(b) is determinative in their investment decision.

COMMISSION RESPONSE

As indicated on the Fall 2019 Unified Agenda,[185] the Division of Corporation Finance is considering recommending that the Commission adopt changes to the "accelerated filer" definition in Exchange Act Rule 12b-2 that would have the effect of reducing the number of registrants that are subject to the Sarbanes-Oxley Act Section 404(b) attestation requirement. Staff in the Division of Corporation Finance will consider this Advisory Committee recommendation in connection with this initiative.

END NOTES

1 *See, e.g.*, *Last Week Tonight with John Oliver*, https://www.youtube.com/watch?v=XkLXMH-YLTAY.

2 The Office was established pursuant to sections 4(j) and 40 of the Securities Exchange Act of 1934 (15 U.S.C. §§ 78d and 78qq), as added by the SEC Small Business Advocate Act of 2016 (P.L. 114-284) and amended by the Small Business Access to Capital after a Natural Disaster Act (title IX of division S of Public Law 115-141). *See* https://www.sec.gov/files/Small%20Business%20Advocate%20Act%20of%202016-as%20amended.pdf

3 *See* https://www.sec.gov/files/2019%20OASB%20Business%20Plan.pdf.

4 The legislation that created the Office also established a Small Business Capital Formation Advisory Committee at the SEC. *See* 15 U.S.C. §78qq. The Office uses the Committee's parameters to define the scope of small businesses that it serves.

5 *See supra* note 3.

6 *See id*.

7 *See* https://www.state.gov/global-entrepreneurship-summits/; *see also* https://www.sec.gov/secs-small-business-advocate-meets-midwest-entrepreneurs.

8 Introductory remarks published at https://www.sec.gov/news/speech/speech-miller-032019; *see also https://www.sec.gov/secs-small-business-advocate-meets-midwest-entrepreneurs*.

9 Remarks published at https://www.sec.gov/news/speech/miller-bolstering-capital-formation-040819.

10 *See supra* note 3.

11 *See* https://www.sec.gov/about/offices/oia/oia_institutes.htm.

12 *See* http://cle.cobar.org/securities-conference/.

13 *See* https://www.sec.gov/page/capital-formation-between-coasts.

14 Remarks published at https://www.sec.gov/news/speech/speech-miller-060419.

15 Opening remarks published at https://www.sec.gov/news/public-statement/statement-miller-081419.

16 Remarks and slide deck published at https://www.sec.gov/news/speech/sec-office-advocate-small-business-capital-formation-long-title-big-mission.

17 *See* https://usblackchambers.org/conference/.

18 *See* https://www.sec.gov/page/small-business-capital-formation-runs-deep-arkansas.

19 *See* https://www.ruralrise.org/; *see also* https://www.sec.gov/page/small-business-capital-formation-runs-deep-arkansas.

20 https://www.theice.com/insights/conversations/inside-the-ice-house/a-champion-for-small-businesses-in-washington.

21 *See*, *e.g.*, Amy Balliett, "The 5 Most Engaging Types of Marketing Content," *Inc.* (Apr. 15, 2019), https://www.inc.com/amy-balliett/5-types-of-content-your-audiences-will-love.html.

22 *See* https://www.sec.gov/page/oasb-videos.

23 The SEC conducts the Forum annually and prepares a report in accordance with the Small Business Investment Incentive Act of 1980 [15 U.S.C. 80c-1 (codifying section 503 of Pub. L. No. 96-477, 94 Stat. 2275 (1980))].

24 This graphic depicts amounts reported or estimated as raised from July 1, 2018 through June 30, 2019. Data on offerings under Regulations D and Crowdfunding is based on information reported by companies and was collected from filings (new filings and amendments) on EDGAR on Forms D and C, respectively. Data on registered offerings was collected from Thomson Financial's SDC Platinum database. For offerings under Regulation A, estimates are based on proceeds reported in filings made during the report period. Capital raised is based on information reported by companies in Forms 1-Z, 1-K, 1-SA, 1-U, and offering circular supplements pertaining to completed and ongoing Regulation A offerings and post-qualification amendments, and for companies whose shares have become exchange-listed, information from other public sources. Estimates represent a lower bound on the amounts raised given the time frames for reporting proceeds following completed or terminated offerings and that offerings qualified during the report period may be ongoing. For the offerings that permit pooled investment funds, such as Rule 506(b) and (c) of Regulation D and registered offerings, the data includes offerings conducted by pooled investment funds. We do not yet have data to provide an estimated amount raised under Section 4(a)(2) of the Securities Act or transactions occurring under Rule 144A for the period under consideration.

25 Data for public offerings includes international companies.

26 17 C.F.R. § 227.100 *et seq.*; *see* https://www.sec.gov/smallbusiness/exemptofferings/reg-crowdfunding.

27 17 C.F.R. § 230.504; *see* https://www.sec.gov/smallbusiness/exemptofferings/rule504.

28 Securities Act of 1933 § 3(a)(11), 17 C.F.R. § 230.147, and 17 C.F.R. § 230.147A; *see* https://www.sec.gov/smallbusiness/exemptofferings/intrastateofferings.

