A ROADMAP FOR GROWTH: REFORMS TO ENCOURAGE CAPITAL FORMATION AND INVESTMENT OPPORTUNITIES FOR ALL AMERICANS

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTEENTH CONGRESS

FIRST SESSION

APRIL 19, 2023

Printed for the use of the Committee on Financial Services

Serial No. 118–14

U.S. GOVERNMENT PUBLISHING OFFICE
52–392 PDF WASHINGTON : 2023

HOUSE COMMITTEE ON FINANCIAL SERVICES

PATRICK MCHENRY, North Carolina, *Chairman*

FRANK D. LUCAS, Oklahoma
PETE SESSIONS, Texas
BILL POSEY, Florida
BLAINE LUETKEMEYER, Missouri
BILL HUIZENGA, Michigan
ANN WAGNER, Missouri
ANDY BARR, Kentucky
ROGER WILLIAMS, Texas
FRENCH HILL, Arkansas
TOM EMMER, Minnesota
BARRY LOUDERMILK, Georgia
ALEXANDER X. MOONEY, West Virginia
WARREN DAVIDSON, Ohio
JOHN ROSE, Tennessee
BRYAN STEIL, Wisconsin
WILLIAM TIMMONS, South Carolina
RALPH NORMAN, South Carolina
DAN MEUSER, Pennsylvania
SCOTT FITZGERALD, Wisconsin
ANDREW GARBARINO, New York
YOUNG KIM, California
BYRON DONALDS, Florida
MIKE FLOOD, Nebraska
MIKE LAWLER, New York
ZACH NUNN, Iowa
MONICA DE LA CRUZ, Texas
ERIN HOUCHIN, Indiana
ANDY OGLES, Tennessee

MAXINE WATERS, California, *Ranking Member*
NYDIA M. VELÁZQUEZ, New York
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
DAVID SCOTT, Georgia
STEPHEN F. LYNCH, Massachusetts
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
JIM A. HIMES, Connecticut
BILL FOSTER, Illinois
JOYCE BEATTY, Ohio
JUAN VARGAS, California
JOSH GOTTHEIMER, New Jersey
VICENTE GONZALEZ, Texas
SEAN CASTEN, Illinois
AYANNA PRESSLEY, Massachusetts
STEVEN HORSFORD, Nevada
RASHIDA TLAIB, Michigan
RITCHIE TORRES, New York
SYLVIA GARCIA, Texas
NIKEMA WILLIAMS, Georgia
WILEY NICKEL, North Carolina
BRITTANY PETTERSEN, Colorado

MATT HOFFMANN, *Staff Director*

SUBCOMMITTEE ON CAPITAL MARKETS

ANN WAGNER, Missouri, *Chairwoman*

FRANK D. LUCAS, Oklahoma
PETE SESSIONS, Texas
BILL HUIZENGA, Michigan
FRENCH HILL, Arkansas
TOM EMMER, Minnesota
ALEXANDER X. MOONEY, West Virginia
BRYAN STEIL, Wisconsin
DAN MEUSER, Pennsylvania
ANDREW GARBARINO, New York, *Vice Chairman*
MIKE LAWLER, New York
ZACH NUNN, Iowa
ERIN HOUCHIN, Indiana

BRAD SHERMAN, California, *Ranking Member*
GREGORY W. MEEKS, New York
DAVID SCOTT, Georgia
JUAN VARGAS, California
JOSH GOTTHEIMER, New Jersey
VICENTE GONZALEZ, Texas
SEAN CASTEN, Illinois
WILEY NICKEL, North Carolina
STEPHEN F. LYNCH, Massachusetts
EMANUEL CLEAVER, Missouri

CONTENTS

WITNESSES

WEDNESDAY, APRIL 19, 2023

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

A ROADMAP FOR GROWTH: REFORMS TO ENCOURAGE CAPITAL FORMATION AND INVESTMENT OPPORTUNITIES FOR ALL AMERICANS

Wednesday, April 19, 2023

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:01 p.m., in room 2128, Rayburn House Office Building, Hon. Ann Wagner [chairwoman of the subcommittee] presiding.

Members present: Representatives Wagner, Sessions, Huizenga, Hill, Mooney, Steil, Meuser, Garbarino, Lawler, Nunn, Houchin; Sherman, Vargas, Gottheimer, Casten, Nickel, Lynch, and Cleaver.

Ex officio present: Representative McHenry.

Also present: Representative Foster.

Chairwoman WAGNER. The Subcommittee on Capital Markets will now come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Today's hearing is entitled, "A Roadmap for Growth: Reforms to Encourage Capital Formation and Investment Opportunities for All Americans."

I now recognize myself for 5 minutes to give an opening statement.

First, I would like to thank you all for joining us today. It was a pleasure to meet all of you prior to this hearing, as we bring our four-part capital formation series to a close. As I outlined in the previous three hearings, I have heard from small businesses, the absolute backbone of our economy, and we must ensure that our markets are working efficiently and effectively to provide companies access to the capital that they need to innovate, to grow, and to create jobs.

To accomplish that goal, we must also ensure a regulatory framework that is streamlined and not overly-burdensome. As we have heard throughout our capital formation hearings, a framework that fails to, I will say right-size regulation, will stifle innovation. It will limit wealth-creating opportunities for investors and prevent small businesses from reaching their potential.

Over the past several months, we have had the opportunity to hear from a range of experts and stakeholders on the ways in which Congress can help promote economic growth and investment.

At our first hearing, we heard how our private markets have been reserved for the wealthiest Americans. Our witnesses also shared insights into the challenges that entrepreneurs face when raising capital, and identified some of the senseless regulations that limit their pool of investors. Their testimony proved the need for commonsense reforms that expand wealth-creating opportunities to those Americans who have effectively been relegated to the sidelines.

Our second hearing was on the critical role of small businesses and entrepreneurs in driving economic growth and job creation in the United States. We discussed several ways to reduce obstacles, and our witnesses identified policies to promote capital formation for small businesses across the country. From this discussion, it became clear that Congress must do more to enhance the ways in which small businesses raise capital in our markets.

At our third hearing, we focused on the role of public markets in promoting economic growth and investment. We found that many companies are delaying their initial public offerings (IPOs) or are remaining private to avoid unreasonable regulatory and disclosure obligations. Witnesses also discussed their concerns with declining IPOs, a reduction in the number of publicly-traded companies, and the impact of these trends on investors and, I would say, the broader economy. Their testimony underscored the need for proposals that again, right-size regulation, making public markets more attractive without compromising investor protection.

As we begin our final hearing, it is clear that these issues are deeply interconnected. Expanding investment opportunities for all Americans, improving access to capital for small businesses, and strengthening our public markets are all critical components of a healthy and vibrant economy. As we look ahead, there is much work to be done to ensure that our capital markets are functioning efficiently and effectively for all Americans. This includes supporting policies that promote investment, encourage innovation, and remove unnecessary regulatory burdens.

Thank you again to my colleagues and today's witnesses for joining us in this important undertaking. Your insights and contributions are invaluable, and I think we all look forward to today's discussion.

I am now pleased to recognize the ranking member of the subcommittee, Mr. Sherman of California, for 4 minutes for an opening statement.

Mr. SHERMAN. This is our fourth subcommittee hearing on the most-important thing that financial institutions and capital markets do, which is provide capital for businesses, particularly small, medium-sized, and growing businesses. Most mainstream businesses turn to banks for loans, and they are increasingly not getting those loans because our system, presided over by the regulators and this committee, is tilted against banks making business loans. We saw what happened with Silicon Valley Bank. They didn't go bad because they made bad business loans; they went under because of their bad bond investments. So, what are the problems?

First, credit unions face severe and unjustified limits on making any business loans at all. Second, the Current Expected Credit

Losses (CECL) accounting system brutally and unjustifiably penalizes any bank that does make a business loan. If a bank creates a portfolio of business loans by making highly-profitable, very-secure business loans, it must still list those loans on its balance sheet at less than par.

Third, the rival to making business loans for a bank is investing in securities, chiefly bonds, and our system rewards banks by a bizarre accounting system. If they list these bonds as held-to-maturity and the bonds happen to go down in value, well, heads, I win, tails, no bet. You can still list those bonds on the balance sheet at par, even though they aren't worth par. But if the bonds go up in value, the bank simply sells one group of bonds, replaces them with another group of bonds, and puts the gain right there on the balance sheet.

Finally, we have a system where business development companies (BDCs) are unduly penalized by the SEC because those mutual funds that invest in BDCs are penalized by having to show wrongful overstatement of their costs. And that is why, Madam Chairwoman, I am glad you have included in the bills we are considering today the bill I introduced, along with Representative Huizenga, to change this bias.

The other avenues for businesses to get capital are partially foreclosed by unjustified laws, so businesses will often turn to private placements. Critical to a private placement is the definition of, "accredited investor." I agree with the Majority that our current definition is unfair and illogical. It should be replaced by a definition that does two things: first, it doesn't include or allow a private placement in which any individual credited investors put more than 5 or perhaps 10 percent of their net worth in any one offering, or more than 50 percent of their net worth in all private offerings; and second, it makes sure that accredited investors have expertise, or have truly independent advisors who have the expertise to evaluate the investment.

I agree with the Majority that simply saying somebody has a million dollars in net worth, therefore, they are accredited, is unfair to those who don't have a million dollars in net worth, and ridiculously complimentary to assume that anybody with a million bucks is sophisticated and knowledgeable.

Finally, in defining the difference between a public and a private company, Congress set the limit at a very generous 2,000 shareholders. But the SEC, in counting shareholders, uses a funny math in which you can have thousands and thousands of shareholders and still be under the 2,000 limit, and we will explore that during my question time. I yield back.

Chairwoman WAGNER. We will now turn to our witnesses.

First, Mr. Brandon Brooks. Mr. Brooks is a founding partner at Overlooked Ventures, a venture capital fund investing in historically-overlooked founders. Additionally, he is the founder of Zinsu, a platform to increase efficiency in the entrepreneurial ecosystem. Prior to Zinsu, and Overlooked Ventures, he started the first Black-owned crowdfunding platform in the U.S.: Inventrify.

Second, Mr. Rodney Sampson. Mr. Sampson serves as the executive chairman and CEO of Opportunity Hub, which he founded in 2013 in Atlanta, Georgia. Today, Opportunity Hub is a business

and foundation with an ecosystem-building venture fund. It is a leading technology startup and venture ecosystem-building platform created to ensure that everyone has equitable access to the future of work.

Third, Mr. Joel Trotter. Mr. Trotter is a partner at Latham & Watkins, and the co-chairman of the Latham & Watkins National Office, a central resource for clients and Latham lawyers facing complex issues arising under the U.S. securities laws. Mr. Trotter was a leading member of the IPO Task Force, and served as a principal author of the IPO-related provisions of the JOBS Act in 2012.

Fourth, Mr. Henry Ward. Mr. Ward is a co-founder and CEO of Carta, an organization that helps issuers, investors, and employees manage and value equity ownership from idea to IPO. Carta is trusted by more than 30,000 companies, over 5,000 investment funds, and half-a-million employees for cap table management, compensation management, liquidity venture capital solutions, and more. Carta's liquidity solutions have returned $13 billion to shareholders in secondary transactions.

And last, but certainly not least, we have Commissioner Melanie Senter Lubin. Commissioner Lubin was appointed in 1998 by the Maryland Attorney General as a Maryland Securities Commissioner for the Securities Division. In September of 2021, Ms. Lubin began her 1-year term as the 104th president of the North American Securities Administrators Association, the oldest international organization devoted to investor protection and responsible capital formation.

I want to thank each of you for taking the time to be here. Each of you will be recognized for 5 minutes to give an oral presentation of your testimony. And without objection, each of your written statements will be made a part of the record.

Mr. Brooks, you are now recognized for 5 minutes for your oral remarks.

STATEMENT OF BRANDON BROOKS, FOUNDING PARTNER, OVERLOOKED VENTURES

Mr. BROOKS. Thank you. Good afternoon, esteemed members of the House Financial Services Committee. I stand before you today as a representative of the voiceless, the marginalized, the overlooked, and the underestimated. I stand before you to speak on behalf of the forgotten founders who were never given a chance to showcase their potential and the hard-working people who were being shut out of investment opportunities because they don't belong to the elite class of the wealthy.

Today, I bring a message of hope and a call to action. The time has come to break down the barriers that have held back our economy and empower the next wave of American innovation. The time has come to put the American Dream back within reach of all those who seek it.

It is time for IPO reform, support for overlooked founders, and safer investment opportunities for non-wealthy investors, and if you don't act now, the consequences will be dire. The American Dream will become nothing but a distant memory, and the economic gap between the haves and the have-nots will grow wider than ever before, but together we can make a change. Together, we

can create a better future for all Americans. Thank you for your attention.

According to a report by the National Venture Capital Association, the number of IPOs has declined by more than 38 percent since 2014. This decline is troubling because IPOs provide a critical source of capital for companies to grow and expand. By going public, companies can access a larger pool of investors and raise the capital they need to expand the new products, hire more employees, and expand in the new markets. But going public is a daunting process for many companies, especially the smaller ones. It is expensive, time-consuming, and comes with a host of regulatory requirements that can be overwhelming. That is why we need to make it easier and more attractive for companies to go public.

The reality is that many talented entrepreneurs don't have access to the resources and networks they need to start and grow successful companies. Women, Black founders, and people who exist outside the lines of the traditional startup ecosystem, in particular, face significant barriers when it comes to accessing capital and building the networks that are necessary for success. To address this, we need to create more opportunities for overlooked founders to access capital and build networks.

Finally, we need to make it easier for everyday Americans to invest in the future of our economy. The reality is that most Americans are excluded from investing in early-stage companies because they simply don't have the financial resources to do so. To address this, we need to create more opportunities for non-wealthy investors to invest in early-stage companies.

In conclusion, we are at a crucial moment in our nation's history. The old rules no longer work and the status quo is holding us back, but we have an opportunity to chart a new course, one that empowers overlooked founders, opens up investment opportunities to all, and drives economic growth for all Americans. It won't be easy and it won't happen overnight, but if we have the courage to act, we can create a future that is more just, more prosperous, and more equitable for all. Bless you, and thank you all.

[The prepared statement of Mr. Brooks can be found on page 38 of the appendix.]

Chairwoman WAGNER. That's very kind of you, Mr. Brooks. Thank you.

Mr. Sampson, you are now recognized for 5 minutes to give your oral remarks.

STATEMENT OF RODNEY SAMPSON, CEO AND CO-FOUNDER, OPPORTUNITY HUB, INC.

Mr. SAMPSON. Good afternoon, Chairwoman Wagner, Ranking Member Sherman, and members of the subcommittee, and thank you for the opportunity to appear before you today. I am humbled to have my wife, Shanterria Alston Sampson, and our children here with us as well.

Today, I am here as a pioneer and a stakeholder in our nation's Black technology startup and venture ecosystem, an ecosystem that I have been a part of building from the ground up as a founder, investor, and ecosystem builder for nearly 23 years. And in the last decade as the co-founder, executive chairman, and CEO of Oppor-

tunity Hub, the nation's leading innovation, entrepreneurship, and investment ecosystem-building organization created to ensure that everyone, everywhere, has equitable opportunities in the fourth industrial revolution and beyond as a path to creating new multigenerational wealth with no reliance on pre-existing multigenerational wealth.

Twenty-three years ago, I co-founded my first technology startup company in Atlanta, Georgia. This was my first introduction to the venture capital and angel investing ecosystem, and I learned very fast that access to early-stage private capital in America was not equal. In our era, there were only three Black technology founders who had raised millions in venture capital for their startups: Omar Wasso at BlackPlanet.com, Clarence Wooten at ImageCafe.com, and me at Multicast Media Technologies and Streamingfaith.com. As a note of outcome, all three of our companies were successfully acquired.

In 2021, Harlem Capital reported that less than 1,000 Black and Hispanic startups had ever raised over $1,000,000 in angel and venture capital in American history. When juxtaposed to the over 15,000 startup investments that were consummated in 2021, and again in 2022, according to a report by Pitchbook and the National Venture Capital Association, the amount of capital invested in socially- and economically-disadvantaged individuals who have experienced institutional, personal and interpersonal racism, discrimination and bias in the American startup ecosystem is dismal, negligible, and shameful.

In my 2021 report entitled, "Building Racial Equity in Tech Ecosystem To Spur Local Recovery," published by the Brookings Institution, where I serve as a nonresident senior fellow, I point out that approximately $26 billion annually should be going to the Black technology, startup, and venture ecosystem to build tech hubs in hundreds of American cities to rapidly upskill millions for existing software, sales, cyber, new energy, and AI technology careers; incubate thousands of new high-growth ventures leveraging edge technologies, and back them with the early startup capital to hire build, go to market, sell, and grow.

Ecosystem-building organizations like Opportunity Hub, venture capital firms like 100 Black Angels & Allies Fund, and angel investors like my wife and I are exhausted from asking the existing private markets to invest in the thousands of brilliant Black technologists, operators, and founders who are a part of our growing ecosystem. Outside of the performative pitch competitions and diversity announcements of 2020, no consistent private commitment exists to fund Black-founded early-stage startups, venture funds, tech hubs, incubators, accelerators, upskilling schools, and ecosystem-building organizations at scale.

The current relevant public sector commitments, like the State Small Business Credit Initiative (SSBCI), EDA's Build Back Better Regional Challenge, Regional Tech Hubs, and NSF Engines in the CHIPS and Science Act, are very exciting for overall global American innovative competitiveness. Yet, there is little hope in the Black technology startup and venture ecosystem that this funding will actually make it to America's overlooked and under-invested communities with any sizable traction or scale.

The Black technology ecosystem has started to innovate from within. When possible, we invest in each other's companies and initiatives. Opportunity Hub created the Black Technology Ecosystem Investors Certificate in collaboration with the University of North Carolina, Duke, Stanford, and The Links, Incorporated. To date, nearly 50 Black affluent and accredited men and allies have been certified. Imagine this certificate in collaboration with FINRA as a path towards accreditation.

In closing, I would like to thank you for your time. If we do not get on the capitalization tables of these startups that are transforming society as we meet today, we will have future generations in America of haves and have-nevers. Thank you.

[The prepared statement of Mr. Sampson can be found on page 91 of the appendix.]

Chairwoman WAGNER. Thank you very much, Mr. Sampson. Mr. Trotter, you are now recognized for 5 minutes to give your oral remarks.

STATEMENT OF JOEL H. TROTTER, PARTNER, LATHAM & WATKINS LLP

Mr. TROTTER. Good afternoon, and thank you, Chairwoman Wagner, Ranking Member Sherman, and members of the subcommittee. It is a pleasure to be here today appearing before you. Based on my experience as part of the IPO Task Force leadership, I am pleased to share my perspectives on reforms to encourage capital formation and investment opportunities.

The JOBS Act of 2012 is a bipartisan success story and a model for the innovative solutions we are now considering. By an overwhelming bipartisan majority, Congress enacted the IPO Task Force On-Ramp proposal as Title I in the JOBS Act, and 11 years ago this month, President Obama signed it into law. Title I has been called the most-successful title in the JOBS Act, and academic research has demonstrated that the on-ramp provision significantly increased IPO volume overall. We should encourage more IPO activity. The research of the IPO Task Force showed that companies that go public experience more than 90 percent of their job growth after their IPO.

Today, however, public companies face higher compliance burdens than ever before. And the SEC has formally acknowledged that when its rules increase the cost of being a public company, that discourages some companies from accessing the public markets. For this reason, the JOBS Act offers an important series of lessons for successful bipartisan legislation. I will highlight four of these lessons.

First, find small changes that will have a big impact. The IPO On-Ramp comprised multiple small changes that had an outsized impact. Together, these changes streamlined the IPO process, and made it easier to transition to public company status.

Second, use a balanced approach that scales the regulatory burden to accompany size and maturity. The IPO On-Ramp concept allowed the regulatory burden to scale to the size of the company, a simple, but powerful concept borrowed from SEC rules. In the debate over more versus less regulation, this is a compelling way forward rather than more versus less securities regulation, a balanced

regulation that scales over time. This approach encourages IPO activity while maintaining the existing and continuously-increasing level of securities regulation for mature public companies.