29 17 C.F.R. § 230.506(b); *see* https://www.sec.gov/smallbusiness/exemptofferings/rule506b.
30 17 C.F.R. § 230.506(c); *see* https://www.sec.gov/smallbusiness/exemptofferings/rule506c.
31 17 C.F.R. § 230.251 *et seq.*; *see* https://www.sec.gov/smallbusiness/exemptofferings/rega.
32 15 U.S.C. § 77a, *et seq.*; *see* https://www.sec.gov/smallbusiness/goingpublic.
33 This graphic presents capital raised in registered, Regulation D and Regulation A offerings across the top six industries from July 1, 2018 through June 30, 2019. Offerings by non-pooled investment funds in other industries accounted for approximately $217 billion, $45 billion and $37 million in registered, Regulation D and Regulation A offerings, respectively. Regulation A and registered offerings were classified into industry groups based on the primary SIC code reported by the company. Industry groups were self-reported by companies on Form D. Differences in data sources and definitions may limit the comparability of industry data. Offerings by pooled investment funds, which accounted for approximately $26 billion and $1.38 trillion in registered offerings and Regulation D, respectively, are excluded from this table. *See* note 24 for a description of how these amounts were reported or estimated.
34 The maps included in this section depict the amounts reported or estimated as raised by issuers, including pooled investment funds that report a primary location in the U.S., including U.S. territories, from July 1, 2018 through June 30, 2019. *See* note 24 for a description of how these amounts were reported or estimated.
35 The Board of Governors of the Federal Reserve System, "Small Business Credit Survey: 2019 Report on Employer Firms" (2019), https://www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2019/sbcs-employer-firms-report.pdf.
36 *Id.*
37 Board of Governors of the Federal Reserve System, "Report to the Congress on the Availability of Credit to Small Businesses" (Sep. 2017) at 1, https://www.federalreserve.gov/publications/files/sbfreport2017.pdf.
38 Federal Deposit Insurance Corporation, "FDIC Community Banking Study Reference Data" (updated August 19, 2019), https://www.fdic.gov/regulations/resources/cbi/data.html.
39 Karen G. Mills, *Fintech, Small Business & The American Dream*, Palgrave Macmillan (2018) at 52.
40 Brad Feld and Jason Mendelson, *Venture Deals: Be Smarter Than Your Lawyer and Venture Capitalist*, John Wiley & Sons, Inc. (4th ed. 2019) at 149.
41 Mills, *supra* note 39, at 7.
42 Originally the term "angel" was used to describe patrons of Broadway Theater who provided money to support theatrical productions.
43 *See* Angel Capital Association, "FAQs for Angels and Entrepreneurs" (accessed Oct. 29, 2019), https://www.angelcapitalassociation.org/faqs/; *see also* Jason Rowley, "Where Venture Capitalists Invest and Why," *TechCrunch* (Nov. 9, 2017), https://techcrunch.com/2017/11/09/local-loyalty-where-venture-capitalists-invest-and-why/.
44 Feld and Mendelson, *supra* note 40, at 113.
45 *See* Jeffrey Sohl, "The Angel Market in 2018: More Angels Investing in More Deals at Lower Valuations", *Center for Venture Research* (May 9, 2019), https://www.icoast.com/news/2019/08/01/2investornews/the-angel-market-in-2018-more-angels-investing-in-more-deals-at-lower-valuations/.
46 Angel Capital Association, *supra* note 43; *see also* Marianne Hudson, "In-Depth Angel Investor Survey Sheds Light On Angel Success," *Forbes* (Dec. 1, 2017), https://www.forbes.com/sites/mariannehudson/2017/12/01/in-depth-angel-investor-survey-sheds-light-on-angel-success/.
47 Concept Release on Harmonization of Securities Offering Exemptions, Release No. 33-10649 (June 18, 2019), https://www.sec.gov/rules/concept/2019/33-10649.pdf at Table 3 ("Harmonization Concept Release"). The underlying household data for this analysis was obtained from the Federal Reserve Board's Survey of Consumer Finances for 2016, https://www.federalreserve.gov/econresdata/scf/scfindex.htm.
48 *See* 17 U.S.C. § 230.501(a); *see also* "Investor Participation in Private Offerings" section below.
49 *See* Harmonization Concept Release at Table 4.
50 *See* Feld and Mendelson, *supra* note 40, at 265.
51 *See* Harmonization Concept Release at note 47. As a comparison point, during the same four-year period, non-accredited investors were reported as participating in over 60% of the Rule 504 offerings. *See* Harmonization Concept Release at note 264. Rule 504 permits companies to raise up to $5 million in a 12-month period from an unlimited number of investors (without regard to whether or not those investors are accredited).
52 Ewing Marion Kauffman Foundation, "State of Entrepreneurship 2017 | Zero Barriers: Three Mega Trends Shaping the Future of Entrepreneurship" (2017) at 22, https://www.kauffman.org/what-we-do/resources/state-of-entrepreneurship-addresses/2017-state-of-entrepreneurship-address.
53 Feld and Mendelson, *supra* note 40, at 14.

54 PitchBook-NVCA, "2Q 2019 Venture Monitor" (Jul. 10, 2019) at 6, https://nvca.org/research/pitchbook-nvca-venture-monitor/.
55 *Id*.
56 *See* Ewing Marion Kauffman Foundation, "The State of Capital Access for Entrepreneurs: From Barriers to Potential" (Feb. 5, 2019), https://www.kauffman.org/-/media/kauffman_org/entrepreneurship-landing-page/capital-access/capital_access_lab_exec_summary_final.pdf
57 Pitchbook, "Private Markets: A Decade of Growth" (Jul. 19, 2019), https://pitchbook.com/news/reports/3q-2019-pitchbook-private-markets-a-decade-of-growth.
58 *Id*.
59 Bhandari, Ryan, "The Opportunity Fund," *Third Way* (Jul. 9, 2019), https://www.thirdway.org/report/the-opportunity-fund, citing Rebel A. Cole, Douglas J. Cumming, and Dan Li, "Do Banks or VCs Spur Small Firm Growth?" *Journal of International Financial Markets, Institutions and Money* (Mar. 2016) at 41, 60-72, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2684049. "Small employer," for purposes of this study, was defined as firms with 5-19 employees.
60 Pitchbook, *supra* note 57.
61 *Id*.
62 Committee on Capital Markets Regulation, "Expanding Opportunities for Investors and Retirees: Private Equity" (Nov. 2018), https://www.capmktsreg.org/wp-content/uploads/2018/10/Private-Equity-Report-FINAL-1.pdf.
63 *See*, *e.g.*, McKinsey & Company, "McKinsey Global Private Markets Review 2019" (Feb. 2019) at 11, https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/mckinseys-private-markets-annual-review.
64 PitchBook-NVCA, *supra* note 54, at 13 (Q&A with Sulu Mamdani, Managing Partner, SVB Capital).
65 *Id*.
66 Pitchbook, *supra* note 57.
67 *Id*.
68 *Id*.
69 *See* World Bank Group Open Data, https://data.worldbank.org/indicator/CM.MKT.LDOM.NO?locations=US.
70 *See*, *e.g.*, Committee on Capital Markets Regulation, *supra* note 62; Michael Ewens and Joan Farre-Mensa, "The Deregulation of the Private Equity Markets and the Decline in IPOs," *National Bureau of Economic Research* (Sep. 2019 working paper) at 3.
71 *See, e.g.*, "Expanding the On-Ramp: Recommendations to Help More Companies Go and Stay Public" (Apr. 2018) at 5-6, https://nvca.org/wp-content/uploads/2018/04/Expanding-The-On-Ramp-Recommendations-to-Help-More-Companies-Go-and-Stay-Public.pdf.
72 Data registered offerings was collected from Thomson Financial's SDC Platinum database.
73 Small public companies include public companies with a size less than or equal to $250 million on the date of the offering, calculated by multiplying price of the company's stock at the close of the day of the offering by the number of outstanding shares on the day of the offering. Data from the Center for Research in Securities Prices (CRSP) and Dealogic were used to fill in missing information from SDC Platinum. Mutual funds and Closed-end funds are excluded from the statistics. Those companies with missing a stock price on the offering day or number of outstanding shares are not included in the statistics.
74 "Expanding the On-Ramp," *supra* note 71, at 5-6.
75 *Id*.
76 Matt Levine, "The Unicorn Stampede is Coming," *Bloomberg* (Mar. 22, 2019), https://www.bloomberg.com/opinion/articles/2019-03-22/the-unicorn-stampede-is-coming.
77 Ewing Marion Kauffman Foundation, "Data Show that Gender-Inclusive Founding Teams Have Greater Success in Fundraising and Innovation" (Oct. 3, 2019), https://www.kauffmanfellows.org/journal_posts/data-show-that-gender-inclusive-founding-teams-have-greater-success-in-fundraising-and-innovation.
78 Kauffman Foundation, *supra* note 56 (citing 2004 figures).
79 *Id*.
80 Sohl, *supra* note 45.
81 Emma Hinchcliffe, "Funding For Female Founders Stalled at 2.2% of VC Dollars in 2018," *Fortune* (Jan. 28, 2019), https://fortune.com/2019/01/28/funding-female-founders-2018/.
82 *See* Katie Abouzahr, *et. al.*, "Why Women-Owned Startups Are a Better Bet," *Boston Consulting Group* (Jun. 6, 2018), https://www.bcg.com/en-us/publications/2018/why-women-owned-startups-are-better-bet.aspx.
83 *See* H. Waverly Deutsch, *et al.*, "The State of LGBT Entrepreneurship in the U.S.," *StartOut* (Jul. 2016), https://startout.org/wp-content/uploads/2018/03/State_of_LGBT_Entrepreneurship.pdf.
84 Sohl, *supra* note 45.