Third, remember that the innovations under consideration will not reduce the demanding and rigorous liability provisions of the Federal securities laws. The JOBS Act changed none of the robust anti-fraud provisions of the Federal Securities Laws. This is of paramount importance in understanding the limited nature of the changes. There is a long list of liability provisions and compliance obligations that apply to all public companies. They are extensive and rigorous, and they will remain undiminished by any of the proposals before you.

Fourth, use self-executing statutory text that will become immediately effective and will not burden an already-busy agency. The IPO On-Ramp statutory text was self-executing rather than relying on SEC rulemaking. In this regard, the JOBS Act is a study in contrast.

As I sat in the Rose Garden on April 5, 2012, I watched the IPO On-Ramp provisions become effective at the moment President Obama signed them into law. In contrast, other provisions of the JOBS Act required SEC rulemaking by specified deadlines, none of which were met.

The Dodd-Frank Act of 2010 presents a similar dichotomy. The self-executing provisions were immediately effective, whereas the Dodd-Frank mandate for an executive compensation clawback rule will have taken 13 years to implement when the final rules become effective later this year.

You have the ability and the opportunity to build on the success of Title I of the JOBS Act and the lessons that offers us today. Given the direct connection between capital formation and job creation, that opportunity is compelling. I welcome your questions.

[The prepared statement of Mr. Trotter can be found on page 98 of the appendix.]

Chairwoman WAGNER. Thank you very much, Mr. Trotter.

Mr. Ward, you are now recognized for 5 minutes to give your oral remarks.

STATEMENT OF HENRY WARD, CEO & CO-FOUNDER, CARTA, INC.

Mr. WARD. Chairwoman Wagner, Ranking Member Sherman, and members of the subcommittee, thank you for the opportunity to be here. My name is Henry Ward, and I am the CEO and co-founder of Carta, a financial technology company that sits at the center of the innovation economy. I am proud to be here today as an advocate for the venture ecosystem, for the entrepreneurs who have an idea for the startups they create, for the investors who support them, and for the employees who build for them.

Startups are America's innovation engine, and it is this venture ecosystem that allowed us to build Carta. We started Carta with the vision of connecting startups with their investors and employees by lowering barriers for companies to issue and manage equity. We launched our product in January of 2014 with seven employees. Our first customer paid us $120. As an entrepreneur, you never forget the first time someone paid you for something you built.

Today, we are 2,000 employees across 9 offices with $300 million in revenue. We continue to grow by supporting the founders that start companies and the investors that back them.

I understand the words, "venture capital," may not elicit the most positive response today, but I am here to remind us why entrepreneurs and the ecosystem that support them are vital to America's growth story and leadership in the world, and allow me to explain why.

First, the venture ecosystem drives innovation and growth. Most of our innovative companies have been backed by venture. Apple was venture-backed. Uber was venture-backed. Amazon was venture-backed. Moderna was venture-backed. We take for granted what venture does for America's innovation and how it has transformed our lives. So much of the technology we use today is a direct product of startups and venture capital. America has driven every major technological innovation in the last 30 years, not China, not Russia, not Europe, not Asia. It is one of the most important ways we lead the world, and most of that innovation has come out of the venture ecosystem, and we must not take that ecosystem for granted.

Second, we can't make the venture model work better. Innovation requires time to build, experiment and scale, and uncertainty and volatility is inherent in building something new. The private markets provide patient capital with a tolerance for risk that allows entrepreneurs to transform concepts into companies. This is the innovation engine of America and it should not be limited to coastal regions. It should be accessible to more.

Much of the criticism of venture—the concentration, lack of diversity, and exclusivity—are largely reflective of the private market regulatory framework. Let me give you two examples.

First, the primary avenue to raise capital requires entrepreneurs to have, "a preexisting relationship with an investor." This rewards those who are in the club and excludes those who are not. It creates a slanted system where it isn't what you know, but whom you know.

Second, the accredited investor definition limits investing to the wealthy. This rule, coupled with the pre-existing relationship rule, makes things worse. It limits access to not just people you know, but only the rich people you know. If we want to democratize access to America's growth engine, we should take a hard look at this framework.

Third and last, a thriving venture ecosystem is the future of public markets. A growing criticism is that private companies take too long to go public and that regulations should push companies public earlier. This is not a good idea for the company, the employees, the investors, or the public markets. Every entrepreneur dreams of building a company that goes public. When companies wait to go public, it is not because they don't want to; they wait because they are not ready to. Public markets have changed. Companies that went public 20 years ago could not go public today. The expectations for scale, quarterly predictability, resiliency of business model, and financial means have grown. For companies that have achieved this level of maturity, the public markets are a wonderful

place, but for companies that have not, the public markets are unforgiving.

We saw this recently with the Special Purpose Acquisition Companies (SPAC) craze, where many private companies were taken public prematurely. Those companies, employees, and investors were severely punished and they are now picking up the pieces. The answer to creating more public companies is not to make private markets more hostile but to make private markets work better. Doing so makes it easier to start companies, nurture their growth, and create the pipeline of tomorrow's great public companies. And that is why I am here today, to advocate for your involvement in creating a better framework for private markets and America's innovation economy.

Thank you, and I look forward to your questions.

[The prepared statement of Mr. Ward can be found on page 131 of the appendix.]

Chairwoman WAGNER. Thank you, Mr. Ward. And Commissioner Lubin, you are now recognized for 5 minutes to give your oral remarks.

STATEMENT OF MELANIE SENTER LUBIN, COMMISSIONER, MARYLAND SECURITIES DIVISION, OFFICE OF THE MARYLAND ATTORNEY GENERAL, TESTIFYING ON BEHALF OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION (NASAA)

Ms. LUBIN. Good afternoon, Chairwoman Wagner, Ranking Member Sherman, and distinguished members of the subcommittee. My name is Melanie Lubin. I am a 36-year veteran of the Division of Securities within Maryland's Office of the Attorney General, and of the North American Securities Administrators Association (NASAA). Last year, I served as NASAA's president. Since 2015, I have also served as NASAA's non-voting representative to the Financial Stability Oversight Council (FSOC).

State securities regulators play several vital roles in responsible capital formation. For example, many of our regulators support the business community by working with local organizations to conduct seminars for small businesses by responding regularly to capital-raising inquiries, and by maintaining websites devoted to capital formation resources. We also protect and educate investors working to build secure financial futures. At the end of the day, our work helps to ensure the integrity and efficiency of the capital markets that power our economy.

Today, we are examining legislation that is intended to help entrepreneurs and small businesses to increase opportunities for investors and to strengthen public markets. NASAA supports these laudable goals. Unfortunately, we respectfully submit that many of the proposals under discussion today are counterproductive to our collective efforts to achieve these goals. In particular, we urge Congress to reject proposals that would take away certain longstanding State authorities to promote responsible capital formation, including the Small Entrepreneurs' Empowerment and Development Act of 2021 (SEED Act), the Improving Crowdfunding Opportunities Act, the Restoring the Secondary Trading Market Act, and the Unlocking Capital for Small Businesses Act.

If these preemption bills were to become law, State Governments likely would reduce funding for the great work that State securities regulators are doing to empower entrepreneurs to understand their capital-raising options and avoid compliance mistakes. Meanwhile, Congress would not increase resources for the Federal Government to fill the regulatory and boots-on-the-ground gaps created by preemption.

At the same time, we believe there are proposals under discussion today that should be pursued. By way of example, NASAA endorses the Promoting Opportunities for Non-Traditional Capital Formation Act, which lawmakers noticed for today's hearing. This legislation would expand the functions of the Office of the Advocate for Small Business Capital Formation at the SEC and require meetings with State securities regulators at least annually. In addition, we endorsed the legislation under discussion that would direct the SEC to revise their definition of, "accredited investor," to exclude retirement accounts from the net worth calculation used to determine eligibility. At NASAA, we firmly believe that we all need to heed the lessons learned from the past JOBS Act.

Importantly, it would be a net negative for everyone to continue down a de-regulatory path in which we further expand the private securities markets at the expense of the public markets. These private markets are rife with scams and frauds because of their lack of transparency. These frauds or, rather, their consequences, typically affect not only the harmed investors but also the hardworking Americans who hear about events like the FTX collapse and begin to question the wisdom of participating in our markets.

As we heed these lessons learned, we need to refine the securities regulatory framework so that it better balances the needs of entrepreneurs and retail investors. I expect that we all agree that entrepreneurs are not automatically entitled to the hard-earned money of Americans. I expect that we also agree that retail investors are entitled to disclosure. In turn, we should all work together to refresh the regulatory framework in ways that better reflect these principles.

In closing, I want to emphasize that we understand and share the same goals as the Members of Congress who support robust public markets. State securities regulators want to continue helping entrepreneurs and small businesses. We also want to increase opportunities for investors and strengthen public markets. I look forward to answering your questions today. Thank you very much.

[The prepared statement of Commissioner Lubin can be found on page 47 of the appendix.]

Chairwoman WAGNER. Thank you, Commissioner Lubin.

We will now turn to Member questions, and the Chair recognizes herself for 5 minutes.

Mr. Trotter, last year, the U.S. IPO market reached one of its lowest points on record. In fact, the U.S. has recently recorded several of its worst years on record for IPOs, as the cost to go public has more than doubled since the 1990s. In addition, regulatory burdens on public companies, along with the ongoing compliance costs for publicly-traded companies, are likely to continue to rise, especially if the SEC continues to finalize burdensome rules, such as the climate rule.

Mr. Trotter, as a leading member of the IPO Task Force and principal author of the IPO-related provisions of the JOBS Act, please explain how the policies in our capital formation package will help make our public markets more attractive?

Mr. TROTTER. They will build on the success of the JOBS Act. They have all of the four ingredients that I outlined in my opening remarks. And it is critical to help for purposes of fostering IPO activity and making it easier to go public and encouraging job creation, to streamline the IPO process, and to continue to build on the success of past legislative reform. We have seen that it helps a lot. You can put together a collection of small changes that have a big impact in combination. And you can approach the streamlining process using scaled disclosure, a balanced approach that cuts through the debate of more versus less, and you can do all that and make a meaningful impact in fostering IPO activity. So, we need more of that. We have had over a decade, 11 years of successful experience. It is time to build on that and do more.

Chairwoman WAGNER. Yes. And as you know, Mr. Trotter, SEC rules allow all issuers to test the waters with qualified institutional buyers and institutional accredited investors, either prior to or following the filing of a registration statement, to gauge potential interest in a contemplated registered security offering. Prior to the IPO, SEC staff reviews test-the-water materials to make sure that the information is consistent with the information presented in the company's registration statement.

Would requiring issuers to include test-the-waters materials, such as slide decks, in their S-1 registration statement be unnecessary and potentially harmful to both investors and issuers?

Mr. TROTTER. It would be not only unnecessary, but a terrible step backward, and let me explain why. Testing the waters was implemented through Section 5(d) and its power is in its simplicity. It cuts through a problem, a communications restriction that made sense in 1933 but makes no sense in 2023, and that is, you need to be able to communicate with prospective investors about your potential IPO. And the investor protection that is included in 5(d), which implemented testing the waters is based on the audience, so communicate away, as long as you are speaking with institutional accredited investors and qualified institutional buyers. And Section 163(b) recognized the success of that and expanded it to all issuers. If you destroy the simplicity of that by loading it up with additional requirements, again, it is just going to be a step back.

Chairwoman WAGNER. My bill in our capital formation package, the Encouraging Public Offerings Act, aims to simply codify the current SEC rules allowing issuers to test the waters prior to an IPO.

Mr. Trotter, would requiring these testing-the-waters materials to be filed as part of a company's registration statement represent a significant step backwards, even if done in conjunction with codifying the current rules. Yes or no?

Mr. TROTTER. Yes.

Chairwoman WAGNER. Thank you. Mr. Ward, millions of investors rely on closed-end funds as an important source of retirement savings and for investment opportunities. However, the SEC's 15-percent limitation on a closed-end funds investment in the private

markets effectively denies retail investors access to the private markets. Given that closed-end funds are strictly regulated and professionally managed, do you think it is appropriate to limit their investment in the private market and exclude so many Americans from potential high-growth opportunities?

Mr. WARD. I think the closed-end funds are a very responsible way to give retail investors exposure to private assets. There is a lot of portfolio theory and modern financial theory on how much you should diversify a fund and investments across different asset classes. I think that should be the North Star of how the individual fund managers decide how much to allocate into illiquid or private market assets on behalf of their investors. As part of their fiduciary responsibility, it doesn't make sense to me that it would be a regulatory number that decides how to diversify a portfolio.

Chairwoman WAGNER. Thank you. I am out of time, but I have so many more questions.

I now recognize the distinguished ranking member of the subcommittee, Mr. Sherman, for 5 minutes for questioning.

Mr. SHERMAN. It is frustrating to see people get rich when they invest in just one thing, and you wish it had been you. But keep in mind, I would like to think I would have invested in Apple, but I might have invested in pear or in banana or in kumquat and lost all my money. Wages are too low, most Americans are living close to paycheck to paycheck, and, frankly, people shouldn't be investing in private offerings until they have several months of living expenses in the bank.

That being said, a system in which to be an accredited investor means you are a millionaire, in other words, if you are not a millionaire, you can't invest, is hard to defend, and I would not try. But keep in mind, the professionals who do this, the venture capitalists say you are going to lose money on 9 out of every 10 investments and make it all back hopefully on the 10th. If you can't afford to lose money 9 out of 10 times, this may not be the market for you.

If you are trying to raise money to run your business, you have a tendency to look at each element of investor protection as a barrier to you doing what you need to do for your business, but ultimately, if you don't have investor protection in the economy, you don't have investors. Investor protection is not the antithesis of capital formation; it is a necessary antecedent.

Mr. Trotter, you have a good point when you say that we ought to pass laws that become effective immediately. I think we should do that, but then we should give the SEC the right to make modifications by regulation. The chairwoman pointed out that a statistic that it now costs twice as much to go public as it did in the 1990s. But tomatoes are 5 times as expensive as they were in the 1990s. I don't know if that number is inflation-adjusted. I do know that the biggest cost in going public is what you give the underwriter for selling the investment rather than the governmental costs.

Does anybody know, on an inflation-adjusted basis, if the cost to prepare, not the underwriters fee, but the cost to prepare the going public document, has more than doubled or has even gone up at all? I am looking for a witness to raise their hand. I don't see one,

so I will invite you all to respond for the record, and go on to another question.

At least the way Congress wrote the law, once a company has 2,000 beneficial owners, it is a public company, and yet we have a circumstance where you can have hundreds of owners all use the same street name. I am at Merrill Lynch. Merrill Lynch may have 500 of us who have invested in one company. It is listed as just one. That is kind of an absurd definition of private company that has 5,000 or 10,000 different beneficial owners. Now, when I say, "beneficial owner," I mean the entity. For example, in Mr. Smith's estate, he may have eight children. I am counting Mr. Smith's estate as one beneficial owner even though there are eight descendants who benefit.

Ms. Lubin, does it make any sense to count each street name as just one beneficial owner? Can we, as a practical matter, make sure that in street name-listed securities ownership, we identify how many beneficial owners there are?

Ms. LUBIN. Thank you for that question. I think you are exactly right. I think it is antithetical to the idea that there is one public company, but then if you just count the broker-dealer that lists the name, you can have thousands and thousands of shareholders underneath that, and you are only counting them as one shareholder.

Mr. SHERMAN. I would point out that the SEC hasn't done its job in defining it, and even worse, some of my colleagues want to lock in and prohibit the SEC from changing how it counts.

Ms. Lubin, does it make any sense to say you are an accredited investor just because you have a million-dollar net worth, and that if you don't have a million-dollar net worth, you are not accredited? And when I say, "million-dollar net worth," or, "a quarter-million-dollar income," then I know there are some adjustments.

Ms. LUBIN. Thank you for that. The accredited investor definition is complicated, and it is being looked at by the SEC, and there are a lot of different standards. I think there are a lot of proposals on the table to take a look at it, the net worth, the income level, could an independent adviser help someone who has no conflicts or their possible—

Mr. SHERMAN. My time has expired. I will ask you to respond at greater length for the record.

Ms. LUBIN. Okay. Thank you. We would be happy to do that.

Chairwoman WAGNER. The Chair now recognizes the Chair of the full Financial Services Committee, the gentleman from North Carolina, Chairman McHenry, for 5 minutes.

Chairman MCHENRY. I want to thank the Chair for yielding, and I want to thank the panel for being here. You have all testified before in different environments. Mr. Trotter, thank you for your work on the original JOBS Act, in particular. And thank you all for your help in reviewing the legislation that has been put forward before this committee, some bipartisan, most bipartisan, and some that don't have full bipartisan support, but I am grateful for that.

I want to continue the theme that the ranking member had with you, Mr. Sampson, about accredited investors. Right now, we have income thresholds of net worth of over a million dollars and very high-income threshold for folks to be considered an accredited investor. My question for you is, do you think that unfairly rep-

resents or fairly represents people's capacity to invest, and what are the economic impacts of that accredited investor standard and the limitations thereof?

Mr. SAMPSON. Thank you for the question. Just because someone has the ability to generate a million dollars, perhaps as an entertainer, as a professional football player, or even a professional, does not mean they have the sophistication to look at this asset class, and it does not mean they have the sophistication to make a decision on understanding the risk outside of them, perhaps being able to afford the risk. When you look at the lack of capital contextually that has gone to Black founders in an asset class, that is maybe 50- to 60-years-old, but if you look at the last 20 years or so, less than 1 percent going to Black founders in particular, the current framework is not working for all Americans.

I know the devil may be in the details and there may be some nuances to kind of reach bipartisanship, but we have to do something. And I don't see a lot of legislation stopping folks from buying Yeezys, or flying to Vegas and purchasing non-appreciating assets. Yet, if I want to invest in my fraternity brother, my classmate that I know, and I have some knowledge on the particular industry of this particular offering, I think there should be an opportunity to invest.

Think about the professionals who come into entry-level careers, or even the gig workers or the suppliers who are contractors to those respective companies. They work for 5, 10, 15, 20, or 30 years and they leave with a fake gold watch, never having been given the opportunity to actually invest $100, $500, or $1,000. Maybe, there is a small equity package that they are given, but the multigenerational wealth creation is happening amongst the founders in the C-suite.

So, if you really talk about democratizing access to wealth creation in the fourth industrial revolution, amending the definition to include people who may have been certified by some type of FINRA tests or some type of institutional test is incredibly important, or who have domain expertise in a respective supply chain industry and/or problem.

Chairman MCHENRY. Austin, Boston, and Silicon Valley still have a disproportionate share of venture capital investment in this country. We have diverse founders who are being left behind, not because of any other reason than the statistics that are evident that we know this to be true. And this cannot simply be true that if you are born in the right ZIP Code in America, you have better ideas than if you are born in the wrong ZIP Code. That doesn't make a bit of sense. So, everything we can do to make sure that we link capital with the best ideas in our economy is going to be a useful thing. We can protect consumers absolutely, and we should. We should protect investors, but we should also give them the economic opportunity for the upside benefit as well. So, Mr. Sampson, thank you for speaking to that.

Madam Chairwoman, I yield back. Thank you.

Chairwoman WAGNER. The gentleman from California, Mr. Vargas, is now recognized for 5 minutes.

Mr. VARGAS. Thank you very much, Madam Chairwoman, and Ranking Member Sherman. Again, I appreciate the opportunity.

Now, this is a little odd for me, because normally the way it works is when the Democrats are in charge is we have the first four witnesses who testify basically saying what we believe, and then you have the Republican at the end basically saying what they believe. But since the Republicans are in charge now, normally you would have the first four basically stating the facts as the Republicans would believe, and then we would have the Democrats at the end basically saying what we believe. However, I found very little to disagree with in what was said, with most of what everybody said. There were some discrepancies, and I do want to probe them a little bit.

And I would state at the outset that I do believe in disclosures, and I especially believe that ESG disclosures are material. I do like, again, where this is going on that. I will set that aside because that is one thing we just like to fight about here.

But, Mr. Trotter, you said some things that were very interesting. First, you said that you have these basic four facts or four issues that are important. And second, you mentioned a balanced approach to scale regulatory burden to the size of the company. I think that is what you said. I don't want to put words in your mouth.

Mr. TROTTER. That is correct. I did say that.

Mr. VARGAS. Okay. And I think that what Commissioner Lubin said is, well, this has kind of taken us down a deregulatory path where we shouldn't go.

Ms. LUBIN. I did say that.

Mr. VARGAS. But there seems to be some logic in what Mr. Trotter said. It would seem to me that as the company is small, you wouldn't have to necessarily load it up with all of the burdens that you would want to load up on a larger company. For example, we do that with the banks. Obviously, if a bank is significant and it is going to have systemic issues, we want to do stress tests that are very important to make sure that we don't have massive failures. But if it is a community bank, we don't require all of that. We allow them to exist, but we don't require all of those regulations. There seems to be some logic to that. What do you think?

Ms. LUBIN. There are a lot of issues that we are trying to tackle and a lot of these issues become conflated. We have very small businesses on the one hand that we are trying to take care of, the mom and pops, the pizza shops, the beauty salons, and things like that, and those are very small businesses that are taken care of very adequately under provisions that we all have in our statutes. And there are some bills here that we don't like, that are going to give them—

Mr. VARGAS. Right, but let's move forward. It is the ones that are ready to go up to the IPO.

Ms. LUBIN. Right. There are some really big businesses right now, really large companies that are sitting in a space where they don't have to go public because they are so comfortable in the private market, when they really ought to be public companies. And they are the companies that everybody is lamenting, we have enough IPOs, we don't have big companies, and there isn't disclosure in the market. There isn't the information.

Mr. VARGAS. Right.

Ms. LUBIN. There aren't rules about the auditors. There aren't rules about third party—

Mr. VARGAS. I am going to interrupt you just for a second because I think you are taking this in a different direction than what I was asking. I am talking about companies that want to go to the IPO and want to be in the public side. That is what I am asking about. Obviously, there are large private companies that I think would benefit from going IPO, but they don't because they are comfortable because they have the backing that they need.

Mr. Trotter, why don't you comment on this? It seems to me that it would make some sense for the smaller companies that want to go into this IPO.

Mr. TROTTER. Absolutely, and I will start with a comment that I have heard Ranking Member Sherman make in the past, which is, "You can't give 404(b) relief." You can't give relief from the Sarbanes-Oxley internal controls audit requirement because then you are going to have more WorldComs and Enrons. WorldCom and Enron were mega cap companies. WorldCom had $30 billion in revenue. Enron had reported $100 billion in revenue—$10 billion in revenue 4 years before it melted down, right? So, they would never have qualified as an emerging growth company. And this is exactly the point.

If you had a time machine, and the JOBS Act existed previously, and Sarbanes-Oxley existed previously, they would have been mega cap companies. They would have had to comply with the full panoply of regulation exactly as you are describing, and a startup that is trying to enter a public company status gets relief. And it is based on an original SEC rule that says, when you initially go public, even if you are a mega cap on day one, you have until your second annual report before you have to comply with 404(b), even for the largest company. So, the idea of the IPO On-Ramp was, let's extend that. We did it for 5 years. It is time to extend it more.

Mr. VARGAS. My time is up, and I apologize because I had more questions with that. I thank you, and I yield back.

Chairwoman WAGNER. I appreciate it. The gentleman from Michigan, Mr. Huizenga, who is also the Chair of our Subcommittee on Oversight and Investigations, is now recognized for 5 minutes.

Mr. HUIZENGA. Thank you, Madam Chairwoman, and at the risk of appearing like I am picking a fight, which I am not trying to do, I can't let stand exactly what my friend from California seemed to be creating the image of, because I can tell you that back in February, we had a similar hearing on wealth creation and opportunity that specifically plumbed the depths of qualified investors. And a friend of mine, David Olivencia, who runs Angeles Investors, testified, along with Eli Velasquez, the founder and managing partner of Investors of Color, and a woman from Washington, D.C., named Omi Bell, who runs Black Girl Ventures. And we also had a Duke Law University professor, who literally, after they went through the opportunities that they could have had and how they had been stymied, sat at the end of that panel saying, in fact, these people shouldn't be able to invest. And I have to tell you, way too often, we have seen regulators, academics, and, yes, politicians who

have said, no need to apply because you are not wealthy enough, and we don't think you are sophisticated enough.

And Mr. Sampson, I know you have been here, and Mr. Trotter, Mr. Ward, and Mr. Brooks, I am going to ask you this question in the same good-natured way that I asked my friend, David Olivencia, and I hope you take it the same way he did. Are you a sucker, are you a dupe, because I can tell, based on your Twitter account, you are not. I looked you up. I retweeted you, by the way, because I know you are very excited about this, and hopefully, my 30,000 followers will be able to comingle with your 30,000 followers and vice versa. But I can tell you it is frustrating to me. It is frustrating to me when we have people saying, you know what, we are just not sure. We don't think you can really handle this.

Mr. Ward, in your testimony, you said, "Investors often turn to their local communities for support to get their ideas off the ground." And that is interesting, because in a subcommittee hearing, that February hearing that we had, I noted that of the 50-plus proposals from the Securities and Exchange Commission Chair on his regulatory agenda, none, zero of his proposals focused on supporting capital formation, none of them, let alone updating the definition of, "accredited investors." And we are just having a chat up here, and there are rumors out there that they may even go in the opposite direction.

So, I actually introduced the Accredited Investor Definition Review Act, which, among other things, would require the SEC to review the list of certifications, designations, and credentials for individuals to qualify as an accredited investor.

Mr. Ward, quickly, what is your definition of a, "sophisticated investor?"

Mr. WARD. I look at a sophisticated investor as someone who has unique expertise or knowledge in the area in which they are investing.

Mr. HUIZENGA. Okay. Mr. Sampson, do you believe that the SEC has overstepped their authority by basically telling investors what and where they can invest?

Mr. SAMPSON. I don't know if I would go as far to say they have overstepped it. I think there is definitely—

Mr. HUIZENGA. Have they fostered that?

Mr. SAMPSON. I think about some of the titles—Title VII of the JOBS Act actually created a diversity, equity, and inclusion officer, and some of the outreach they have done to underrepresented communities. I think they definitely tried. I have worked closely with the SEC throughout my tenure. I did want to say something really quickly to the gentleman, and I have jokingly said this to Congressman McHenry over the years—we haven't agreed upon much politically, but I have been voting since 1991, since I was an undergraduate in New Orleans at Tulane University, and David Duke was running. We registered to vote so that David Duke wouldn't become governor, and I have voted Democrat all of my voting career. But when it comes to capital formation from the JOBS Act, to redefining the definition of an, "accredited investor," and some of the other regulatory frameworks, I have agreed with the GOP on that in specific.

Mr. HUIZENGA. To be honest, I am not concerned about whether you are a Republican, a Democrat, or an independent, or whether you are Black, White, or green. It doesn't really matter. It is about opportunity, freedom, and liberty, and way too often, you are seeing government get in the way of that, and I will finish with that. We don't want to see these rules hurt private companies seeking capital. My time is up, and I blew up my whole plan on what I was going to do, but I just felt that I couldn't let that stand.

I want to say thank you all for what you are doing, what you are fighting for, and what you are standing for, because you are exactly the voices and the faces that we need to see, that the American people need to see, and that, frankly, Chair Gensler needs to see to make sure that we are going in the right direction. I yield back. Thank you.

Chairwoman WAGNER. And let the record reflect that Mr. Brooks was also applauding and giving a thumbs up.

The gentleman from Missouri, Mr. Cleaver, is now recognized for 5 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman. Commissioner, I am curious about the type of population that the accredited investor definition intended to capture. What group are we trying to capture? What segment of our population is the accredited investor definition intended to seduce?

Ms. LUBIN. Thank you for the question. Originally, when Reg D was set up back in the early 1980s, less than 2 percent of the population qualified to be accredited investors. And the theory behind it was that investors who would be in a position to protect themselves, who had the wherewithal to lose the money if they were going to lose that investment money, would be putting their money into these private deals.

Now, because the numbers have not been adjusted for inflation, the only real change to it that had a meaning over the past 40 years was to take the primary residence out of that calculation. It now covers 13 percent of the population. And some of these proposals will expand it well beyond that to a group when you think that a significant number of Americans only have $65,000 in their savings account, and that is all they have. It will expose significant money to the riskiest investments in the market.

So, I understand that people should have freedom, but you don't get the phone calls I get on a regular basis. You don't see the arbitrations I see filed. You don't get the complaints we see where people are losing their money all the time. And this is their life savings that they are losing, people who do not have the ability to go in and re-earn the money that they have earned because they lose them in these kinds of investments. There are private deals. There is no backup. There is nobody else. There is no way for them to get their money back and replenish it, and the money is gone. The deals are gone, and they can't get it back. And the more these standards are liberalized, the more people are going to lose their money and not have the ability to get the money back.

The problem with these deals is the more investors who get into them, they will not have any transparency. There is not going to be information. There is not going to be the ability to have a line of sight into the deals and see what the financials are, what the

background is, what is really going on inside those businesses and have the ability. There are wonderful entrepreneurs. I saw the prior hearings. But there are also a lot of people out there who are interested in taking advantage of these investors.

Mr. CLEAVER. I want to follow up. Do you believe that the existing thresholds are accomplishing that?

Ms. LUBIN. Over all my years in the Securities Division, I think the existing thresholds at this point need to be adjusted. I think things like pulling out savings accounts, and adjusting the numbers up to reflect inflation is important. I think if you look at a lot of the bills that were noticed for this hearing, they were adjusting the numbers up for thresholds for the businesses, and giving them more leeway.

Some of the billion-dollar businesses are being adjusted for inflation, so they continue to qualify for a lot of the standards and will continue to qualify. I think we should give the investors the same leeway and let their standards give them the protections they will get by adjusting their numbers, the same way we are giving the businesses the benefit of being able to be bigger and still qualify for some of the breaks that they get.

Mr. CLEAVER. So, you believe that lowering these standards will somehow accomplish the objective?

Ms. LUBIN. No. I think, actually, that we need to raise the standards for accredited investors so that they continue to have the protections that were originally intended. I think there are other things that we can do to maybe free up some of the requirements.

Mr. CLEAVER. My time is running out. Do you have any ideas on what we could do instead of lowering the threshold?

Ms. LUBIN. There are some other things that the SEC is considering, that I think we can talk about, and we would be happy to provide some additional information for you.

Mr. CLEAVER. Okay. Thank you.

And thank you, Madam Chairwoman.

Chairwoman WAGNER. The gentleman from Wisconsin, Mr. Steil, is now recognized for 5 minutes.

Mr. STEIL. Thank you, Madam Chairwoman.

Mr. Trotter, you are one of the creators of the IPO On-Ramp in Title I of the JOBS Act. And as Commissioner, a few of them noted last month, Title I is the most successful title in the JOBS Act, and significantly increases IPO volume overall. I have a handful of questions here, so if you can please be concise, why should policymakers be interested in increasing the volume of IPOs?

Mr. TROTTER. Because it is directly linked to job creation. Over 90 percent of a company's job growth when it goes public occurs after the IPO.

Mr. STEIL. Job creation in the United States of America. Title I created the emerging growth company construct, giving new and growing companies balanced regulation that scales over time. How should we quantify the cost savings that come with scaled emerging growth company (EGC) disclosures?

Mr. TROTTER. They are readily apparent to anybody who lives in the IPO ecosystem. I hear a lot of criticism from academia, and I hear criticism from lawyers who have never done an IPO, but for any IPO practitioner, it is readily apparent and makes a big dif-

ference. You don't have to present a third year of financial statements; you can go public with two. That is a meaningful cost savings. You are not subject to Sarbanes-Oxley 404(b), which is a huge cost savings, at least a million dollars a year.

Mr. STEIL. So, significant cost savings—you reference that people do have criticisms of this, claiming that it will put investors at risk and all sorts of claims that we see out there. How do you respond to those criticisms?

Mr. TROTTER. That is my point number three in my opening remarks. Every public company, including every EGC, including any company after all of the things that are being proposed right now, is subject to immense liability and compliance obligations. None of that changes. That is why the doom and gloom is wrong because all of the liability remains intact.

Mr. STEIL. I agree. I think a lot of regulatory things are still intact. EGC is a great on-ramp for companies to create jobs here in the United States of America. Would you agree that existing qualification thresholds for EGC status should be revisited? Yes or no?

Mr. TROTTER. Absolutely, yes.

Mr. STEIL. I have a bill that addresses this. It would raise the EGC threshold so more companies can continue to benefit from the IPO On-Ramp that you helped build. How would this impact startups overall in the United States if we revisited that threshold?

Mr. TROTTER. Your bill would be a game changer. I highly recommend it.

Mr. STEIL. Thank you. Let me shift gears with you. I am going to stay with you though, if I can, Mr. Trotter. I have another bill regarding the Well-Known Seasoned Issuer (WKSI) status. Can you explain really quickly the WKSI status, and, in particular, the proposal to lower the public float threshold from $700 million to $75 million, that minimum companies would qualify for use of short-form registration. Would you support lowering the threshold from $700 million to $75 million?

Mr. TROTTER. Yes, I do.

Mr. STEIL. And why do you believe we should lower it to $75 million, or maybe you have a different number? Mine is $75 million. What would you do?

Mr. TROTTER. No, I applaud your number. The SEC said that is the number, that is the amount of float that gives you analyst following, and that was the basis of the Well-Known Seasoned Issuer definition. When the SEC proposed it in 2004, they actually proposed $300 million as a possibility, back when it was still an experiment. Now, we have almost 20 years of experience. It works. It is time.

Mr. STEIL. Then, the follow-up question would be, some people would say, oh no, it might not be safe, it might not be this, or it might not be that. If you look at WSKI over the time that it has been available, has it proven to be safe and effective over the last 2 decades since its introduction?

Mr. TROTTER. Absolutely. It is a resounding success. All companies are required under Sarbanes-Oxley to be reviewed by the SEC at least on a 3-year basis, so all of the companies are having their filings reviewed.

Mr. STEIL. Is it safe to say that your view is we could go back, review, and analyze these constructs inability to a lot more companies to become public companies here in the United States. We have a sufficient and substantive regulatory framework to provide protection for investors. And if we take advantage of that opportunity, it will actually help to create jobs here in the United States of America?

Mr. TROTTER. Yes, 100 percent. Well said.

Mr. STEIL. Thank you very much. I appreciate you being here. And I appreciate all of our witnesses. Thank you, Madam Chairwoman. I yield back.

Chairwoman WAGNER. The gentleman from North Carolina, Mr. Nickel, is now recognized for 5 minutes.

Mr. NICKEL. Thank you so much, Chairwoman Wagner. I am very glad you are holding today's hearing on capital formation, as I share your goal of improving our markets and increasing access to capital for small businesses. One of my main priorities in Congress is ensuring equity and access to capital. According to recent studies, 6 in 10 Black entrepreneurs faced challenges in obtaining capital. When women and minorities can access capital for their small businesses, our entire economy benefits from it.

Commissioner Lubin, what should Congress do to improve minority access to capital through our public markets?

Ms. LUBIN. Thank you for the question. I think there are a lot of things going on. I have listened to the prior hearings, and I think one of the things that I have heard a lot of venture capitalists and a lot of entrepreneurs say is that one of the things that happens is that the venture capitalists and the entrepreneurs aren't seeing each other. I have heard a lot of discussions about what goes under the coast; you have to be in the right cities.

And I think one of the things that we all could do together is to do a better job of introducing people and getting them together, and one of the things that we were asked is, what could we do as securities regulators? I think expanding some of the projects we have of getting people to meet and to network and going into some of the programs and trying to set things up, like having clinics where we have pro bono attorneys meeting up with entrepreneurs and getting some venture capitalists involved in it and having people meet each other, because what I have been told and what we have seen is that good businesses get funded, and people just need to meet each other.

So, I think if we can facilitate that and get people meeting each other and talking to us some more, because they talked to us about, how do we get into compliance, so we can help them avoid some pitfalls. For example, we have some small business programs in Maryland where we say, look, you are probably in the position where you want to take on shareholders right now, because there are a lot of things small businesses don't understand about that, but maybe you want to take on some debt and do debt offerings. So, there is a lot that we do to help businesses develop things and do those kinds of programs.

Mr. NICKEL. Thank you. I applaud the efforts to enhance capital formation and remove roadblocks to ensure that entrepreneurs can access the resources they need to be successful. But at the same

time, we need to ensure that new investors are adequately protected. Underrepresented entrepreneurs often struggle to find capital, and they would benefit from a larger pool of more-diverse investors who look like them.

Some of my colleagues on the other side of the aisle proposed changing the requirements to qualify as an accredited investor. One example would be to include individuals who pass an exam established and administered by the Securities and Exchange Commission (SEC) or the Financial Industry Regulatory Authority (FINRA).

Mr. Sampson, you discussed in your testimony wanting to grow the pool of Black investors in this ecosystem. Would this proposal to allow people to become an accredited investor after taking an exam do that?

Mr. SAMPSON. It absolutely will. We created a Black Technology Ecosystem Investors Certificate Program during my visiting professorship at Kenan-Flagler at the University of North Carolina, in collaboration with Duke and Stanford, and The Links, Incorporated was a national organization of many affluent and wealthy Black women in this country. We graduated 50 people in that program, who now understand the asset class, know how to identify deal flow, and know how to invest in venture funds and startups. We need to do that at the level of the thousands. Why? Because it is not that founders are not meeting investors. They are getting in the rooms and they are still getting told, no.

So, the meetups are not working, the conferences are not working, and we have to develop a new investor class who is educated to actually make investments in respective companies. And I think we will see traction with increasing that less than one percent and getting it to more equitably around 13 to 20 percent.

Mr. NICKEL. Thank you, Mr. Sampson. You have identified some outstanding research universities there.

Mr. Ward, what are your recommendations to ensure that such a test is as robust as possible?

Mr. WARD. If you want to do a knowledge-based testing into accreditation, I think the fastest path is through FINRA, where they already have a series of exams that test financial literacy. I think that is the first step. I think if you want to extend that, there is accreditation into different sectors. For example, a doctor might not pass the financial test but may pass a sector-specific test. But I think the fastest path would be through the FINRA registration exams that already exist.

Mr. NICKEL. Thank you so much to all of the witnesses for joining us. Madam Chairwoman, I yield back.

Chairwoman WAGNER. The gentleman from New York, Mr. Garbarino, is now recognized for 5 minutes.

Mr. GARBARINO. Thank you, Madam Chairwoman, and thank you for holding this hearing. We have some great witnesses today. I want to touch on something I know that Chairwoman Wagner and Chairman McHenry both spoke about. I got this text from a buddy of mine a couple of weeks ago, and he said, "Are you guys doing anything about that B.S. accredited investor rule? I am shut out of investing in my 5,000-employee major company with a 1-to-1 investment match because I am not worth enough money under the

rule. I am allowed to invest in highly-risky penny stocks and bitcoin, but not my own company. Such a dumb rule."

Mr. Brooks, the current definition of, "accredited investor," limits private markets investments to those it deems to be sophisticated. However, using wealth as the sole indicator of sophistication excludes a significant amount of potential investors who may possess other forms of knowledge and expertise. Can you discuss your thoughts on expanding the definition to include other criteria?

Mr. BROOKS. Yes, that is asinine. It is simply asinine that we are allowing this. One of the most open secrets in Silicon Valley is these people just get money from their friends. One of the fourth or fifth investors in Uber got a $25,000 friendly check to invest in Uber and ended up making tens of millions off of that, and is now one of the most well-known angel investors in the world, who has written the handbook on angel investing. But I couldn't get a loan from that firm. I didn't have friends and family who could give me that, so it is an asinine rule.

I guess if I were to step back for a second, when I started my company, I was living out of a Jeep Patriot that didn't have roll-up windows and didn't have locks in the car. That was 7 years ago. I am sitting here today because I don't want entrepreneurs and founders to go through that same thing that I had to go through. That struggle, the sacrifices that I have had to make to sit here today is asinine. Those accredited investor rules weren't in place. Maybe I could have asked, if I even knew what venture capital was, and have gotten some better things.