85 Rebecca Kaden, "How VC Can Help More Women Get Ahead," *Harvard Business Review* (Oct. 1, 2019), https://hbr.org/2019/10/how-vc-can-help-more-women-get-ahead; *compare* Deloitte University Leadership Center for Inclusion, "NVCA-Deloitte Human Capital Survey," 2nd ed. (June 2019), https://www2.deloitte.com/us/human-capital-survey-2nd-edition (copyright Deloitte) (citing survey data that 45% of the workforce at VC firms are women, accounting for 21% of all investment professionals and 14% of investment partners).
86 Kaden, *supra* note 85.
87 U.S. Minority Business Development Agency, "Fact Sheet: U.S. Minority-Owned Firms" (Jan. 2016), https://www.mbda.gov/sites/mbda.gov/files/migrated/files-attachments/2012SBO_MBE-FactSheet020216.pdf.
88 *Id.*
89 *Id.*
90 *Id.*
91 U.S. Minority Business Development Agency, "The Minority Business Development Agency: Vital to Making America Great" (Dec. 20, 2018), https://www.mbda.gov/page/minority-business-development-agency-vital-making-america-great.
92 Kauffman Foundation, *supra* note 56.
93 Sohl, *supra* note 45.
94 Kauffman Foundation, *supra* note 56.
95 Federal Reserve Bank of New York, Stanford Graduate School of Business, Latino Entrepreneurship Initiative, and Interise, "Latino-Owned Businesses: Shining a Light on National Trends" (Nov. 2018), https://www.newyorkfed.org/medialibrary/media/smallbusiness/2017/Report-on-Latino-Owned-Small-Businesses.pdf.
96 RateMyInvestor, Diversity in U.S. Startups, https://ratemyinvestor.com/pdfjs/full?file=%2F-DiversityVCReport_Final.pdf (data in the report covered the period from January 2013 to December 2017).
97 Sohl, *supra* note 45.
98 Deloitte University Leadership Center for Inclusion, *supra* note 85.
99 Federal Emergency Management Agency (FEMA), "Hurricane Ready Business Toolkit" (Nov. 15, 2017), https://www.fema.gov/media-library/assets/documents/152381.
100 Federal Reserve Banks, "2017 Small Business Credit Survey: Report on Disaster-Affected Firms" (2017), https://www.fedsmallbusiness.org/survey/2018/report-on-disaster-affected-firms.
101 Data from U.S. Census Bureau, American Community Survey (ACS) was used to estimate the population in zip codes affected by the natural disasters as described in *infra,* note 102. However, certain zip codes were identified as missing population values, so 27% is likely underestimated.
102 Zip codes designated as affected are defined as having one or more residents approved for assistance under FEMA's IHP program for natural disasters with classifications of Major Disaster Declaration and incident start dates between July 1, 2016 and June 30, 2019.Given the trailing impact caused by natural disasters, each zip code affected in that three year period was included. Classification of disaster areas are based on Disaster Declaration Summaries data at https://www.fema.gov/api/open/v1/DisasterDeclarationsSummaries.csv, and FEMA Housing Assistance Program Data at https://www.fema.gov/media-library/assets/documents/34758. The classification method for disaster areas is based on the methodology in the "*2017 Small Business Credit Survey – Report on Disaster-Affected Firms*", Federal Reserve Banks of Dallas, New York, Richmond, and San Francisco at https://www.newyorkfed.org/medialibrary/media/smallbusiness/2017/SBCS-Report-on-Disaster-Affected-Firms.pdf.
103 Evaluated from July 1, 2016 to June 30, 2019 using zip codes affected by natural disasters as described in *supra* note 102.
104 National Bureau of Economic Research, "The Effect of Natural Disasters on Economic Activity in US Counties: A Century of Data" (Jun. 2019), https://www.nber.org/papers/w23410.
105 U.S. Census Bureau, ACS, "Understanding and Using American Community Survey Data: What Users of Data for Rural Areas Need to Know", Section 1 (July 2019) at https://www.census.gov/content/dam/Census/library/publications/2019/acs/ACS_rural_handbook_2019_ch01.pdf ("Data from the ACS indicate that about 61 million people, or 19 percent of the population, lived in rural areas of the United States in 2016.").
106 Federal Reserve, *supra* note 35.
107 Classification of rural areas are based on the list of 2015 Q4 rural area zip codes from the Center for Medicare & Medicaid Services at https://www.cms.gov/Medicare/Medicare-Fee-for-Service-Payment/DMEPOSFeeSched/DMEPOS-Fee-Schedule-Items/DME-Rural-Zip-and-Formats.html?DLPage=1&DLEntries=10&DLSort=2&DLSortDir=descending.
108 Kauffman Foundation, *supra* note 52, at 21; U.S. Census, "How Does the U.S. Census Bureau Define 'Rural?'" at https://gis-portal.data.census.gov/arcgis/apps/MapSeries/index.html?appid=7a41374f6b03456e9d138cb014711e01#map; *See also* https://www.census.gov/population/censusdata/urpop0090.txt.
109 *See* National Community Reinvestment Coalition, "Final Report: Access to Capital and Credit in Appalachia and the Impact of the Financial Crisis and Recession on Commercial Lending and Finance in the Region" (Jul. 2013)

(report prepared for Appalachian Regional Commission), https://www.arc.gov/assets/research_reports/AccessToCapitalAndCreditInAppalachia-July2013.pdf.