What the SEC wants to do is an overstep of their power. Who am I to speak on that, Brandon Brooks with no college degree? And I am not as fancy as everybody else here on this panel, but you know what? I have put in the work, and so I think I have a right to speak on this. What the SEC is doing and others who want to heighten the accredited investor regulations is asinine.

Mr. GARBARINO. I appreciate that, and if you actually have specific thoughts of what we should do, if you could respond in writing, I would love it, because there is a lot. But I do want to get to Mr. Ward, because I have a question about venture facility and venture funding across the country.

Mr. Ward, first-time fund managers and regional emerging managers drive capital beyond the traditional hubs. Can you explain why these entities are a crucial part of venture funding, and what role they play in the startup ecosystem compared to larger funds located in the established venture hubs?

Mr. WARD. In this country, we are very good at producing accountants, lawyers, and doctors. We are not so good at producing entrepreneurs. The best way we know how to do that is to activate these emerging managers, these angel networks that go out around the country and find entrepreneurial talent, cultivate that talent, and help them grow both through advice and through funding their companies. So, if we want to create more entrepreneurs in this country, it starts with creating more emerging managers and more angels that can go find these entrepreneurs and develop them.

Mr. GARBARINO. What is Washington's role in facilitating increased capital access?

Mr. WARD. Anything Washington can do to lower the barriers of entry for these angel networks and emerging managers so that they can start aggregating capital to support these entrepreneurs, I would applaud. As we bring more and more angels into the heartland of America, you will start to see these ecosystems pop up. We know that almost all startups start with early seed funding from angels, not institutional capital. And without those strong angel networks in regions, we can never graduate those companies into institutional capital, and eventually, public markets.

Mr. GARBARINO. I appreciate that. And the investment into other venture capital funds is currently classified as non-qualifying investments for the purposes of exemption from registration under the Investment Advisers Act. If we were to include fund to fund investments as qualifying investments, would this help unlock capital that is otherwise competing for late-stage allocations?

Mr. WARD. It would dramatically increase capital into these sectors in part because there would be more capital going to them. But these institutional investors use these investments in emerging managers to create the deal flow that goes into their larger investments, and that is how they find these early-stage entrepreneurs.

Mr. GARBARINO. Thank you very much. I am out of time, so I yield back. Thank you, Madam Chairwoman.

Chairwoman WAGNER. The gentleman from Illinois, Mr. Casten, is now recognized for 5 minutes.

Mr. CASTEN. Thanks so much to our Chair. I want to start just—I think you have probably seen up here that there is bipartisan agreement that private markets are bigger than public markets right now, and that there is a concern about some risk of arbitrage and the opportunities that affords. I think where there might be a difference of opinion is whether that is necessarily a bad thing and what the causes are.

I wouldn't argue with someone who ran private equity-backed companies. I didn't run private-equity backed companies because it was a compliance issue. There was just a lot of money. And 40 years ago, if you were managing the Harvard endowment, you were in T-bills, and all of a sudden, there was this huge surge of institutional money that created opportunities to grow. And I think it would be disingenuous to say that somehow, it is a surfeit of investor protection rules that made private equity markets grow. At the same time, the distinction between those matters, because in one case, investor protection is done through disclosures, and in the other case, investor protection is done through these accreditation rules. And you can't lower one without increasing the need for the other, and we have to find some balance there.

Mr. Ward, you and I talked before and I appreciate your time. I just want to make sure that I have some of the facts right. Did I get right that you said that the private equity markets are about 6 times as big as venture capital markets in the United States?

Mr. WARD. That is what we think. Yes.

Mr. CASTEN. Okay. So when we are talking about private markets, we are really talking about private equity right now.

Mr. Trotter, I have never seen the analysis, but if you look at the ultimate owners of capital in private markets, not the private equity funds, pension funds, endowments, sovereign wealth funds, in-

dividuals, do you have any sense of what portion of that money is institutional and what portion is individual?

Mr. TROTTER. I cannot say that I do have any sense of that. There has been a lot studied in this area, that sort retailization. I think Mr. Ward could speak to that.

Mr. CASTEN. I guess if I could make just a qualitative observation, in my own experience raising money, there is a lot of institutional money out there. There is a very small number of sort of wealthy family offices—yes, there are some. But my gut feeling, and I see heads nodding, is that mostly they disagree that the bulk of the money in private markets right now is institutional.

Mr. WARD. I think that would be fair, but I do think in the last decade, we have seen the emergence of the family office that competes through institutional capital.

Mr. CASTEN. Sure. Someone once told me that the least-sophisticated, and the way that you all are using the word, "sophisticated," not the way that we define, "sophisticated," the least-sophisticated people in the world are pension fund managers. None of them trust themselves to actually do an analysis of a deal. They entrust their money to a venture capital fund, to a private equity fund, and say, I want you to do the diligence to sit on the board to do the governance to evaluate the deal and essentially outsource that responsibility, right?

So, they are providing that investor protection and their fiduciary obligation, not because they are sophisticated in the Oxford English Dictionary sense, but because they are sophisticated in the legal sense, and can afford to hire those people to do it. I say that because when we frame this as, shouldn't we let more individuals, I think we are missing the point that the investor protections that are there right now are to protect the institutional folks.

And I guess either Mr. Trotter or Mr. Ward, whomever wants to answer this, how easy is it for someone who doesn't have the ability to get the phone call from Tiger Global Management Fund for, would you like to be an LP in my next raise, how easy is it to look at a private equity deal and say, I know who is conflicted up and down the capital stack, I know who has step-in rights in this deal, I know who has governance provisions? How easy is it to find that out if you are not the size of a CalPERS or a Harvard or Yale endowment?

Mr. WARD. I have a perspective on this, Congressman. I think it is difficult. I think all financial markets are led by institutional investors and followed by retail investors. That is true in the public markets and that is true in the private markets.

Mr. CASTEN. I am close to the end of my time, but Commissioner Lubin, I would love to just give you the last word here. If private markets are dominated by institutional people who can afford to hire very sophisticated people to do their analysis on the back end, and if we are to make it easier for people who don't have that level of wealth to participate, who is going to win?

Ms. LUBIN. Investors, the retail investors who are on the ground to protect are going to lose. They always do.

Mr. CASTEN. And is it safe to say that the bills noticed for this hearing are primarily going to serve as a wealth transfer from those small individual investors to the big institutional players?

Ms. LUBIN. To them, or to the scam artists.

Mr. CASTEN. Thank you. I yield back.

Chairwoman WAGNER. The gentleman from Pennsylvania, Mr. Meuser, is now recognized for 5 minutes.

Mr. MEUSER. Thank you, Madam Chairwoman. And thank you very much to our witnesses. I also thank the Chair of the Full Committee, and you, Chairwoman Wagner, for these four hearings on capital formation, as they are very important. These hearings are showing us that our capital markets have been clogged, and they could perhaps become more clogged with government regulations. And we are here to figure out real solutions that help all investors and all of our capital formation, so our committee is doing what we can do to fix these problems. We are here to talk about what we can get done, and we appreciate the feedback being received.

Mr. Trotter, as you know, the sale of securities is regulated both on the Federal and State levels. While there have been efforts to provide greater clarity and uniformity between Federal and State laws by providing exemptions from certain State-level blue sky laws, Federal and State securities regulation remains burdensome and, in fact, is considered a patchwork system. Can you explain some of the challenges companies face when forced to navigate the burdensome patchwork system of State and Federal securities regulations?

Mr. TROTTER. You summed it up nicely when you just described the list, and that is, you are just getting started there. So the compliance obligations, even after you chip away when these small ways that are being proposed, are still onerous, but what we are proposing or what we proposed with the IPO Task Force is scale the regulation, and we have discussed this already.

But it is not about more versus less regulation so much as balancing the regulation so that it scales to the size of the company that is regulated. If you are a mega cap, all of the rules apply to you, and there are going to be more rules every year as we go forward, right? If, however, you are a company that is trying to enter the public company system, you should be encouraged, not discouraged. And you can do that through scale disclosure through the on-ramp type of concept. We have 11 years of successful experience with the JOBS Act and emerging growth companies. We have almost 20 years of successful experience with Well-Known Seasoned Issuers. Those are both categories that should be expanded significantly.

Mr. MEUSER. Thank you. Secondary market transactions take place on exchange or off exchange. Some States have laws that limit off exchange secondary trading and securities. Can you explain how this approach interferes with capital formation without promoting investor protections?

Mr. TROTTER. I'm sorry. Can you—

Mr. MEUSER. Let's move on. I want to get to some other questions in regards to a bill, H.R. 2506, the Restoring the Secondary Trading Market Act, which I am introducing, that will prevent State laws from limiting off-exchange secondary trading and securities of an issuer that makes current information publicly available. And I would like to get the panel's feedback on this bill.

Mr. TROTTER. I would be happy to look at that and follow up with you.

Mr. MEUSER. Great. Thank you.

Mr. Trotter, staying with you, the House passed the JOBS Act, as you well know, in 2012. At the time, the North American Securities Administrators Association released a statement saying that the JOBS Act sacrifices essential investor protections without offering any prospects for meaningful sustainable job growth. Were these predictions correct?

Mr. TROTTER. They were 100-percent false.

Mr. MEUSER. Right. So in your view, has there been weakening investor protections or an increase in fraud since the JOBS Act was passed?

Mr. TROTTER. No, because the liability provisions of the Federal securities laws remained unchanged from the JOBS Act, as well as all of the provisions that you are looking at today.

Mr. MEUSER. Okay. I appreciate that. Obviously, access to capital is very vital.

Mr. Brooks, I am interested in you. You are making some faces over there, and there are a lot of emotions and feelings going on. Tell us some of your thoughts on the questions and some of the answers from both sides of the aisle.

Mr. BROOKS. Yes. I guess overall, I think it is really interesting to see who has stayed, and who has left. Just from my point of view sitting here, I think it is really interesting hearing the questions and just who has put in the work to understand the struggle of being a Black founder, to talk with real Black founders, to talk with real women founders, and to talk with real Latino founders, those who exist outside the lines. I don't know a single one that I have talked with or myself that would not agree with what we are trying to do here today, expanding access to more people who look like me, and unfortunately, many of the people who have left the room today.

Mr. MEUSER. I look forward to keeping the conversation going with you. I appreciate you being here, and I yield back, Madam Chairwoman.

Chairwoman WAGNER. He said the Latinos, too.

The gentleman from New York, Mr. Lawler, is now recognized for 5 minutes.

Mr. LAWLER. Thank you, Madam Chairwoman. Mr. Brooks, I couldn't agree more with your comments. In 2020, the SEC adopted amendments to Reg D to allow for certain demo day communication to be exempt from being considered general solicitation or general advertising. The amendment also defined, "angel investor group," for the purpose of Federal securities laws. These changes were made to support startups discussing their products and business plans, demo day events without it being considered an investment offering. Given that Reg D reform is on the SEC's Reg Flex agenda, and Democratic Commissioners expressed their intention to chill private offerings, how critical are these changes made in 2020 to capital formation, and should Congress solidify these changes by codifying them into law?

Mr. BROOKS. Yes, absolutely. It is a no-brainer because it makes it easier for people who exist outside the lines to get it in front of

people without getting expensive attorneys and people involved. If you have $10 in your bank account, how are you going to pay an attorney thousans of dollars just to prove that you can present on demo day that you can raise money? It is crazy.

Mr. LAWLER. Right. Thank you.

Mr. Ward, as you know, Regulation A enables companies to sell securities to the public with limited disclosure requirements compared to public companies. Despite its potential benefits, Regulation A still seems to be underutilized. How would amendments to Regulation A help small businesses raise capital?

Mr. WARD. I think Reg A, and I will also include Regulation CF, are two great ways for companies to start their journey of raising initial capital. The thing I worry about in Reg A and Reg CF is creating two paths for companies, a Reg D path and a Reg A path. I think it creates issues around adverse selection bias and picking which path they should take. What I would be supportive of is a way to merge Reg CF and Reg A with Reg D, so that Reg CF/Reg A could be a way to jump-start companies to get their local communities to raise their initial seed capital. And then, they move on to Reg D status to start raising more institutional capital over time.

Mr. LAWLER. Would companies benefit from Regulation A if Congress raised the offering cap?

Mr. WARD. I think companies may benefit from that. I think it will benefit the larger, higher-scale companies, but I still think there needs to be a path to Reg D. The amount of money most companies need these days to get to an IPO far exceeds the current Reg A limits.

Mr. LAWLER. I appreciate that.

Mr. Ward, there is currently no suitable regulatory framework for finders who, incidental to their primary business, help match potential investors with private issuers and receive payment for successful introductions. Today, finders are treated as broker-dealers due to the mishmash of SEC staff interpretations and no-action letters. Is this a problematic framework for those seeking to make connections between investors and private companies seeking capital?

Mr. WARD. I think so. Today, the way that finders work in practice to circumvent the broker-dealer rule is they are usually anointed as advisors and given equity in the company to help the company. It is unclear if advisors will be a big part of the ecosystem. I think we are still learning about what role intermediaries have in the venture ecosystem and how to connect founders to investors.

Mr. LAWLER. Would exempting finders from broker-dealer registration eliminate ambiguity about when companies can engage finders who are not registered as broker-dealers, and would this help facilitate small business capital formation?

Mr. WARD. Yes. I think much like when we liberalized investment banking licenses to help founders sell their companies, I think if we can exempt finders from broker-dealer registration to seed an ecosystem of finders to help founders find capital, I think that could catalyze a much more-liquid market for financings.

Mr. LAWLER. Thank you. In the time I have left, Mr. Trotter, during the passage of the JOBS Act, you were a leading member of the IPO Task Force and served as a principal author of the IPO-

related provisions. Can you compare today's kind of political and economic climate to when that passed a little over a decade ago?

Mr. TROTTER. There is one comparison that is clear to me and, again, you have this debate over more versus less regulation, and you know where that ends. It ends in stalemate. But my answer to that is to follow the path that the JOBS Act took in Title I, the IPO On-Ramp provisions. It is not about more versus less. It is about scaling the regulation. It is about balanced regulation so that the full seed of regulations apply to the largest enterprises, and the new companies that are entering the public company system get a break. It has worked very successfully for 11 years.

Chairwoman WAGNER. The gentleman's time has expired.

Mr. LAWLER. Great. Thank you.

Mr. TROTTER. And it is time for more.

Chairwoman WAGNER. The gentleman from Iowa, Mr. Nunn, is now recognized for 5 minutes.

Mr. NUNN. First, Chairwoman Wagner, thank you very much for calling this hearing, specifically to build upon the important goals of bolstering our private markets, expanding accredited investments, and encouraging investments in small businesses throughout the country. I want to thank each of you on the panel who took time out of what I know is a very busy daily life to come and do what is on no one's bucket list: to testify before Congress. So, compliments to each of you, and to the family members who are here, thank you for supporting your family in this.

Look, you all have very, very incredible stories to share, and it is truly, I think, a lot of Cinderella stories that have been made successful. Mr. Ward, I am now focusing on you. You had to leave your hometown to go to California, to network, to find angel investors. You went through this process over a decade ago and the challenges—as Mr. Brooks said earlier, great ideas and American Dreams happen all across this country. But you were forced to find capital in those very select markets, specifically, as we have identified in this committee, basically three States—Massachusetts, New York, and California—and there are a lot more out there and a lot greater potential.

I would like to point out that in my home State of Iowa, and a number of us represent smaller States on this, just for the rest of the world watching this, 33,000 new small businesses were started in Iowa alone last year, and they did it without the benefit of being in Silicon Valley. Now, imagine for a second what this entire country might look like if we were discussing what is capable this afternoon and we built upon the JOBS Act of 2012, just a decade later.

So, Mr. Ward, share with us, first of all, just that story for of how you got to California and really what that meant for what you left behind?

Mr. WARD. I arrived in California in 2010, and I didn't know anybody. I didn't have a job. I was brought there for family reasons. I decided to start a company as one does if you move to Silicon Valley against your will, and part of that process was trying to meet other founders, trying to meet other investors. The rule back then, which hasn't changed today, is if you want to get an investor, you have to find an introduction to an investor. You have to meet that investor personally. And it was months and months of just net-

working and finding people, and that hasn't changed today. If you are someone who is not in California in the thick of it, it is extremely hard to do if you are in Iowa. It might even be impossible.

I think the path to creating an on-ramp for founders in different geographies and regions is to create strong, robust, emerging managers and angel networks in those regions. And we are starting to see this happen in different hubs like Nashville, Tennessee, Austin, Texas, and Atlanta, Georgia, and there is no reason why we can't do that in places like Iowa as well.

Mr. NUNN. Let me ask then, you have seen this landscape change dramatically just in the last decade. What other opportunities are there for new and emerging businesses to be able to tap into those markets without having to move to the place where the network already exists? How do we expand that network out there, and what kind of things can we be doing on this panel?

Mr. WARD. Yes. I think expanding accredited investor rules will help a lot. For example, in Iowa, an accredited investor rule is the same rule but has different impacts in Iowa than in California. So, I think creating those angel networks by lowering the barriers for access to capital, lowering barriers for angel investors who want to graduate into running their own committed funds. I think will help as well. I think one of the things that we forget is that all investors are entrepreneurs also. They start their own funds, and so anything we can do to help those entrepreneurs build their businesses, which is to invest in other entrepreneurs, has a flywheel effect on the ecosystem.

Mr. NUNN. Mr. Ward, I couldn't agree with you more, and compliments on what you have done with Carta in such a short time.

Mr. Brooks, I would like to return to you here on this idea of really expanding the American Dream. I think one of the things that we underappreciate is just how many dreams are out there that have yet to be fulfilled. Perhaps, you could give us just a little bit of perspective as a father of five daughters, one who is biracial, on how you have managed this, and what are we leaving off the table that we can really grow?

Mr. BROOKS. Just more access, more opportunities, and it is really so simple. It is a fantastic place to be. It was on my bucket list. I am crossing that off today. I thank you. But really, it is so simple and it is creating more opportunities. That is it. This expanding accredited investors creates more opportunities for people to invest, yes. You are going to get some wrong, but guess what? I can go to the craps table and hop the yo as many times as I want, but I can't sit here and invest in a great company that my friend is starting, that I know will be fantastic. But the rich, wealthy, elite class, White male mostly, who live in Silicon Valley, can go and invest in my friend and become a multibillionaire maybe because of it while I sit here in the same position.

Mr. NUNN. Thank you, Mr. Brooks. I would say, always bet on the Heartland. You may find yourself very surprised. With that, I yield back.

Chairwoman WAGNER. Hear, hear, says the gentlewoman from Missouri. Now, I recognize the gentleman from Texas, Mr. Sessions, for 5 minutes.

Mr. SESSIONS. Madam Chairwoman, thank you very much, and let me say, as our colleague, Mr. Vargas said, thank you for having not only a subcommittee hearing that is seemingly bipartisan, but also for your leadership, and Mr. Vargas, for taking the time to stick around to hear all of this great information. It proves how we do need a better roadmap for this integrity.

I would like to ask you all, because I have been working with the SEC, and we have spent a lot of time in here worried about rules, regulations, investor rules, all those kinds of things. But I find that the Securities and Exchange Commission is a huge hindrance to the effectiveness of IPOs becoming capable of what they want to do. I engaged the SEC Chair and the entire SEC last year and found that they were asleep at the switch, did not come to work, gave conflicting information to the investors, weren't willing to stand behind it, and then held it against the investors when their own lawyers were quoted to the Department. The SEC Chair point-blank told me that he was not going to respond back to a request that was made by an IPO investor when they intentionally provided all of the information that they thought they needed to provide, and 7 or 8 months later said, no, we are not going to even respond back. We won't respond back to you, and we are not going to respond back to them.

Tell me about the SEC being a hindrance to people effectively building this wealth and wealth creation of IPOs, because of their oversight of blunders and inattention to capital formation. Anyone?

[No response.]