110 Ruth Simon and Coulter Jones, "Goodbye, George Bailey: Decline of Rural Lending Crimps Small-Town Business," *Wall Street Journal* (Dec. 25, 2017), https://www.wsj.com/articles/goodbye-george-bailey-decline-of-rural-lending-crimps-small-town-business-1514219515.

111 Rural Policy Research Institute, "Access to Capital in Rural America: Supporting Business Startup, Growth and Job Creation, Insights from the Field and Policy Recommendations" (Oct. 2012), http://www.rupri.org/Forms/CapitalMarkets_FieldInsights.pdf.

112 Patricia Scruggs, Wayne Embree, and Rob Wiltbank, "Wealth Creation in Rural Communities: The Role of Equity Capital in Rural Communities" (Feb. 2009), https://community-wealth.org/sites/clone.community-wealth.org/files/downloads/report-scruggs-et-al.pdf.

113 *See* Office of Information and Regulatory Affairs, Office of Management and Budget, "Fall 2019 Unified Agenda of Regulatory and Deregulatory Active Actions in Prerule, Proposed Rule and Final Rule Stages by the Securities and Exchange Commission," https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=3235&Image58.x=44&Image58.y=11. Active regulatory actions are likely to occur in the next 12 months after publication of the Fall 2019 Unified Agenda. *See* Office of Information and Regulatory Affairs, Office of Management and Budget, "Fall 2019 Unified Agenda of Federal Regulatory and Deregulatory Long-term Actions by the Securities and Exchange Commission," https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPubId=201904&showStage=longterm&agencyCd=3235&Image58.x=33&Image58.y=11. Long-term Actions are items under development but for which regulatory action is not expected within 12 months after publication of the Fall 2019 Unified Agenda.

114 *See* "State of Small Business Capital Formation" section above.

115 Conflicts include when non-accredited investors may participate, investment or offering limits, when general solicitation may be used, and the particular itemized disclosure requirements under each of the exemptions, including Regulation A, Rules 504, 506(b) and 506(c) of Regulation D, and Regulation Crowdfunding.

116 *See* "State of Small Business Capital Formation" section above.

117 For example, regulatory uncertainty has been cited as a possible explanation for the relatively low levels of utilization of Rule 506(c) offerings using general solicitation. *See* Harmonization Concept Release at Section II.B.2.f.

118 *See, e.g.,* SEC Release No. 33-97 (Dec. 28, 1933).

119 *See, e.g.*, Final Report of the 2016 SEC Government-Business Forum on Small Business Capital Formation (Mar. 2017), https://www.sec.gov/info/smallbus/gbfor35.pdf ("2016 Small Business Forum Report"); Final Report of the 2017 SEC Government-Business Forum on Small Business Capital Formation (Mar. 2018), https://www.sec.gov/files/gbfor36.pdf ("2017 Small Business Forum Report").

120 *See* Harmonization Concept Release, which solicits comment on the exempt offering framework generally as well as each of the following topics: accredited investor definition, private placement exemption and Rule 506 of Regulation D, Regulation A, limited offerings under Rule 504 of Regulation D, intrastate offerings, Regulation Crowdfunding, integration, pooled investment funds, and the secondary trading of certain securities.

121 *See* "Launch of Video Content" section above.

122 Currently offering caps exist under Rule 504 under Regulation D ($5 million), Regulation Crowdfunding ($1.07 million), and Regulation A ($20 million for Tier 1 and $50 million for Tier 2). Each cap has been subject to critiques and calls for amendment, and some are subject to periodic review requirements by the Commission.

123 *See* Linda C. Quinn, *Reforming the Securities Act of 1933: A Conceptual Framework*, 10 Insights 25 (Jan. 1996), https://www.sec.gov/info/smallbus/acsec/reformingsa33.pdf.

124 *See* Small Business Capital Formation Advisory Committee, Recommendation Regarding Harmonization General Principles (Dec. 13, 2019), https://www.sec.gov/spotlight/sbcfac/recommendation-harmonization-general-principles.pdf. This recommendation was adopted by the Advisory Committee in FY2020 and is not included in the summary of FY2019 activities of the committee.

125 *See, e.g.*, Regulation D Revisions; Exemption for Certain Employee Benefit Plans, Release No. 33-6683 (Jan. 16, 1987) [52 FR 3015 (Feb. 2, 1987)] at note 6; *see also* Amendments for Small and Additional Issues Exemptions under the Securities Act (Regulation A), Release No. 33-9741 (March 25, 2015) [80 FR 21805 (April 20, 2015)] at note 146.

126 Small Business Incentive Act of 1980, Pub. L. No. 96-477, § 602, 94 Stat. 2275 (1980). *See also* 15 U.S.C. § 77b(a)(15).