Mr. SESSIONS. Okay. I guess I will continue on then, since no one has any direct information. I find that we need, as I spoke to the Chair yesterday about a process whereby the SEC would be able to recognize that they are not being forthright about solving problems that when investors have problems as they move forward. If you can get in trouble, you ought to be able to get out of trouble.

But simply to have information, because someone makes a claim against you and not even sharing that information with an investor group or a group of people to where they can resolve that, but waiting months and months, maybe up to a year, perhaps more, when they have contracts, when they have agreements, when they are trying to put together a company as they are going through their formation, whether it be in the stock market or in NASDAQ, I find that disturbing.

And I told a story yesterday I remember that when my dad became the FBI Director for President Reagan, the Department of Justice tended to have a viewpoint that they would not discuss any part of the work that they did, even after an indictment, even with proper counsel, and he changed that. He decided that proper counsel does exist in this company, lawyers who were beholden to a bar, to a court that could for any ethical challenges or mismanagement or things that took place where they did not properly take that information and work for resolution could be held by a court.

I believe that we should have a better process at the SEC for anyone who has a problem when the SEC begins an investigation, that there should be legal counsel that could be brought in on behalf of this IPO or anybody—where there is this recognition to resolve matters, not to wait a year and delay them and last them out.

I find it obnoxious, I think it is unprofessional, and I believe it is an intentional effort that has been made by the SEC to bludgeon investors in this country.

[No response.]

Mr. SESSIONS. Madam Chairwoman, I heard no response, so I will yield back my time.

Chairwoman WAGNER. The gentlewoman from Indiana, Mrs. Houchin, is now recognized for 5 minutes.

Mrs. HOUCHIN. Thank you, Chairwoman Wagner and Ranking Member Sherman, and thank you to the witnesses for coming to speak with us today. Mr. Brooks, you certainly seem happy to be here. That is refreshing.

Among the greatest strengths of the American economy are our public markets and the ability for retail investors to buy shares in companies they support. By expanding access to our public markets for companies, Americans across the country, including Southern Indiana, can build wealth and encourage economic growth. In recent years, however, companies have been pushed away from public markets, and often businesses find that the reasons against pursuing an IPO outweigh the benefits of going public.

Mr. Trotter, the raw number of IPOs has declined significantly in recent years, with the U.S. experiencing some of its worst years on record in 2016, and again in 2022. Recent reports indicate the downward trend in IPOs will continue into 2023. Could you please explain the factors contributing to such a steep decline in the number of IPOs and what that means for everyday investors?

Mr. TROTTER. When a company that is backed by early-stage investors reaches the point where it is ready to go to the next level and return capital to those early-stage investors, it has a choice. It can find a buyer and sell the company and become an acquisition target, or it can follow an IPO, pursue an IPO, and become a new public company, and those are very different paths. And with the public markets less-hospitable to private companies, they are going to be more likely to follow the mergers and acquisitions (M&A) path.

Now, a company should do what makes sense for the company, but if you have tilted the balance away from IPOs and toward an M&A exit scenario, then you are going to see fewer IPOs. So, the IPO On-Ramp was an effort to redress that balance. We have had a decade-plus of successful experience. You have seen the positive impact that it can make. And I have said it a couple of times already, but I don't tire of saying it, it is time to expand that category of emerging growth companies.

Mrs. HOUCHIN. Thank you. With fewer IPOs and a shrinking number of companies on public markets, not only do local businesses have fewer options to raise capital, but retail investors have fewer opportunities to build wealth and secure their futures.

Mr. Ward, Regulation A enables companies to sell securities to the public with limited disclosure requirements compared to public companies. Despite its potential benefits, Regulation A seems to be underutilized. How would amendments to Regulation A help small businesses raise capital? Would more companies benefit from Regulation A if Congress raised the offering cap?

Mr. WARD. I think raising the offering cap and anything we can do to make Reg A more attractive would be helpful to founders. I do think there is a concern around having a two-track system for capital formation in the private markets. The most-successful regulation framework we have today is Reg D, and I strongly encourage all of us to look at, is there a way that we can use Reg A and other capital formation regulations like crowdfunding and marry them with what is working in Reg D?

Mrs. HOUCHIN. That is great. Thank you. Earlier this week, I introduced my first bill in Congress, the Regulation A+ Improvement Act of 2023. It would raise the cap for Regulation A and allow more small to mid-sized companies to sell securities on public markets. As a member of this committee, I am committed to cutting red tape to make it easier for local businesses to grow while also expanding opportunities for everyday investors to build wealth to secure their financial futures. I look forward to continuing to work on this issue with the subcommittee. I thank the chairwoman, and I yield back.

Chairwoman WAGNER. I would like to thank all of our witnesses for their testimony today. I would also like to take a moment to invite any of our witnesses who have family members, not staff, but family members with them to recognize them. Mr. Sampson?

Mr. SAMPSON. Sure. Thank you for that. Joining me today is my wife of nearly 25 years, Shanterria Alston Sampson. She is also my partner in business and investing as well. My oldest son is here today, Rodney Sampson II. He is a recent graduate of Morehouse College and is headed to Georgia Tech to work on his graduate degree in computer science, and he is Phi Beta Kappa.

Chairwoman WAGNER. Congratulations.

Mr. SAMPSON. And Rodney III—you are going to see a trend here. Rodney III is a junior at Morehouse College as well and just secured his first summer internship at Harvard Business Publishing.

Chairwoman WAGNER. Wonderful.

Mr. SAMPSON. Rodney IV just turned 17 and is a freshman at Morris Brown College as well. He is also a software engineer and a gamer as well, so we are really excited about him.

Chairwoman WAGNER. Good.

Mr. SAMPSON. Rodney V is here as well, and, of course, we have Sophia, our youngest.

Chairwoman WAGNER. At last, thank heavens.

Mr. SAMPSON. Our oldest daughter couldn't make it. She is a graduate of Spelman.

Chairwoman WAGNER. Sure.

Mr. SAMPSON. Phi Beta Kappa, working on her Ph.D. at UPenn in computer science.

Chairwoman WAGNER. Wow. Congratulations to you—

Mr. SAMPSON. Thank you.

Chairwoman WAGNER. —and your wonderful family, and to your wonderful wife, who is also a partner with you in business. It is heartwarming to see, so thank you.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these wit-

nesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing is now adjourned.

[Whereupon, at 3:57 p.m., the hearing was adjourned.]

A P P E N D I X

April 19, 2023

Congressional Testimony
Brandon Brooks

Esteemed members of the House Financial Services Committee, I stand before you today as a representative of the voiceless and marginalized, the overlooked and underestimated. I am here to speak on behalf of the forgotten founders who were never given a chance to showcase their potential, and the hardworking people who are being shut out of investment opportunities because they don't belong to the elite class of the wealthy. Today, I bring a message of hope and a call to action. The time has come to break down the barriers that have held back our economy, and empower the next wave of American innovation. The time has come to put the American dream back within reach of all those who seek it.

Overview of the Venture Capital Industry

The venture capital industry is a critical part of the American economy. Venture capital firms invest in early-stage companies that have the potential to grow into large, successful businesses. These investments help create jobs, drive innovation, and promote economic growth.
According to the Q1 2023 PitchBook-NVCA Venture Monitor report, venture capital investment in the United States continued at a record pace in the first quarter of 2023. In total, $70 billion was invested in 3,636 deals in the quarter, up 31% from the previous quarter. While this is a positive development, it's important to note that much of this investment is concentrated in a few select areas and sectors. For example, the software sector received the largest share of venture capital investment in Q1 2023, accounting for 41% of total investment.

Despite the overall growth of the venture capital industry, there are substantial barriers that prevent countless talented entrepreneurs from accessing the capital they need to start and grow successful companies. Women, Black founders and people who exist outside the lines of the traditional startup ecosystem in particular, face significant barriers when it comes to accessing capital and building the networks that are necessary for success. The PitchBook-NVCA Venture Monitor report highlights some of these challenges:

- Women-founded startups received just 2.4% of venture capital investment in Q1 2023
- Black and Latinx-founded startups received just 2.6% of venture capital investment in Q1 2023
- Startups located outside of the major startup hubs (Silicon Valley, New York City, and Boston) received just 16.6% of venture capital investment in Q1 2023

These statistics highlight the need for greater access to venture capital for underrepresented founders and startups located in less-established regions.

IPO Reform

One of the essential ways to promote greater access to capital for startups is to make it easier and more attractive for companies to go public. According to the PitchBook-NVCA Venture Monitor report, the number of IPOs has declined by more than 38% since 2014. This decline is troubling because IPOs provide a critical source of capital for companies to grow and expand. By going public, companies can access a larger pool of investors and raise the capital they need to invest in new products, hire more employees, and expand into new markets.
However, going public is a daunting process for many companies, especially smaller ones. It's expensive, time-consuming, and comes with a host of regulatory requirements that can be overwhelming. To address this, we need to make it easier and more attractive for companies to go public, while maintaining strong investor protections.

Diversity in investing

The NVCA report highlights a concerning trend that the share of venture capital investment going to companies with at least one female founder, one Black founder, or one Latinx founder has remained stubbornly low over the past few years. In fact, female-founded companies received only 3.5% of total venture capital investment in 2022, while Black-founded companies received just 1.2%.
This lack of diversity in venture capital is a major problem for the startup ecosystem and the broader economy. It means that talented and capable entrepreneurs are being overlooked and denied the opportunity to build successful companies, while venture capitalists are missing out on promising investment opportunities.
There are several reasons why we need to support overlooked founders.

1. First, it's a matter of fairness and equity. We should strive to ensure that everyone, regardless of their background, has a fair shot at success. By supporting overlooked founders, we can help level the playing field and create more opportunities for underrepresented groups.
2. Second, supporting overlooked founders is good for the economy. Diverse perspectives and experiences can lead to more innovative ideas, better decision-making, and more effective problem-solving. By supporting overlooked founders, we can unlock this potential and drive economic growth.
3. Third, supporting overlooked founders is good for venture capitalists. By expanding their networks and investing in a more diverse set of founders, venture capitalists can tap into new sources of talent, gain a competitive advantage, and ultimately generate better returns.

To support overlooked founders, we need to take a multi-pronged approach. This could include initiatives like setting diversity and inclusion goals for venture capital firms, providing funding and resources for programs that support underrepresented founders, and creating new tax incentives for venture capitalists who invest in diverse founders.
In addition, we need to do more to address the underlying systemic issues that have contributed to the lack of diversity in venture capital. This could include improving access to education and mentorship for underrepresented groups, addressing unconscious bias in the investment process, and creating more equitable hiring practices in the tech industry.
Overall, supporting overlooked founders is not only the right thing to do, it's also good for the economy, good for venture capitalists, and good for our society as a whole. By taking action to support underrepresented groups, we can help create a more diverse and inclusive startup ecosystem, and ultimately build a stronger, more resilient economy. This concentration of investment not only limits the potential for innovation in other parts of the country but also limits the diversity of ideas and perspectives

that are being funded. This is where non-traditional founders come in - those who exist outside the lines of the traditional startup ecosystem. These founders often bring fresh perspectives and ideas to the table, but they are also more likely to be overlooked by traditional venture capital firms due to unconscious bias and the phenomenon known as homophily.

Homophily is a social phenomenon that refers to people's tendency to associate and bond with individuals who share similar backgrounds, characteristics, and experiences. In the context of venture capital, homophily can lead to a lack of diversity in investment decisions, as venture capitalists tend to invest in founders who resemble them in terms of gender, race, education, and other factors. This can lead to a lack of funding for underrepresented and marginalized founders, who may have the talent and potential for success but don't fit the traditional mold of a successful entrepreneur.
(https://www.nber.org/system/files/working_papers/w23459/w23459.pdf)
To combat homophily in venture capital, it's imperative to increase the diversity of venture capitalists themselves. When venture capitalists come from a variety of backgrounds and experiences, they are more likely to be open-minded and inclusive in their investment decisions, and less likely to rely on biases and stereotypes. Additionally, having more diverse venture capitalists can help attract a more diverse pool of entrepreneurs, who may feel more comfortable seeking funding from investors who understand and appreciate their perspectives.
Therefore, it's crucial to promote diversity and inclusion in the venture capital industry, both by encouraging more underrepresented individuals to become venture capitalists and by supporting existing venture capitalists in their efforts to expand their networks and perspectives. This can include creating mentorship programs, offering training and education on bias and inclusion, and actively seeking out diverse candidates for venture capital positions.
Ultimately, increasing diversity in venture capital can lead to more diverse investment decisions, which in turn can lead to a more equitable and prosperous economy. By breaking down the barriers that hold back underrepresented and marginalized founders, we can unlock a new wave of American innovation and drive economic growth for all.

Innovation

The danger of falling behind in the innovation race is real, as other countries are investing heavily in their own innovation ecosystems. If we want to remain competitive and maintain our position as a leader in innovation, we need to ensure that we are tapping into the full potential of all our talented entrepreneurs, regardless of their backgrounds. This means creating more opportunities for non-traditional founders to access the resources they need to succeed, including access to capital, mentorship, and networking opportunities.

Investing in non-traditional founders not only helps to promote diversity and equity in entrepreneurship but also helps to drive economic growth and job creation across the country. By expanding our investment focus beyond the traditional startup hubs, we can tap into new sources of talent, creativity, and innovation, and help to ensure that America remains at the forefront of the innovation race.
According to the Q1 2023 PitchBook-NVCA Venture Monitor report, the concentration of capital in the hands of a few large venture capital firms has become a growing concern for limited partners (LPs) in the venture capital industry. As more capital is being concentrated into larger funds, many LPs are finding it increasingly difficult to secure allocations in the most sought-after funds. This has resulted in a growing disparity between the returns generated by top-performing funds and the rest of the market.
Furthermore, the concentration of capital has led to a growing number of companies remaining private for longer periods of time, thereby denying LPs access to potentially lucrative investment opportunities. As

companies remain private for longer, they are able to raise larger rounds of funding, making it more difficult for smaller LPs to invest in these companies. This has resulted in a decline in the number of available investment opportunities for LPs, leading to a decreased return on investment for many.
The concentration of capital has also led to a "winner-takes-all" mentality among venture capitalists, leading to a smaller number of companies receiving the majority of the funding. This has created a challenging environment for smaller firms and overlooked founders, who are often overlooked by the larger VC firms due to their lack of established relationships and networks.
To combat this trend, LPs need to shift their focus towards smaller, diverse VC firms that are more likely to invest in overlooked founders and provide a more diversified portfolio. This will allow for greater access to investment opportunities and promote greater innovation in the industry. By investing in smaller funds that are focused on overlooked founders, LPs can help to level the playing field and promote a more equitable distribution of capital in the industry.

As mentioned earlier, homophily or the tendency of individuals to associate with those who are similar to themselves, can lead to a lack of diversity in the VC industry. This homogeneity can result in a lack of access to funding for non-traditional founders and ideas, which can hinder innovation and economic growth. This is a concern not just for the founders but also for the LPs who invest in these VC funds.
VC funds with diverse portfolios and investments in a range of founders and ideas have the potential to generate higher returns for their LPs. Diverse founders bring unique perspectives and experiences to the table, which can lead to innovative solutions and market opportunities. The lack of diversity in VC investments could lead to missed opportunities for growth and returns.
In addition, investing in non-traditional founders and ideas can also serve as a hedge against market volatility. Concentration of capital in a few companies or industries can make a portfolio more susceptible to market downturns. By diversifying their portfolios, LPs can potentially mitigate this risk.

Forbye, institutional LPs have a fiduciary responsibility to generate returns for their stakeholders, such as college endowments or pension funds. Concentration of capital in a few VC funds that primarily invest in traditional networks and founders can result in suboptimal returns for these LPs.
In conclusion, LPs that invest in VC funds should consider the potential risks and missed opportunities that come with a lack of diversity in VC investments. Investing in funds with diverse portfolios and investments in non-traditional founders and ideas, LPs can potentially generate higher returns, mitigate risk, and fulfill their fiduciary responsibility to their stakeholders.

Capital Concentration

The concentration of capital is a major problem not only for the venture capital industry but also for other industries such as banking. The concentration of capital in a few financial institutions, especially those located in a single geographic region, can be dangerous for the entire economy. For instance, the near-collapse of Silicon Valley Bank in 2023 showed how the concentration of capital in a single region can have ripple effects across the entire banking industry.

Silicon Valley Bank, which had become a key player in financing startups, had over-relied on the technology sector, making it vulnerable to market fluctuations. When the pandemic hit and technology companies started to struggle, the bank's losses piled up, and it was on the brink of collapse. The collapse of Silicon Valley Bank could have had a contagion effect on the entire banking industry, leading to widespread economic damage.

If venture capital was more spread out across the country, more founders and VCs would bank with regional banks. This could help provide local economic benefits and diversify the risk of collapse.
Withal, if regional banks had more access to capital, they could provide more loans to local businesses, creating a more diverse and resilient economy.
However, the concentration of capital in venture capital also has broader economic implications. The investors in venture capital funds, including institutional investors like college endowments and pension funds, are risking significant losses due to the lack of diversity in venture capital investments. By investing in a limited number of VC funds that focus on a narrow set of industries and geographic regions, these investors are missing out on the potential returns from investments in overlooked founders and emerging markets.

Moreover, the lack of diversity in VC investments means that VC-backed companies are not representative of the country's diversity, which can lead to a lack of innovation and competitiveness. If more non-traditional founders, including women, people of color, and those from outside traditional startup ecosystems, were funded, it would create more competition and drive innovation.
In conclusion, the concentration of capital in venture capital is a significant problem that extends beyond the industry itself. It can have ripple effects on the entire economy, and institutional investors risk significant losses due to the lack of diversity in VC investments. By investing in overlooked founders and emerging markets, and by spreading venture capital across the country, we can create a more diverse and resilient economy that benefits all Americans.

LPs losing money, which belongs to everyday Americans in pension funds etc:

The case of pension funds losing money by investing in FTX highlights a major problem in the venture capital industry: the tendency to invest in founders from privileged backgrounds without doing adequate due diligence. As a result, investors may overlook critical red flags and invest in companies that are not well positioned to succeed, ultimately leading to significant financial losses.
The FTX case also illustrates the need for increased diversity in the venture capital industry. Research has shown that diverse investment teams are more likely to identify and invest in underrepresented founders, who are often overlooked by traditional venture capital firms. By investing in a more diverse group of founders, the industry can mitigate the risk of investing in companies with insufficient due diligence and improve the likelihood of long-term success.
Moreover, the loss of pension funds' money due to the lack of due diligence hurts everyday Americans who rely on these funds for their retirement savings. It is crucial for venture capitalists to recognize the impact of their investment decisions on broader society and ensure that they are making informed and responsible investment choices.
In conclusion, the FTX case serves as a cautionary tale of the importance of conducting thorough due diligence and investing in a diverse group of founders. Doing so not only helps mitigate risk for investors but also ensures that venture capital funds are making responsible investment decisions that benefit society as a whole. One of the main problems with investing in founders from privileged backgrounds

without doing proper due diligence is that it can lead to significant losses for investors. In the case of FTX, many venture capital funds failed to conduct proper due diligence on the company before investing, relying instead on Bankman-Fried's credentials and reputation within the industry. This lack of due diligence ultimately resulted in significant losses for investors, including pension funds that had invested in funds that in turn had invested in FTX.

The issue of due diligence is particularly important when it comes to investing in founders who come from privileged backgrounds. Research has shown that white-male founders are more likely to receive funding from venture capitalists than founders from underrepresented groups, even when their qualifications and business ideas are similar. This disparity is often due to unconscious bias and a lack of diversity within the venture capital industry.

By investing in founders from privileged backgrounds without conducting proper due diligence, venture capitalists perpetuate this cycle of bias and exclusion, which not only harms underrepresented founders but also leads to significant financial losses for investors. In the case of pension funds, these losses can have a direct impact on the retirement savings of everyday Americans.

Therefore, it is important for venture capitalists to prioritize diversity and inclusion in their investment decisions and to conduct proper due diligence on all potential investments, regardless of the founder's background or reputation within the industry. This not only helps to mitigate financial risks but also promotes a more equitable and inclusive startup ecosystem.

Conclusion

1. Promoting diversity in the startup ecosystem can lead to economic growth and job creation: According to a study by the National Bureau of Economic Research, diverse startup teams are more likely to be successful and generate more revenue, leading to increased economic growth and job creation. Therefore, it is essential to support and encourage diversity in the startup ecosystem to drive long-term economic growth.

A study conducted by McKinsey & Company in 2018 (https://www.mckinsey.com/capabilities/people-and-organizational-performance/our-insights/delivering-through-diversity) found that companies in the top quartile for ethnic and racial diversity in management were 33% more likely to have above-average profitability compared to those in the bottom quartile. Similarly, companies in the top quartile for gender diversity in management were 21% more likely to have above-average profitability compared to those in the bottom quartile.

Another study by Boston Consulting Group (BCG) (https://www.bcg.com/publications/2018/how-diverse-leadership-teams-boost-innovation) found that diverse management teams lead to more innovation and revenue growth. The study analyzed 1,700 companies across eight countries and found that companies with more diverse management teams had 19% higher innovation revenues compared to companies with below-average diversity. In addition, these companies had higher revenue due to innovation (45% of total revenue) than companies with below-average diversity (26% of total revenue).

Furthermore, research from the Harvard Business School (https://faculty.wharton.upenn.edu/wp-content/uploads/2021/07/Calder-Wang-Gompers-JFE-Forthcoming-2021-And-the-children-shall-lead-Gender-diversity-and-performance-in-venture-capital.pdf) found that venture capital firms with more gender-diverse teams are more likely to invest in companies with women founders. In contrast, all-male teams are less likely to invest in women-led startups. The study suggests

that a lack of gender diversity within the VC industry could be one of the reasons why women-led startups are underrepresented in venture capital.
These studies and others suggest that diverse teams can bring a range of benefits, including increased profitability, revenue growth, and innovation. By investing in overlooked founders and supporting more diverse venture capital teams, we can not only improve equity and access in the industry but also reap the economic benefits of a more diverse and innovative economy.

2. Increasing access to venture capital can help reduce the gender gap in entrepreneurship: Despite the significant contributions made by women entrepreneurs to the U.S. economy, female founders still face significant hurdles in accessing capital. According to Pitchbook, only 2.4% of venture capital went to female-founded companies in 2021. By increasing access to venture capital for female entrepreneurs, we can help bridge the gender gap in entrepreneurship and promote economic growth.

The gender gap in entrepreneurship is a persistent problem in the United States. Women face numerous challenges in starting and growing businesses, including access to capital. According to a 2021 report by Pitchbook, only 2.4% of venture capital funding went to female-founded companies in 2021. This figure represents a slight increase from previous years, but it is still a shockingly low number given that women-owned businesses account for approximately 42% of all businesses in the U.S.
One reason for this disparity is the lack of diversity among venture capitalists, who tend to invest in companies led by people who look like them. As we discussed earlier, homophily is a phenomenon that can lead to a lack of diversity in venture capital investment. When VCs only invest in companies led by people who are similar to themselves, they may overlook innovative ideas from women and other underrepresented groups.
Another contributing factor is the implicit bias that exists in the venture capital industry. Studies have shown that male investors tend to favor male founders, and that female founders are often subjected to more scrutiny than their male counterparts when seeking funding. A 2018 study by Harvard Business Review found that venture capitalists asked female entrepreneurs significantly different questions than they did male entrepreneurs. The study also found that investors tended to perceive female entrepreneurs as less competent than male entrepreneurs, even when they had the same qualifications.
By increasing access to venture capital for female entrepreneurs, we can help reduce the gender gap in entrepreneurship and promote economic growth. Studies have shown that women-owned businesses have a significant impact on the economy, generating $1.9 trillion in revenue and employing over 9 million people in the U.S.

3. Encouraging venture capital investment in underserved communities can promote economic development: Many underserved communities across the U.S. lack access to venture capital, which can hinder economic growth and development. By incentivizing venture capital investment in these communities, we can create new economic opportunities and promote sustainable growth.

Underserved communities face significant barriers to accessing venture capital, including a lack of available funding and limited access to networks and resources that can help connect them with potential investors. This lack of investment can have a significant impact on economic growth and development, particularly in communities that have been historically marginalized or disadvantaged.
Studies have shown that increasing venture capital investment in underserved communities can lead to significant economic benefits. For example, a study by the National Bureau of Economic Research found that venture capital investment in underserved areas can lead to higher job growth, increased patenting activity, and overall economic growth.

Additionally, there are a growing number of initiatives and programs focused on increasing access to venture capital for underserved communities. For example, the Opportunity Zone program, established as part of the 2017 Tax Cuts and Jobs Act, provides tax incentives to investors who invest in designated low-income communities. Similarly, the Minority Business Development Agency provides funding and resources to support minority-owned businesses and help them access capital.
By incentivizing venture capital investment in underserved communities and supporting initiatives that help connect underserved entrepreneurs with potential investors, we can help promote economic development and create new opportunities for growth and prosperity. This, in turn, can help to reduce economic disparities and create more inclusive and equitable communities across the United States.

4. Supporting emerging industries and technologies can drive economic growth: Emerging industries and technologies, such as biotech, artificial intelligence, and blockchain, have the potential to drive significant economic growth. By supporting venture capital investment in these industries, we can help promote long-term economic growth and job creation.

Improving access to capital for small businesses is crucial for economic resilience, as small businesses are major contributors to job creation and economic growth. According to the Small Business Administration, small businesses employ nearly half of the U.S. private sector workforce and are responsible for 65% of net new job creation. However, access to capital remains a significant challenge for small businesses, especially those in underserved communities.
Moreover, supporting emerging industries and technologies is essential for driving economic growth. The United States has been a leader in developing cutting-edge technologies, such as artificial intelligence (AI), biotech, and blockchain. These technologies have the potential to revolutionize various sectors, from healthcare to finance to transportation. A report by the McKinsey Global Institute estimates that AI alone could contribute $13 trillion to global GDP by 2030.
(https://www.mckinsey.com/industries/public-and-social-sector/our-insights/the-potential-value-of-ai-and-how-governments-could-look-to-capture-it)

However, access to capital remains a significant barrier for small businesses and startups in emerging industries. According to a report by the Brookings Institution, venture capital investment is highly concentrated in a few geographic areas, with the top five metropolitan areas accounting for 75% of all venture capital investment. This concentration of capital limits the ability of entrepreneurs in underserved communities and emerging industries to access the resources they need to grow their businesses.
By increasing access to venture capital for small businesses and startups in emerging industries, we can help promote economic growth and resilience. This is especially true for technologies like AI, which are poised to have a significant impact on the economy. According to a report by the Information Technology and Innovation Foundation, AI has the potential to create more than $5 trillion in economic value in the United States over the next decade.

However, the benefits of emerging technologies and industries will not be realized if venture capital investment remains concentrated in a few geographic areas and industries. By incentivizing venture capital investment in underserved communities and emerging industries, we can promote economic growth and job creation across the country. This will not only help drive innovation and competitiveness but also promote a more inclusive economy that benefits all Americans.
Expanding access to venture capital is not only critical for individual entrepreneurs but for the overall growth and development of our economy. By breaking down the barriers that prevent talented and innovative individuals from securing funding, we can promote economic growth, create jobs, and foster technological innovation.

As we have discussed, this is not just about expanding access to capital for traditional founders and VCs, but also about supporting underrepresented groups, underserved communities, and emerging industries and technologies. By promoting diversity in our investor base and investing in communities and industries that have been historically overlooked, we can unlock a new wave of economic growth and innovation that benefits all Americans.

This is an important moment in time, and we have a unique opportunity to shape the future of our economy for generations to come. By passing legislation that expands access to capital, encourages diversity in the investor community, and promotes investment in underserved communities and emerging industries, we can help build a more prosperous and equitable society.
Let us seize this opportunity to support our entrepreneurs, drive economic growth, and advance the frontiers of innovation. The time to act is now.

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION

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

Regarding

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

April 19, 2023

Submitted by

Melanie Senter Lubin
Commissioner, Maryland Securities Division
Office of the Maryland Attorney General
2022-2023 NASAA Past-President

NASAA

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

I. Introduction

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

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

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

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

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

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

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

II. Summary of NASAA's Written Testimony

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

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

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

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

---

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

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

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

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

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

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

---

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

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

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

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

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

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

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

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

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

---

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

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

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

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

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

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

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

---

[12] *See* JOBS Act 1.0 at § 101.

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

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

[15] *See* JOBS Act 1.0 at § 104.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

---

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

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

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

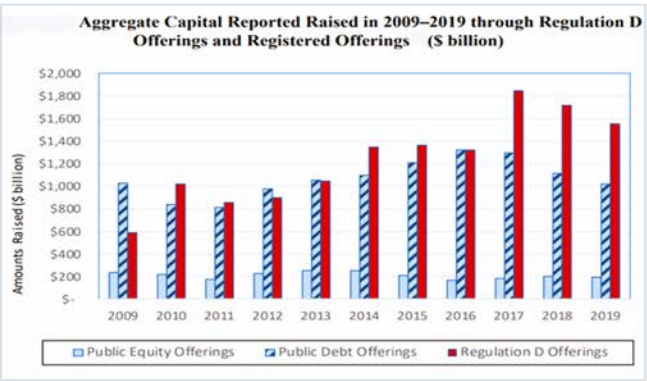
[28] *See* JOBS Act 1.0 at §§ 301-305. Since 2012, changes have been made to Regulation Crowdfunding ("Regulation CF"). *See also* SEC, Regulation Crowdfunding (last updated Apr. 6, 2023) ("Regulation Crowdfunding enables eligible companies to offer and sell securities through crowdfunding. The rules: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

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

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

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

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



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

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

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

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

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

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

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

---

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

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

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

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

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

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

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

---

[37] *See* JOBS Act 1.0 at § 201.

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

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

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

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

[42] *See* JOBS Act 2.0 at § 76001.

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

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

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

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

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

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

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

---

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

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

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

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

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

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

---

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

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

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

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

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

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

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

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

---

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

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

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

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

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

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

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

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

---

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

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

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

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

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

---

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

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

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

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

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

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

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

---

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

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

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

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

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

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

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

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

---

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

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

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

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

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

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

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

---

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

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

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

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

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

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

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

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

[64] *See* 15 CFR § 80a-3(c)(1).

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

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

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

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

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

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

---

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

[66] *See* JOBS Act 2.0 at § 74002.

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

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

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

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

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

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

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

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

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

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

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

---

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

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

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

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

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

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

---

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[78] *See* 17 CFR § 230.701.

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

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

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

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

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

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

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

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

---

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

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

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

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

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

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

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

---

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

---

[91] *See* JOBS Act 1.0 at § 105.

[92] *See* JOBS Act 1.0 at § 105.

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

[94] *See* 17 CFR § 230.163(b).

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

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

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

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

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

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

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

[97] *See* 17 CFR § 240.12g5-1.

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

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

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

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

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

---

[99] *See* JOBS Act 1.0 at § 501.

[100] *See* JOBS Act 1.0 at § 601.

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

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

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

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

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

[102] *See* 17 CFR § 230.405.

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

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

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

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

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

---

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

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

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

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

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

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

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

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

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

VIII. Congress Should Support Common Sense Legislation.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

A. Promoting Responsible Capital Formation

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

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

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

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

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

B. Protecting Investors of All Ages and Backgrounds

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

---

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

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

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

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

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

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

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

---

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

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

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

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

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

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

C. Supporting Inclusion and Innovation in Our Capital Markets

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

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

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

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

---

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

[124] 20 U.S.C. §§ 9701-9709.

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

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

XI. Conclusion

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

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

Testimony Before the U.S. House Committee on Financial Services

Written Statement of Testimony

Testimony of Rodney Sampson

Chief Executive Officer, Opportunity Hub, Inc.

April 19, 2023

2:00P EST

Chair McHenry, Ranking Member Waters, Chair Wagner, Ranking Member Sherman, and Members of the Committee:

Thank you for the opportunity to appear before you today to discuss "A Roadmap for Growth: Reforms to Encourage Capital Formation and Investment Opportunities for All Americans."

I am humbled to have my wife, Shanterria Alston Sampson, and our children here today.

Today, I am here as a pioneer and stakeholder in our nation's Black technology, startup and venture ecosystem; an ecosystem that I have been a part of building from the ground up as a founder, investor and ecosystem builder for nearly 23 years; and the last decade as the Co-founder, Executive Chairman & CEO of Opportunity Hub, the nation's leading innovation, entrepreneurship and investment ecosystem building organization created to ensure that everyone, eveywhere has equitable opportunities in the future of work, fourth industrial revolution and beyond as a path to creating new multi-generational wealth with no reliance on pre-existing multi-generational wealth.

Twenty-three years ago, I co-founded my first technology startup company in Atlanta, Georgia. We were the pioneers of linear audio and video streaming via a digital media management system and infrastructure. This was my first introduction to venture capital and angel investing; and I learned very fast that access to early-stage private capital in America was not equal. In our era, only three Black technology founders had raised millions in venture capital for their startups. Omar Wasso at BlackPlanet.com, Clarence Wooten at ImageCafe.com and myself at Multicast Media Technologies and Streamingfaith.com. As a note of outcome, all three companies were successfully acquired.

In 2021, Harlem Capital reported that there had been less than 1,000 Black and Hispanic startups to ever raise over $1,000,000 in angel and venture capital in American history. When you juxtapose this to the over 15,000 startup investments that were consummated in 2021 and again in 2022, according to a report by Pitchbook and the National Venture Capital Association, the amount of capital that is invested in socially and economically disadvantaged individuals that have experienced institutional, personal and interpersonal racism, discrimination and bias in the American startup ecosystem is dismal, negligible and shameful.

In my 2021 report entitled "Building racial equity in tech ecosystems to spur local recovery," published by the Brookings Institution, where I serve as a Nonresident Senior Fellow, I point out that approximately $26 billion annually should be going to the Black technology, startup and venture ecosystem to build tech hubs in hundreds of American cities to rapidly upskill millions for existing software, sales, cyber, new energy and AI technology careers; incubate thousands of

new high growth ventures leveraging edge technologies and back them with the early startup capital to hire, build, go to market, sell and grow.

Ecosystem-building organizations like Opportunity Hub, venture capital firms like 100 Black Angels & Allies Fund and angel investors like my wife and I are exhausted of asking the existing private markets to invest in the thousands of brilliant Black technologists, operators and founders that are a part of our growing ecosystem. Outside of the performative pitch competitions and diversity announcements of 2020, no consistent private commitment exists to fund Black-founded early-stage startups, venture funds, tech hubs, incubators, accelerators, upskilling schools and ecosystem-building organizations at scale.

The current relevant public sector commitments like the State Small Business Credit Initiative (SSBCI) reauthorized by the Biden-Harris Administration in the American Recovery Plan Act; Regional Tech Hubs and NSF Engines in CHIPS and Science Act are very exciting for overall global American innovative competitiveness; yet, there is little hope in the Black technology, startup and venture ecosystem that this funding will actually make it to America's overlooked and under-invested communities with any sizeable traction or scale. Why? Because the agencies traditionally select existing organizations and funds to disperse funding, and these organizations, although more open-minded to intersectional racial and gender equity in their proposals, do not actually have a track record of identifying, accelerating and investing in Black founders equitably based on their brilliance, problem-solving skill, operating abilities and market viability.

The Black technology, startup and venture ecosystem has started to innovate from within. When possible, we invest in each other's companies and initiatives. At OHUB, we created the Black Technology Ecosystem Investment Certificate [BTEI] in collaboration with The University of North Carolina Kenan Flagler Business School, Duke University Innovation and Entrepreneurship Center, Stanford Technology Ventures Program and The Links, Incorporated. To date, nearly 50 Black women, men and allies have been certified to invest in this emerging asset class. To create a lasting impact, we must educate and certify thousands to bring new capital to the ecosystem. Having a completed certification like BTEI offered in collaboration with a national securities association count toward an American's accredited investor status is a simple amendment to our securities laws and would have an exponential impact on early-stage private capital reaching underinvested communities.

As an American citizen that has voted Democrat in every election since 1991, I support the passage of the following Republican-sponsored legislation as a part of the 118th Congress:

- The "Fair Investment Opportunities for Professional Experts Act"
- The "Equal Opportunity for All Investors Act of 2023"
- The "Accredited Investor Definition Review Act"
- The "Accredited Investor Self-Certification Act"
- The "Investment Opportunity Expansion Act"
- A bill to amend the definition of an accredited investor to include individuals receiving advice from certain professionals, and for other purposes.
- The "Increasing Investor Opportunities Act"
- The "Gig Worker Equity Compensation Act."

In closing, I would like to tell a brief story about a dear friend and mentor. During the 2013 *Kingonomics: Access To Innovation, Entrepreneurship and Investment Emancipation of Gala*, my wife and I honored Emmit McHenry. Emmit's story, like mine and thousands of other Black founders, is contextual to today's committee hearing. Emmit McHenry is the Black American technologist, inventor and entrepreneur who created the computer code that enables us to access the internet and send data like emails between applications and devices today. He co-created the .com and TCP/IP. Emmit, the founder of Network Solutions, was awarded a competitive contract to manage all domain names on behalf of the United States government. Emmit now had to raise private angel and venture capital to deliver on this sole source contract that would privatize, productize and eventually commercialize domain names. As brilliant as Emmit is, he struggled to raise the early-stage capital to grow and scale Network Solutions. McHenry eventually sold Network Solutions to Science Applications International Corp (SAIC) for $4.8 million. Within a few months, the government granted SAIC the authority to charge $70.00 per year for each domain name. SAIC transformed its $4.8 million acquisition of Network Solutions into a $21 billion sale to Verisign. Imagine how much new multi-generational wealth could have been created in a community that today has a median net worth of approximately $17,000 per family and is projected to decrease to zero by 2053. Imagine how much new multi-generational wealth with no reliance on pre-existing multi-generational wealth could have been created by and for our community if Emmit could have raised early-stage capital in a regulatory environment that empowers the everyday American, the Black American, with expertise in technology and a certifiable understanding of this high risk, yet necessary asset class that is driving two-thirds of our nation's net new jobs and responsible for a quarter of our nation's gross domestic product.

If we do not get on the capitalization tables of these startups that are transforming society as we meet, we will have future generations in America of "have and have nevers."

Congress and the Securities and Exchange Commission have the power to increase who responsibly sits at this table of meaningful and executable unprecedented opportunity - not the rare fraudulent stories that are signaled out of false meritocracies like Silicon Valley and other coastal hubs. Truthfully, we do not even get access to most of those investments because of systemic and personal exclusion. We see investment deals in cities like New Orleans, where Sevetri Wilson is building her enterprise SaaS startup Resilia; and in Atlanta, where Dr. Lonnie Johnson is building new energy sources at JTECH Energy; and in Chicago, where Garry Cooper is building Rheaply to productize the circular economy; and in Dallas, where Mandy Price is building Kanarys to help companies improve their diversity, equity and inclusion solutions. These are real high-growth startups building real-edge technology to solve real-world problems in the real communities that you represent.

Please understand that most of the current accredited Black angel investors and venture capitalists that intentionally invest in the Black founders I just referenced are barely sitting at this table of opportunity. We understand the risks; yet we understand the responsibility to ensure that Black brilliance, innovation, entrepreneurship and wealth exist in the future.

To scale, succeed and sustain, Congress and the SEC must make it easier, not harder, to become an accredited investor in America. I personally commit to work with Congress, this committee and the SEC to safely expand and equitably diversify the existing pool of investors in the private

markets, including those who are sophisticated but not yet wealthy. Together, we must grow the pool of Black investors in this ecosystem, not shrink it by increasing the income and net-worth minimums.

Collectively, we have a shared responsibility and opportunity to close the $26 billion annual funding gap to the growing Black technology, startup and venture ecosystem and beyond. The Black community shares this responsibility. This committee shares this responsibility. Congress shares this responsibility. The Securities & Exchange Commission shares this responsibility. Treasury, Commerce and the Small Business Administration share this responsibility. This Whitehouse also shares the responsibility of ensuring that the most overlooked ecosystem of brilliant innovators, entrepreneurs and investors have the resources they require to build a future that ultimately will benefit all.