127 S. Rep. No. 96-958, at 12 (1980).
128 17 C.F.R. § 230.501(a).
129 For further discussion, *see* Harmonization Concept Release at Section IV.A.2.
130 Mutual funds make up 56% of defined contribution retirement accounts and 45% of individual retirement account assets. *See* Investment Company Institute, "2019 Investment Company Fact Book" (Apr. 2019) at 34, https://www.ici.org/pdf/2019_factbook.pdf.
131 *See, e.g.*, 17 CFR 270.22e-4 (liquidity risk management programs); *see also* 15 U.S.C. 80a-2(a)(41) (defining "value").
132 *See* Harmonization Concept Release at Section IV.A.
133 For example, as of December 31, 2018, there were only 250 closed-end funds, compared with 17,707 mutual funds and 3,371 ETFs. *See* Investment Company Institute, *supra* note 130, at 32.
134 A BDC is a type of closed-end investment company that does not register under the Investment Company Act, but rather elects to be subject to Sections 55-65 of that act. *See* 15 U.S.C. 80a-2(a)(48).
135 An SBIC is a type of fund registered under the Small Business Investment Act of 1958 or that is approved by the U.S. Small Business Administration. *See* 17 CFR 230.501(a)(1).
136 *See* Harmonization Concept Release at Section IV.C.
137 *See, e.g.*, Transcript of SEC and Morehouse College event "REACHING NEW HEIGHTS: Conversations on Raising Capital for Businesses of Color," (Oct. 24, 2019), https://www.sec.gov/files/Morehouse%20Conference%20Transcript%20PDF%20-%20Revised%20%2812.11.19%29.pdf.
138 U.S. Department of the Treasury, "A Financial System That Creates Economic Opportunities Capital Markets" (Oct. 2017) ("2017 Treasury Report") at 27, https://www.treasury.gov/press-center/press-releases/documents/a-financial-system-capital-markets-final-final.pdf.
139 *See* 17 CFR 230.501(a)(1), (3) and (7).
140 *See* Small Business Capital Formation Advisory Committee Recommendation on the Accredited Investor Definition (Dec. 11, 2019), https://www.sec.gov/spotlight/sbcfac/recommendation-accredited-investor.pdf. This recommendation was adopted by the Advisory Committee in FY2020 and is not included in the summary of FY2019 activities of the committee.
141 *See* Advisory Committee on Small and Emerging Companies, Recommendations Regarding the Accredited Investor Definition (Jul. 20, 2016), https://www.sec.gov/info/smallbus/acsec/acsec-recommendations-accredited-investor.pdf.
142 *See* Final Report of the 2019 SEC Government-Business Forum on Small Business Capital Formation (Dec. 2019), https://www.sec.gov/files/small-business-forum-report-2019.pdf; Final Report of the 2018 SEC Government-Business Forum on Small Business Capital Formation (Jun. 2019), https://www.sec.gov/info/smallbus/gbfor37.pdf ("2018 Small Business Forum Report"); 2017 Small Business Forum Report; and 2016 Small Business Forum Report.
143 *See* 2017 Treasury Report at 44 *et seq*.
144 *See* SEC's Division of Investment Management's Small Fund Outreach Initiative, https://www.sec.gov/new-smaller-fund-outreach-effort-seeks-to-promote-choice-for-main-street-investors.
145 *See* Small Business Capital Formation Advisory Committee Recommendation on Retail Investor Access to Registered Closed-End Funds Investing in Private Funds (Dec. 11, 2019), https://www.sec.gov/spotlight/sbcfac/recommendation-closed-end-fund-of-funds.pdf. This recommendation was adopted by the Advisory Committee in FY2020 and is not included in the summary of FY2019 activities of the committee.
146 Committee on Capital Markets Regulation, *supra* note 62.
147 2017 Treasury Report at 43.
148 *See, e.g,* Final Report of the Securities and Exchange Commission Advisory Committee on Small and Emerging Companies (Sept. 21, 2017), https://www.sec.gov/info/smallbus/acsec/acsec-final-report-2017-09.pdf at Section IV.1.A.
149 Broker-dealers are generally "engaged in the business" of "effecting transactions in securities for the account of others." Securities Exchange Act §§ 4(a)(4) (defining "broker") and 4(a)(5) (defining "dealer").
150 *See*, *e.g.,* Country Business, Inc., SEC No-Action Letter (Nov. 8, 2006); International Business Exchange Corporation, SEC No-Action Letter (Dec. 12, 1986); Paul Anka, SEC No-Action Letter (Jul. 24, 1991); AngelList LLC, SEC No-Action Letter (Mar. 28, 2013); FundersClub Inc. & FundersClub Mgm't LLC, SEC No-Action Letter (Mar. 26, 2013); and M&A Brokers, SEC No-Action Letter (Feb. 4, 2014); *see also SEC v. Kramer*, 778 F.Sup.2d 1320, 1334 (M.D. Fla. 2011).
151 *See, e.g.,* SEC Government-Business Forum on Small Business Capital Formation historical reports, https://www.sec.gov/info/smallbus/sbforumreps.htm; American Bar Association, "Report and Recommendations of the Task Force on Private Placement Broker-Dealers" (Jun. 20, 2005), https://www.sec.gov/info/smallbus/2009gbforum/abareport062005.pdf ("ABA Report on Private Placement Broker-Dealers"); SEC Advisory Committee on Small and Emerging Companies, "Recommendation Regarding Finders, Private Placement Brokers, and Investment Platforms Not Registered as Broker-Dealers" (May 10, 2017), https://www.