When America does this, then America will truly be the greatest nation on Earth.

Thank you for listening.

Testimony of Joel H. Trotter
Partner
Latham & Watkins LLP

Before the U.S. House of Representatives
Committee on Financial Services
Subcommittee on Capital Markets

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

April 19, 2023

Chairman Wagner, Ranking Member Sherman,
and Members of the Subcommittee:

Thank you for inviting me to appear before you today.

Introduction

Based on my experience as part of the IPO Task Force leadership, I am pleased to share my perspectives on reforms to encourage capital formation and investment opportunities. I have been a securities lawyer for nearly thirty years and have advised on hundreds of initial public offering (IPO) transactions in my capacity as co-chair of my law firm's National Office, which is our central resource for clear, pragmatic, and action-oriented U.S. securities law advice. We offer an unparalleled ability to deliver sophisticated advice in real time on the most challenging securities law and IPO issues that clients face. I am speaking to you today in my personal capacity and not on behalf of my law firm or any of our clients.

As a leader of the IPO Task Force, I was involved extensively in 2011 with other members of the Task Force leadership team in preparing and formulating our recommendations to the U.S.

Department of the Treasury, providing specific measures for policymakers to use to increase U.S. job creation and drive overall economic growth by improving access to the public markets for emerging growth companies.[1] The IPO on-ramp refers to our recommendations for streamlining the IPO process. Congress enacted our IPO on-ramp proposal as Title I of the JOBS Act of 2012, which President Obama signed into law in a Rose Garden ceremony. Title I has been called the "most successful title in the JOBS Act," and academic research has concluded that the on-ramp provisions "significantly increased IPO volume overall."[2]

The JOBS Act is a bipartisan success story that provides a model for new initiatives today. The success of the JOBS Act offers important lessons for how to think about a perennial question in the federal securities laws. The question is how to optimize the level of regulation to balance investor protection with market efficiency and capital formation. This goal is consistent with the three-part mission Congress has long assigned to the Securities and Exchange Commission—namely, to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.[3]

---

[1] IPO Task Force, "Rebuilding the IPO On-Ramp: Putting Emerging Companies and the Job Market Back on the Road to Growth" (Oct. 20, 2011) [hereinafter "Task Force Report"], available at https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf.

[2] Michael J. Piwowar, Testimony, U.S. House of Representatives Committee on Financial Services, Subcommittee on Capital Markets (Mar. 9, 2023) (citing Michael Dambra et al., "The JOBS Act and IPO Volume: Evidence that Disclosure Costs Affect the IPO Decision," 116 J. of Fin. Economics 121 (2015)), available at https://docs.house.gov/meetings/BA/BA16/20230309/115394/HHRG-118-BA16-Wstate-PiwowarM-20230309.pdf.

[3] See, e.g., Securities Act of 1933, 15 U.S.C. § 77b(b) ("Whenever . . . the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."); Securities Exchange Act of 1934, 15 U.S.C. § 77b(f) (same).

The three-part mission is ubiquitous on the SEC's website. See, e.g., About the SEC ("The mission of the SEC is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation."), available at https://www.sec.gov/about.

This is an especially important topic. First, IPOs have a demonstrable effect in fostering job creation. Easing the path to going public and streamlining the ability to operate as an ongoing public company have important benefits not only to our capital markets but to the job creation that public companies foster. Second, as other jurisdictions consider market reform, it is especially important for securities markets in the United States to encourage capital formation by maintaining their global competitive edge.

My purpose today is to build on, rather than duplicate, the excellent testimony you have already received from other witnesses. Michael J. Piwowar, a former SEC commissioner and trained economist with a Ph.D. in finance, has detailed the connection between capital formation and job creation and the implications for the proposals before you.[4] Anna T. Pinedo, a respected securities law expert with decades of capital markets experience, has provided her recommendations on many of the specific proposals.[5] I would like to add my perspective based on my experience with the IPO Task Force and in helping create Title I of the JOBS Act. As we look back on more than a decade of experience under the JOBS Act, we can learn important lessons from that highly successful bipartisan legislation adopted by an overwhelming majority of both houses of Congress.

Balancing Rather than Increasing or Reducing Regulation

Often the debate is about more regulation or less regulation, with the predictable stalemate that inevitably results. On the one hand, those who want more regulation focus on the costs that fraud imposes. They see more regulation as a way to reduce fraud-related costs and bolster investor confidence. On the other hand, those who want less regulation focus on the costs that regulatory compliance entails. They see less regulation as a way to reduce compliance

---

[4] Piwowar, *supra* note 2.

[5] Anna T. Pinedo, Testimony, U.S. House of Representatives Committee on Financial Services, Subcommittee on Capital Markets (Mar. 9, 2023), available at https://docs.house.gov/meetings/BA/BA16/20230309/115394/HHRG-118-BA16-Wstate-PinedoA-20230309.pdf.

costs, freeing up capital for companies to hire more employees and invest in research and development.

But the JOBS Act showed a way forward in this debate: Not more versus less regulation, but balanced regulation that scales over time. Companies can be encouraged to enter the public markets through regulatory accommodations that offer an on-ramp to public company status. This approach encourages IPO activity while maintaining the existing—and continuously increasing—level of securities regulation for mature public companies. Using this type of balanced approach to enhance the design of regulatory compliance obligations will prove increasingly important as SEC rules continue to become more expansive and complex.

Template for Success: What the JOBS Act Did Not Do

Three key features of the JOBS Act warrant special emphasis. They are often overlooked because these features do not appear in the statute. They are, instead, elements that the statute did not contain. In my view, they are fundamental aspects of the legislation that allowed it to gain overwhelming bipartisan support in both houses of Congress.

First, the JOBS Act did not repeal any of the new securities laws and regulations that Congress and the SEC had adopted in the prior decade. Instead, the innovations in the IPO on-ramp provisions provided a limited group of companies with a limited number of regulatory accommodations for a limited period of time. Eventually, the full panoply of regulatory obligations would apply to those public companies when they would cease to qualify as emerging growth companies.

Second, the JOBS Act did not alter any of the robust antifraud provisions of the federal securities laws. The demanding liability matrix of both the Securities Act of 1933 and the Securities Exchange Act of 1934 remained completely unchanged. This is of paramount importance in understanding the limited nature of the changes embodied in the JOBS Act. In Appendix A to these remarks, I have summarized some of the compliance obligations that apply to all U.S. domestic public companies, including emerging growth companies. They are extensive and rigorous.

Third, the JOBS Act did not limit the IPO on-ramp accommodations to a junior-varsity category of favored companies. Instead, the definition of emerging growth company was designed to include nearly all IPOs. Had the statute limited the IPO on-ramp's availability only to a narrow category of small-revenue companies, it would have created a second-class IPO that would have failed to garner the immediate and widespread market acceptance that the IPO on-ramp regime experienced. Practitioners who are familiar with some of the SEC's small business initiatives understand this phenomenon.[6]

Template for Success: What the JOBS Act Did

Three additional features of the IPO on-ramp contributed to its decisive success. These are affirmative design elements that do appear in the statutory framework, and they are similarly instructive for future legislative solutions.

First, the IPO on-ramp concept allowed the regulatory burden to scale to the size of the affected company. This is a simple but powerful concept borrowed from SEC rules in other areas. For example, the first annual report of all newly public companies, regardless of the company's size, need not comply with the requirement to include an external audit of internal controls. This is a pre-existing transition period that the SEC adopted in implementing its rules under the Sarbanes-Oxley Act of 2002. This transition period inspired the IPO Task Force's recommendation to provide a meaningful on-ramp transition period for newly public emerging growth companies. The approach also resolves an otherwise intractable debate over repealing recent regulatory enactments versus adopting increased levels of regulation in response to recent events. An on-ramp allows new regulations to stay in place while offering smaller companies a finite time in which they benefit from regulatory accommodation.

---

[6] For example, the SEC's annual report on Form 10-KSB for small business issuers offered the advantage of scaled disclosure through abbreviated reporting but failed to achieve widespread market acceptance due to the stigma of the SB designation.

Second, the IPO on-ramp comprised multiple small changes that would have an outsized impact in streamlining the IPO process. Examples include modernizing the IPO communications restrictions, permitting the SEC review process to begin confidentially, and allowing scaled disclosure. In each instance, a small change made a big difference in how IPOs are conducted. The JOBS Act fundamentally changed the IPO playbook, offering more flexibility in the offering process and an easier path to compliance as a newly public company.

Third, the IPO on-ramp's statutory text was wisely self-executing rather than relying on rulemaking mandates that require agency action. In this regard, the JOBS Act is itself a study in contrasts: the IPO on-ramp provisions in Title I were immediately effective the moment that President Obama signed the bill into law on April 5, 2012, whereas other parts of the statute required SEC rulemaking by specified deadlines, none of which were met. The Dodd-Frank Act of 2010 presents a similar dichotomy: its self-executing provision exempting non-accelerated filers from the requirement to provide an external audit of internal controls became effective immediately, whereas the clawback rulemaking mandate will not be implemented until later this year, thirteen years after Congress mandated that rulemaking.[7]

JOBS Act History

The first decade of the new millennium saw an unprecedented number of new SEC rulemakings, and public companies faced an equally unprecedented level of securities regulatory compliance obligations. Congress enacted the Sarbanes-Oxley Act of 2002 in response to a wave of corporate scandals involving meltdowns of major public companies with huge market capitalizations. Less than a decade later, Congress enacted the Dodd-Frank Act of 2010 in response to the global financial crisis and the seemingly overnight meltdown of some of the largest financial institutions in the world. Together, these two statutes and the SEC rules that followed

[7] *Compare* Section 989G of the Dodd-Frank Act (providing a self-executing provision that, in 2010, immediately exempted non-accelerated filers from Section 404(b) of the Sarbanes-Oxley Act) *with* Section 954 of the Dodd-Frank Act (mandating SEC rulemaking to implement clawback requirements that, as of April 19, 2023, have not yet become effective).

introduced major levels of new corporate governance requirements and securities regulation. Public companies now faced much higher compliance obligations.

Not only had the compliance burden increased, but it was sometimes wildly underestimated. The SEC correctly anticipated in 2003 that its rules implementing Section 404 of the Sarbanes-Oxley Act would "discourage some companies from seeking capital from the public markets" because those "rules increase the cost of being a public company."[8] However, the SEC's cost-benefit analysis supporting its adoption of the rules underestimated by orders of magnitude the true annual cost of compliance implementation. Specifically, the SEC estimated Section 404(a) compliance costs at a mere $91,000 per company.[9] But, in fact, a survey of large public companies complying with the new rules under Section 404 during the first year indicated that compliance costs averaged $4.36 million and 27,000 hours.[10] These and other compliance obligations, over the course of a decade, "significantly and continuously increased the compliance burden associated with public company status and made IPOs more costly and difficult."[11]

---

[8] Release No. 33-8238 (June 5, 2003) at text accompanying n.174 (implementing Sarbanes-Oxley Section 404).

[9] Id. The $91,000 estimate excluded "the costs associated with the auditor's attestation report, which many commenters have suggested *might* be substantial." Id. (emphasis added).

[10] See Financial Executives International, FEI Special Survey on SOX 404 Implementation (March 2005).

[11] Task Force Report at 21; see also Release Nos. 33-9136 & 33-9259 (implementing Section 404 of the Sarbanes-Oxley Act through rules expected to "discourage some companies from seeking capital from the public markets" because those "rules increase the cost of being a public company"); Release No. 33-7881 (adopting Regulation FD); Release No. 33-8048 (requiring additional disclosures regarding equity awards); Release No. 34-42266 (requiring specific disclosures regarding audit committees); Release No. 34-46421 (requiring accelerated reporting of insider beneficial ownership); Release No. 33-8124 (requiring officer certifications under Sarbanes-Oxley Section 302); Release Nos. 33-8128 & 33-8128A (requiring accelerated filing of periodic reports and disclosure regarding website access to such reports); Release No. 33-8176 (adopting disclosure requirements regardiug non-GAAP financial measures); Release No. 34-47225 (restricting officer and director transfers of equity securities during pension fund blackout periods); Release Nos. 33-8177 & 33-

In October 2010, President Obama met with Steve Jobs. Walter Isaacson's biography of the legendary founder and CEO of Apple Inc. recounts the 45-minute meeting:

> Jobs did not hold back. "You're headed for a one-term presidency," Jobs told Obama at the outset. To prevent that, he said, the administration needed to be a lot more business-friendly. He described how easy it was to build a factory in China, and said that it was almost impossible to do so these days in America, largely because of regulations and unnecessary costs.[12]

8177A (requiring disclosure regarding code of ethics and audit committee financial experts); Release No. 33-8180 (requiring seven-year retention of audit work papers under Sarbanes-Oxley Section 802); Release No. 33-8182 (requiring disclosure regarding off-balance sheet arrangements); Release No. 33-8183 & 33-8183A (requiring audit committee pre-approval of audit and non-audit services, audit partner rotation, auditor reports to audit committees, enhanced disclosure regarding audit and non-audit fees and adopting additional requirements for auditor independence); Release No. 33-8185) (requiring attorneys to report evidence of a material violation of securities laws); Release No. 33-8220 (adopting heightened independent requirements for listed company audit committees); (Release No. 33-8230) (requiring electronic filing and website posting of reports under Exchange Act Section 16); Release No. 33-8238 (implementing Sarbanes-Oxley Section 404 requiring an annual management's report and auditor attestation on internal control over financial reporting); Release No. 33-8340 (requiring disclosures regarding nominating committee functions and security-holder communications); Release No. 33-8350 (adopting guidance regarding management's discussion and analysis of financial condition and results of operations); Release Nos. 33-8400 & 33-8400A (increasing the events reportable on Form 8-K and accelerating the reporting deadline); Release No. 33-8565 (interpreting Regulation M to prohibit certain conduct in connection with IPO allocations); Release No. 33-8644 (adopting accelerated deadlines for periodic reporting); Release Nos. 33-8732 & 33-8732A (adopting additional requirements for disclosures relating to executive compensation, including compensation discussion and analysis); Release Nos. 33-9002 and 33-9002A (requiring financial statement data in an interactive data format using XBRL technology); Release No. 33-9089 (requiring additional disclosures regarding corporate governance matters in proxy statements); Release No. 33-9106 (providing interpretive guidance regarding disclosure required in respect of climate change issues).

[12] Walter Isaacson, *Steve Jobs* 544 (2011).

Three months after Jobs implored President Obama to fix burdensome regulations and unnecessary costs, the President took up that task, highlighting a new priority in his State of the Union Address of January 2011. His administration would review government regulations to address "rules that put an unnecessary burden on businesses":

> To reduce barriers to growth and investment, I've ordered a review of government regulations. When we find rules that put an unnecessary burden on businesses, we will fix them.[13]

Two months later, the Obama Administration convened its Access to Capital Conference led by Treasury Secretary Tim Geithner. The March 2011 conference at the Department of the Treasury brought together policymakers, entrepreneurs, investors, academics, and other market participants to explore how to promote access to capital at each stage of growth from seed capital to accessing the public markets. Secretary Geithner convened the conference in part to "examine the causes of IPO decline and to explore solutions."[14]

The Treasury Department's Access to Capital Conference resulted in the formation of the IPO Task Force. We set out to study the decline in IPO activity and recommend changes to make it easier for companies to go public. That is because private companies have two principal ways of returning capital to their early-stage investors: either through a company sale to an acquirer or by going public. Acquired companies are absorbed into a larger enterprise, often with efficiencies realized through the elimination of redundant positions. In contrast, the research of the IPO Task Force showed that companies that go public experience over 90% of their job growth

---

[13] Barack Obama, State of the Union Address (Jan. 25, 2011), available at https://obamawhitehouse.archives.gov/the-press-office/2011/01/25/remarks-president-barack-obama-state-union-address-prepared-delivery.

[14] James Freeman, "How Silicon Valley Won in Washington," *Wall Street Journal* (Apr. 6, 2012), available at https://www.wsj.com/articles/SB10001424052702303299604577326270090887812.

post-IPO.[15] Given the direct connection between IPO activity and job growth, we wanted to restore the balance between the M&A and IPO alternatives that a private company faces when the time is right to return early-stage investment capital and pursue its next level of growth.

We issued the IPO Task Force report in October 2011. Two months later, our recommendations became the basis of Title I of the JOBS Act when, in December 2011, bipartisan co-sponsors in both the Senate and the House of Representatives introduced bills to enact the IPO Task Force's recommendations.

Maintaining Perspective

Testifying in December 2011 before the Securities Subcommittee of the Senate Banking Committee, Harvard Law Professor John Coates described the bipartisan IPO on-ramp bill (which ultimately became Title I of the JOBS Act) as "the most carefully written and calibrated" and "cautious" of the several bills that in combination became the JOBS Act. He also characterized the bill as "an experiment" that "would be a good idea to try."[16]

Professor Coates's description of the IPO on-ramp as an "experiment" drew a memorable response from Senator Pat Toomey (R-Pa.). To the contrary, said Senator Toomey, rather than "experimental," the IPO on-ramp bill was a "very constructive" step to provide a limited period during which a limited number of companies would be "relieved of a relatively new regulation":

> I just want to comment on the characterization . . . made about these bills as a series of proposals for experiments. At least in the case of [the IPO on-ramp bill], certainly, it seems to me that one of the central provisions, one of the most important provisions in this bill, if not the most important provision, is the

[15] Task Force Report at 5 (citing Venture Impact Study 2010 by IHS Global Insight).

[16] Hearing of the Securities, Insurance and Investment Subcommittee of the Senate Banking, Housing and Urban Affairs Committee (Dec. 14, 2011), available at https://www.banking.senate.gov/hearings/examining-investor-risks-in-capital-raising.

> fact that it would allow these emerging growth companies for a limited period of time, so a very small subset of all companies for a limited period of time, to simply be relieved of a relatively new regulation, which is 404(b) of Sarbanes-Oxley, which is only about 10 years old.
>
> So for untold previous decades, while the United States capital markets became the largest, deepest, most efficient, most sophisticated, most advanced markets in the history of the world, we never had any such regulation during that entire period of time. So to suggest that we simply go back to that regime for a brief period for a small subset of companies doesn't strike me as terribly experimental, but it does strike me as very constructive for the companies that would otherwise be faced with the very, very expensive cost of complying with this provision.[17]

If the IPO on-ramp was an experiment, it has succeeded. After more than a decade of experience under the IPO provisions of the JOBS Act, Senator Toomey's remarks have proved prescient.

His remarks also offer an important reminder about designing balanced compliance obligations that scale based on a company's size and maturity. As legal and regulatory compliance burdens continue to accrete with new legislation and SEC rulemakings, a limited accommodation period for a limited number of companies can provide a constructive and tailored approach to regulatory compliance. The success of the JOBS Act confirms that compliance obligations can and often should provide for an extended transition period for newly public companies, and the category of emerging growth companies offers a useful vehicle for doing so.

Small Changes Can Make a Big Difference

Last month, a witness told this Subcommittee that the public company compliance obligations are so extensive that they cannot

---

[17] Id.

be reduced enough to make any meaningful difference to private company executives considering whether to pursue an IPO and that "neither Congress nor the SEC would ever be able to lower the public company bar enough to materially alter that calculus."[18]

That claim, if true, sounds more like an urgent call to corrective action than a basis for complacent resignation. But, in fact, the claim is not true. I doubt any lawyer with meaningful IPO experience would make such a claim. It is reminiscent of Professor Coates's agnosticism in 2011 when assessing the potential efficacy of the IPO on-ramp provisions.

First, incremental changes can have a disproportionately positive impact. The IPO on-ramp demonstrated this with targeted, incremental changes that streamlined the IPO process in meaningful ways. These incremental changes with outsized impact included (i) permitting offering-related communications to institutional accredited investors before and during the offering process; (ii) allowing companies to begin the SEC review process confidentially; (iii) scaled, less extensive disclosures; and (iv) relief from the requirement to provide an external audit of internal controls, wholly separate from the external audit of the company's financial statements. The SEC and its staff extended the first two accommodations for all companies based on years of successful experience with the IPO on-ramp. And the IPO Task Force based the latter two accommodations on pre-existing exceptions available to smaller companies before the JOBS Act.