sec.gov/info/smallbus/acsec/acsec-recommendation-051517-finders.pdf ("ACSEC Finders Recommendation"); Unlocking Capital for Small Businesses Act, H.R. 6127, 115th Cong. (2018), https://www.congress.gov/bill/115th-congress/house-bill/6127/text; Proposed NASAA Model Rule Exempting Certain Merger and Acquisition Brokers from Registration Pursuant to State Securities Acts (Jan. 2015); 2017 Treasury Report at 43-44; and Gregory C. Yadley, "Notable by Their Absence: Finders and Other Financial Intermediaries in Small Business Capital Formation" (Jun. 3, 2015), https://www.sec.gov/info/smallbus/acsec/finders-and-other-financial-intermediaries-yadley.pdf.

152 *See* note 151.

153 *See, e.g.,* Faith Colish, *Finders and Private Placement Brokers: The Missing Link and H.R. 6127*, Bloomberg Law (Nov. 14, 2018), https://news.bloomberglaw.com/corporate-law/insight-finders-and-private-placement-brokers-the-missing-link-and-hr-6127; Transcript of the 38th Annual Government-Business Forum on Small Business Capital Formation (Aug. 14, 2019), https://www.sec.gov/files/2019-sec-government-business-forum-small-business-capital-formation-transcript.pdf, at 164-166.

154 *See, e.g.,* 2019 Small Business Forum Report; 2018 Small Business Forum Report; 2017 Small Business Forum Report; and 2016 Small Business Forum Report.

155 *See* Crowdfunding, Release No. 33-9974 (Oct. 30, 2015) [80 FR 71387 (Nov. 16, 2015)].

156 Australia developed the first equity crowdfunding model, followed by the United Kingdom and many other countries, including the United States. *See* Sam Raymond, Anthony Lambkin, Richard Swart, Sherwood Neiss, and Jason Best, "Crowdfunding's Potential for the Developing World," infoDev, Finance and Private Sector Development Department, World Bank (2013), http://documents.worldbank.org/curated/en/409841468327411701/Crowdfundings-potential-for-the-developing-world.

157 *See* Mills, *supra* note 39, at 7.

158 *See id*.

159 Many portals also facilitate capital formation under Regulation A offerings, sometimes referred to as "mini-IPOs."

160 *See, e.g.,* Douglas Cumming, Michele Meoli, and Silvio Vismara, "Does Equity Crowdfunding Democratize Entrepreneurial Finance?," *Small Business Economics* (Jun. 3, 2019), https://doi.org/10.1007/s11187-019-00188-z (reporting on international crowdfunding); *see also* Republic, "Republic Report – The Business of Diversity" (May 3, 2018), https://republic.co/blog/the-business-of-diversity; *cf* Sifan Liu and Joseph Parilla, "Hidden Entrepreneurs: What Crowdfunding Reveals about Startups in Metro America," Brookings Institute (Sep. 18, 2018), https://www.brookings.edu/research/hidden-entrepreneurs-what-crowdfunding-reveals-about-startups-in-metro-america/ (regarding rewards-based crowdfunding: "While closely tracking venture capital investment, Kickstarter funding has a more diverse distribution, both by gender and geography. […] Women also enjoy higher rates of success in funding their projects across all project categories except for games.").

161 *See, e.g.,* Kaden, *supra* note 85 ("Last year a mere 12% of venture capital dollars went to companies with a woman on the founding team, a decline from 15% in 2017. The numbers get even worse when you look at female-founded startups that aren't focused on female customers: They've gotten less than 2% of VC investment dollars since 2014.").

162 *See* Mills, *supra* note 39, at 52 ("Another factor working against small business lending is that the cost of loan underwriting does not scale with the size of the loan. In other words, it costs about as much for a bank to process a $100,000 loan as a $1 million loan. That means that smaller-dollar loans are less profitable for banks. As a result, banks are less likely to lend at lower dollar amounts. One response for a bank is to move away from small business lending and focus on more profitable activities. Some banks have reduced or eliminated loans below a certain threshold, typically $100,000, and some will not lend to small businesses with annual revenues of less than $2 million."); *id* at 56 ("Three-quarters of small business loan applications from employer firms were for small-dollar loans—loans under $250,000—and more than half of the loan applications were for amounts under $100,000.").

163 *See* Report to the Commission on Regulation Crowdfunding (Jun. 18, 2019), www.sec.gov/smallbusiness/exemptofferings/regcrowdfunding/2019Report.

164 *See id*.

165 *See id* at Section III.A.1.

166 *See* Harmonization Concept Release at Section II.F.1.d.

167 *See supra* note 53.

168 For example, the United Kingdom does not limit the amount a company can raise using crowdfunding, but does require a prospectus for a company to raise more than £8 million, matching a recent rule change by Germany. *See* Explanatory Memorandum to The Financial Services and Markets Act 2000 (Prospectus and Markets in Financial Instruments) Regulations 2018, 2018 No. 786, http://www.legislation.gov.uk/uksi/2018/786/pdfs/uksiem_20180786_en.pdf; https://www.crowdfundinsider.com/2018/06/135692-germany-raises-

the-equity-crowdfunding-limit-to-e8-million/; and Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC, https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX-:32017R1129&from=EN.

169 *See* Connie Loizos, "A Quick Look at How Series A and Seed Rounds Have Ballooned in Recent Years, Fueled by Top Investors," *TechCrunch* (Apr. 25, 2019), https://techcrunch.com/2019/04/25/a-quick-look-at-how-fast-series-a-and-seed-rounds-have-ballooned-in-recent-years-fueled-by-top-investors/.

170 *See* Small Business Capital Formation Advisory Committee Recommendation on Regulation Crowdfunding (Dec. 13, 2019), https://www.sec.gov/spotlight/sbcfac/recommendation-regulation-crowdfunding.pdf. This recommendation was adopted by the Advisory Committee in FY2020 and is not included in the summary of FY2019 activities of the committee.

171 *See* Association of Online Investment Platforms letter to the Commission (Jul. 5, 2019), https://www.sec.gov/comments/s7-08-19/s70819-5761538-186947.pdf.

172 *See* 2019 Small Business Forum Report; 2018 Small Business Forum Report; 2017 Small Business Forum Report; 2016 Small Business Forum; and Final Report of the 2015 SEC Government-Business Forum on Small Business Capital Formation (May 2015), https://www.sec.gov/info/smallbus/gbfor34.pdf ("2015 Small Business Forum Report").

173 *See, e.g.,* PwC survey of CFOs, 83% of whom estimate spending more than $1 million on one-time costs associated with their IPOs. PwC Deals, "Considering an IPO to Fuel Your Company's Future? Insight into the Costs of Going Public and Being Public" (Nov. 2017), https://www.pwc.com/us/en/services/deals/library/cost-of-an-ipo.html.

174 *Id.*

175 Pitchbook, *supra* note 57.

176 *See* "Small Public Companies" section above.

177 President Obama's Council on Jobs and Competitiveness, "Interim Report: Taking Action, Building Confidence: Five Common-Sense Initiatives to Boost Jobs and Competitiveness" (Oct. 2011), http://files.jobs-council.com/jobscouncil/files/2011/10/JobsCouncil_InterimReport_Oct11.pdf.

178 *See, e.g.,* Jumpstart Our Business Startups Act of 2012 ("JOBS Act"), Pub. L. No. 112-106, 126 Stat. 306 (2012); Proposed Amendments to the Accelerated Filer and Large Accelerated Filer Definitions, Release No. 34-85814 (May 9, 2019), https://www.sec.gov/rules/proposed/2019/34-85814.pdf; Smaller Reporting Company Definition, Release No. 33-10513 (June 28, 2018), https://www.sec.gov/rules/final/2018/33-10513.pdf.

179 *See, e.g.,* Proposed Modernization of Regulation S-K Items 101, 103, and 105, Release No. 33-10668 (Aug. 8, 2019), https://www.sec.gov/rules/proposed/2019/33-10668.pdf; Proposed Amendments to Financial Disclosures about Acquired and Disposed Businesses, Release No. 33-10635 (May 3, 2019), https://www.sec.gov/rules/proposed/2019/33-10635.pdf; FAST Act Modernization and Simplification of Regulation S-K, Release No. 33-10618 (Mar. 20, 2019), https://www.sec.gov/rules/final/2019/33-10618.pdf; Disclosure Update and Simplification, Release No. 33-10532 (Aug. 17, 2018), https://www.sec.gov/rules/final/2018/33-10532.pdf; and Proposed Financial Disclosures about Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant's Securities, Release No. 33-10526 (Jul. 24, 2018), https://www.sec.gov/rules/proposed/2018/33-10526.pdf.

180 *See* 2019 Small Business Forum Report; 2018 Small Business Forum Report; 2017 Small Business Forum Report; 2016 Small Business Forum Report; and 2015 Small Business Forum Report.

181 https://www.sec.gov/page/small-business-capital-formation-advisory-committee.

182 *See* SEC Press Release 2019-61, "SEC Announces Members of Small Business Capital Formation Advisory Committee" (Apr. 25, 2019), https://www.sec.gov/news/press-release/2019-61.

183 https://www.sec.gov/spotlight/sbcfac/recommendations-rule-3-05-and-accelerated-filer-definition.pdf.

184 *See* Office of Information and Regulatory Affairs, Office of Management and Budget, "Fall 2019 Unified Agenda of Federal Regulatory and Deregulatory Long-term Actions by the Securities and Exchange Commission," RIN 3235-AL77, https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201910&RIN=3235-AL77.

185 *See* Office of Information and Regulatory Affairs, Office of Management and Budget, "Fall 2019 Unified Agenda of Federal Regulatory and Deregulatory Long-term Actions by the Securities and Exchange Commission," RIN 3235-AM41, https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201910&RIN=3235-AM41.

OFFICE OF THE ADVOCATE FOR SMALL BUSINESS CAPITAL FORMATION

U.S. Securities and Exchange Commission

100 F Street NE

Washington, DC 20549

202.551.5407

www.sec.gov/oasb

smallbusiness@sec.gov