Second, some of the incremental changes of the IPO on-ramp offer meaningful cost savings. One example is the ability to go public using two years rather than three years of audited financial statements. That offers a meaningful savings in financial statement audit costs. Another, even more significant example is relief from the requirement to provide an external audit of internal controls. As Senator Toomey demonstrated in his remarks in 2011, that accommodation makes a real difference to a newly public company. An annual internal controls audit can easily cost $1 million or more.

---

[18] Stacey L. Bowers, Testimony, U.S. House of Representatives Committee on Financial Services, Subcommittee on Capital Markets (Mar. 9, 2023), available at https://docs.house.gov/meetings/BA/BA16/20230309/115394/HHRG-118-BA16-Wstate-BowersS-20230309.pdf.

That money would otherwise go straight to the bottom line. For a software company trading at a 12x EBITDA multiple, $1 million in compliance costs equals $12 million in enterprise value.

Do not discount incremental changes. When carefully chosen, they can make a big difference. In Appendix B to these remarks, I have summarized proposals to increase economic growth and job creation by facilitating capital formation, many of which are reflected in bills under current consideration.

Looking Back
On a Decade of Success

In 2012, the JOBS Act had plenty of detractors. Some critics of the IPO on-ramp predicted that the regulatory accommodations were too extensive and would lead to increased fraud and a crisis of investor confidence that would cause more harm to the IPO market. These critics overlooked the effect of the extensive and rigorous liability provisions of the federal securities laws that would continue to apply to all IPOs and public companies. Other critics of the IPO on-ramp claimed that the changes were unlikely to make a meaningful difference or that the new accommodations would fail to gain market acceptance. These critics proved mistaken when market acceptance of the IPO on-ramp quickly ensued. Moreover, the SEC and its staff followed Congress's lead by extending two of the key on-ramp accommodations—confidential SEC review and testing-the-waters—to apply to all companies across the board. Today, the IPO on-ramp provisions of the JOBS Act have been vindicated, and no serious detractors remain after more than a decade of successful experience.

That is why the story behind the JOBS Act merits your careful consideration today. It offers a template for successful bipartisan legislation. It offers an approach to balancing compliance obligations to allow for regulatory burdens to scale based on the size and maturity of the affected company. It leaves all regulatory compliance obligations in place for all companies over the long run as they mature into larger enterprises. And it leaves intact all of the extensive and rigorous antifraud liability provisions of the federal securities laws.

Conclusion

Implementing changes to the federal securities laws is no easy task. But the experience of the IPO on-ramp provisions in Title I of the JOBS Act shows the path to success. To conclude, I will highlight four important lessons learned from the IPO Task Force experience.

First, simplicity. Look for small, even seemingly technical, changes that offer a disproportionately significant practical impact.

Second, look for ways to scale the regulatory obligations so that the largest, most mature companies bear the full regulatory compliance burden while smaller and less mature public companies benefit from meaningful regulatory accommodations. The winning regulatory approach is scaled to company size and maturity, building on longstanding approaches that have succeeded in tailoring the level of compliance obligations.

Third, recognize what does not change in the context of proposals for regulatory accommodations. In particular, the robust and comprehensive liability regime of the federal securities laws offers very significant, tried-and-true investor protections that are unaffected by the innovative changes currently before you. Critics of the JOBS Act overlooked this fact when they predicted doom and gloom, but a decade of success has proved them wrong.

Fourth, implement new changes using self-executing statutory text. Enacting clear amendments to the statutory framework is the best way to achieve the intent of Congress and far preferable to mandatory rulemakings, especially given the agency's exceedingly crowded rulemaking docket.

You have the opportunity to build on the success of Title I of the JOBS Act and the lessons it offers us today. Given the direct connection between capital formation and job creation, the opportunity is compelling.

I welcome your questions.

Appendix A

EXISTING REGULATORY PROTECTIONS UNCHANGED BY THE JOBS ACT OR BY ANY OF THE PENDING PROPOSALS

Investor protections that apply to all public companies including emerging growth companies

I. General Antifraud Provisions

A. ***Duty to Disclose All Material Information.*** Rule 12b-20 under the Securities Exchange Act of 1934 requires that companies must, in addition to providing the information expressly required in a report or other statement to the SEC, include any additional material information that may be necessary to make the required statements not misleading in light of the circumstances.

B. ***Liability for False and Misleading Statements.*** Section 18 of the Exchange Act imposes liability for false and misleading statements in documents filed with the SEC to any person who makes such false or misleading statements, subject to applicable defenses.

C. ***Exchange Act Section 10(b) and Rule 10b-5.*** These provisions broadly prohibit fraudulent and deceptive practices and untrue statements or omissions of material facts in connection with the purchase or sale of any security. Unlike Section 18, these provisions apply to any information released to the public by the issuer and its subsidiaries, including press releases and annual and quarterly reports to stockholders.

D. ***Executive Officer Certification of Reports and Financial Statements.*** As discussed in more detail below, a company's certifying officers can be held personally liable for any untrue statement of material fact or material omission necessary to ensure that statements contained in the reports or other statements to the SEC are not misleading.

E. ***Control Person Liability.*** Section 20 of the Exchange Act and Section 15 of the Securities Act of 1933 provide that a person controlling any person liable under those statutes may be liable jointly and severally and to the same extent as its controlled person for violations of the Exchange Act or the Securities Act.

F. ***Liability for Securities Offerings.*** Sections 11 and 12 of the Securities Act impose liability for any material misstatements or omissions made in connection with registered offerings conducted under the Securities Act. Section 5(b)(1) of the Securities Act prohibits the use of any prospectus that does not satisfy SEC requirements. In addition, Section 5(b)(2) of the Securities Act prohibits any registered sale of a security unless the security is preceded or accompanied by a prospectus that satisfies SEC requirements.

II. SEC Disclosure and Reporting Obligations

A. ***Regulation FD.*** Public companies must comply with Regulation FD's prohibition on selective disclosure of material nonpublic information.

B. ***Limitations on Use of Non-GAAP Financial Measures.*** Regulation G and Item 10(e) of Regulation S-K provide specific requirements for the presentation of any financial measures that are not in compliance with generally accepted accounting principles (GAAP). Non-GAAP financial measures must not be misleading and must include a reconciliation to the most nearly comparable GAAP measure.

C. ***Annual Reporting (Form 10-K).*** Under Section 13(a)(2) of the Exchange Act, Companies must, within 90 days of the end of each fiscal year, file with the SEC annual reports that include:

1. ***Audited Financial Statements.*** Companies must provide (i) audited balance sheets, (ii) audited financial statements of income and cash flows and (iii) summary financial data. All financial statements

must be prepared in accordance with, or reconciled to, GAAP.

2. ***Description of the Business.*** Regulation S-K requires annual reports to include (i) a description of the company's business, including segments, geographic areas, and competitors; (ii) risk factors affecting the business; (iii) pending legal proceedings; (iv) mine safety disclosures; (v) information about directors and officers, including their compensation and any related party transactions; (vi) management's discussion and analysis of financial condition and results of operations (MD&A); (vii) a description of material contractual obligations; (viii) and discussions of off-balance sheet transactions and market risks.

3. ***Market Information.*** Annual reports must also include information about the market for the company's common equity, related stockholder matters and company purchases of equity securities.

4. ***Description of Corporate Governance Policies.*** Annual reports must also disclose information about corporate governance polices and compliance with governance requirements such as (i) whether the company maintains a code of ethics for its principal executive officers, and if so, it must file such code with the SEC as an exhibit to its annual report; (ii) whether the company has at least one audit committee financial expert; (iii) a description of company's leadership structure and why this structure is appropriate; and (iv) a description of risk oversight by the company's board and how such oversight is administered.

D. ***Quarterly Reporting (Form 10-Q).*** Under Section 13(a)(1) of the Exchange Act, public companies must, within 45 days

after each of the first three fiscal quarters of each year, file with the SEC quarterly reports that include:

1. ***Condensed Financial Statements.*** These interim financial statements are unaudited, but are reviewed by independent accountants and subject to the auditing standards for interim reviews.

2. ***Additional Information.*** Quarterly reports must update the annual report in several key areas including (i) MD&A; (ii) any changes in risk factors since the annual report; (iii) quantitative and qualitative disclosures about market risk; (iv) any material legal proceedings; (v) any changes in securities or defaults on senior securities; (vi) mine safety disclosure; and (vii) any other materially important event not reported in previous current reports.

E. ***Current Reporting (Form 8-K).*** Under Section 13(a)(1) of the Exchange Act, public companies must file current reports with the SEC within four business days after the occurrence of a reportable event, including events such as (i) the acquisition or disposition of significant assets; (ii) a change in auditors; (iii) any departure or resignation of directors or officers; (iv) material plans or contracts with officers and directors; and (v) many other events relevant to investors.

F. ***Certification of Reports.*** Each principal executive officer and principal financial officer must each make individual certifications on each annual and quarterly report.

1. ***Substance of Certification.*** Certifying officers must certify that (i) such officer has reviewed the reports; (ii) based upon the officer's knowledge, the report does contain any untrue statement of material fact or material omission necessary to ensure that statements in the reports are not misleading; and (iii) based on such officer's knowledge, the financial statements, and other financial information included in the reports fairly present, in all material aspects,

the company's financial condition and results of operations and cash flows.

2. ***Internal Control over Financial Reporting.*** Certifying officers are responsible for establishing, designing and maintaining effective internal controls, must annually assess and report on the effectiveness of the internal controls, and must disclose any change in the company's internal controls in annual and quarterly reports.

3. ***Disclosure Responsibilities to the Board of Directors, Audit Committee and Independent Auditors.*** Certifying officers must disclose to the board, audit committee and the company's auditors (i) all significant deficiencies and material weaknesses in the design or operation of internal controls and (ii) any fraud, whether or not material, that involves management or any other employee with a significant role in the company's internal controls.

4. ***Criminal Penalties Enforced Against Certifying Officers.*** Certifying officers that knowingly or willfully certify a report that does not meet the standards summarized above face criminal penalties of up to 20 years in prison and $5 million in fines.

G. ***Additional Requirements.*** The federal securities laws also require public companies to comply with additional disclosure and reporting requirements:

1. ***Accounts and Accounting Controls.*** Section 13(b)(2) of the Exchange Act requires companies to keep books and records that accurately and fairly reflect transactions and dispositions of assets and to maintain a system of internal accounting controls sufficient to provide reasonable assurance that transactions are executed in accordance with management's authorization and related requirements.

2. ***Foreign Corrupt Practices Act.*** Section 30A of the Exchange Act prohibits public companies and any related persons acting on behalf of a company from bribing any foreign official, political party or candidate for political office for the purpose of obtaining or retaining business.

3. ***Prohibition on Personal Loans to Directors and Executive Officers.*** Section 402 of Sarbanes-Oxley prohibits any issuer from directly or indirectly extending, maintaining or arranging credit in the form of a personal loan to or for any director or executive officer.

4. ***Whistleblower Procedures and Rules.*** Section 301 of Sarbanes-Oxley requires audit committees to establish procedures for confidential and anonymous "receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters." In addition, under the Dodd-Frank Act, the SEC has adopted rules for a program under which monetary awards are given to whistleblowers who disclose fraud directly to the SEC. For successful enforcement actions resulting in monetary sanctions exceeding $1 million, whistleblowers are entitled to receive between 10% and 30% of the monetary sanctions paid to the SEC.

5. ***Regulation M.*** Companies must comply with Regulation M whenever they make or propose to make a "distribution" of their stock. Under Regulation M, neither the company nor any of its "affiliated purchasers" may bid for or purchase, or induce others to bid for or purchase, any company stock during the applicable "restricted period" unless a specified exception is available.

6. ***Self-Tenders.*** Rule 13e-4 under the Exchange Act applies to any tender offer for a company's shares by the company or one of its affiliates. Under Rule 13e-4, the proposed purchaser must file with the SEC and

promptly disseminate public disclosure regarding the proposed purchaser, the issuer and the offer. In addition, the offer must be held open for a minimum period, stockholders must receive withdrawal rights, and other requirements apply to such transactions.

7. ***Open-Market Repurchases.*** Public companies typically rely on Rule 10b-18 under the Exchange Act to secure a safe harbor from the anti-manipulation requirements of the Exchange Act in connection with open-market bids and purchases made by an issuer with respect to its own shares.

8. ***Going-Private Transactions.*** Rule 13e-3 under the Exchange Act imposes filing and disclosure requirements for going-private transactions (including share purchases and tender offers by a company or an affiliate of a company, as well as mergers, sales of assets and other transactions involving an affiliate of the affected company), that are likely to cause that company's shares to be held by fewer than 300 holders of record or to be delisted from a stock exchange.

III. Corporate Governance Standards

A. ***Exchange Act and Sarbanes-Oxley Corporate Governance Requirements.*** Companies listed on a national securities exchange are subject to the following corporate governance requirements pursuant to the Exchange Act and the Sarbanes-Oxley Act of 2002:

1. ***Audit Committee.*** Section 10A(m) of the Exchange Act requires listed companies to have an audit committee that complies with applicable requirements.

   a. ***Establish Audit Committee.*** The audit committee of the board of directors is directly responsible for the appointment, compensation, retention and oversight of the company's auditors.

b. ***Independence Requirement.*** Each member of the audit committee must be independent as defined by listing standards established in accordance with Rule 10A-3 under the Exchange Act.

c. ***Financial Expert.*** At least one member of the audit committee must have financial management expertise, in accordance with Section 407 of Sarbanes-Oxley.

d. ***Whistleblower Protection.*** The audit committee must establish procedures to receive and respond to any complaints and concerns regarding the company's accounting, accounting controls or auditing matters.

2. ***Independent Auditor.***

a. ***Public Company Accounting Oversight Board (PCAOB).*** Auditor must follow the standards established by the PCAOB.

b. ***Audit Partner Rotation.*** Companies must rotate their audit firm partners every five years, in accordance with Section 203 of Sarbanes-Oxley.

c. ***No Conflicts of Interest with Auditor.*** An outside auditor may not perform audit services for a company if a chief executive officer, controller, chief financial officer or any other equivalent person of the company was employed by that auditor and participated in the audit of the company during the one-year period preceding the date of the audit, in accordance with Section 206 of Sarbanes-Oxley.

d. ***Prohibition on Improperly Influencing Auditors.*** Section 303 of Sarbanes-Oxley

prohibits any officer or director of an issuer from directly or indirectly taking action to coerce, manipulate, mislead, or fraudulently influence any auditor of financial statements that are required to be filed with the SEC.

3. ***Duty of Attorneys to Report Violations.*** Section 307 of Sarbanes-Oxley requires attorneys to report specified violations to the company's chief legal officer or chief executive officer and, if such persons do not respond appropriately within a reasonable time, to report further to the company's board of directors or audit committee. These reporting obligations apply if the attorney is representing a company before the SEC and becomes aware of evidence of a material violation of federal or state securities laws or any other federal or state laws or a material breach of fiduciary duty by the company, or any officer, director, employee or agent of the company.

B. ***Listing Standards.*** Companies must also comply with the corporate governance standards established by any securities exchange upon which they list securities, such as the New York Stock Exchange or Nasdaq, which are often more rigorous.

IV. Proxy Statement Obligations

A. ***Duty to Deliver Proxy Statement (Regulation 14A).*** Solicitations of proxies or consents in respect of a US domestic public company's shares are subject to the SEC's proxy rules. Under Section 14 of the Exchange Act, companies must deliver a detailed proxy statement to stockholders in connection with their annual meetings to address such issues as (i) the election of directors; (ii) selection of accountants; (iii) voting on stockholder proposals; (iv) adoption or approval of amendments to the corporate documents, stock option or other plans; and (v) other material issues and transactions.

B. ***Antifraud Requirements.*** In addition to general antifraud requirements under the federal securities laws, Rule 14a-9 under the Exchange Act specifically prohibits false or misleading statements made in connection with any proxy solicitation.

V. Reporting Obligations of Officers, Directors and Significant Stockholders

A. ***Reporting Persons (Forms 3 & 4).*** Under Section 16(a) of the Exchange Act, a US domestic public company's directors, certain designated officers, and 10% stockholders must continually report their direct or indirect beneficial ownership of the company's equity and derivative securities.

B. ***Disgorgement of Short-Swing Profits.*** Section 16(b) of the Exchange Act imposes strict liability on reporting persons to pay to the company any short-swing profits realized on a purchase and sale (or vice versa) of the company's shares within any six-month period, regardless of whether the reporting person was in possession of or used inside information in connection with the trades.

C. ***5% Stockholder (Schedule 13D).*** Under Section 13(d)(1) of the Exchange Act, any person who acquires direct or indirect beneficial ownership of more than 5% of a company's common stock must, within 10 calendar days after the acquisition, send a statement on Schedule 13D to the company and the SEC, stating (i) the identity, residence, citizenship and nature of beneficial ownership of the stockholder; (ii) the source and amount of funds used in making the purchases; and (iii) the purpose of the purchases. Institutional investors, passive investors and certain other persons may report their beneficial ownership on a short-form Schedule 13G.

Appendix B

PROPOSALS TO INCREASE ECONOMIC GROWTH AND JOB CREATION BY FACILITATING CAPITAL FORMATION*

We applaud the ongoing bipartisan efforts to increase economic growth and job creation by facilitating capital formation. To that end, we are submitting our proposals for consideration by your Committee.

As leaders of the IPO Task Force, whose recommendations in the Report to the U.S. Department of the Treasury formed the basis of Title I of the Jumpstart Our Business Startups (JOBS) Act of 2012, we are pleased to offer our perspective on current reform proposals. We are submitting these proposals in our individual capacity and not as representatives of our respective organizations.

Simplicity contributed to the success of the IPO Task Force recommendations. Today, we recommend three simple changes based on our experience and the last decade of success. Congress should (1) extend the IPO on-ramp by updating the emerging growth company (EGC) definition; (2) expand the category of well-known seasoned issuers (WKSIs) to apply to all short-form eligible registrants; and (3) adopt specific clarifications to eliminate certain inefficiencies remaining after the JOBS Act reforms.

1. Extend the IPO on-ramp based on a decade of successful experience.

Congress should extend the IPO on-ramp by updating the EGC definition to (i) increase the $1.07 billion revenue test to $2.0 billion; (ii) extend EGC status for a minimum of five years post-IPO; (iii) secure this five-year minimum period for any company that is an EGC when it begins the IPO review process but loses EGC status before completing IPO; (iv) eliminate disqualification based

---

* Previously submitted to the U.S. Senate Committee on Banking, Housing & Urban Affairs, Letter to Ranking Member Patrick J. Toomey (June 25, 2022), available at https://www.banking.senate.gov/imo/media/doc/Joel%20Trotter%20and%20Katie%20Mitchell.pdf.

on large accelerated filer status; and (v) increase the current maximum five-year IPO on-ramp period to 10 years.

The JOBS Act's IPO on-ramp succeeded by providing accommodations that streamlined the IPO process and promoted efficiency without compromising investor protection. The IPO on-ramp accommodations are limited, measured and based on analogous pre-existing principles or practices in federal securities regulation. The proposed enhancements to the IPO on-ramp represent a balanced approach to promote IPO activity without compromising investor protections, including all of the disclosure and liability requirements that continue to remain in place for all companies.

As updated, EGC would mean an issuer that had total annual gross revenues of less than $2.0 billion before beginning the IPO registration process until the last day of the fiscal year in which the IPO's fifth anniversary occurs. Thereafter, EGC status will continue until the end of the earliest fiscal year in which (i) revenues exceed $2.0 billion; (ii) the IPO's tenth anniversary occurs; or (iii) the issuer has more than $2.0 billion in non-convertible debt securities outstanding as of year-end.

2. Expand WKSI eligibility based on decades of successful experience.

Congress should expand availability of WKSI status. Currently, WKSI status is unduly limited. As updated, the WKSI definition would apply to companies with a non-affiliate market capitalization, or public float, of $75 million, rather than the public float threshold of $700 million currently required for WKSI status. The last two decades of successful experience have shown that the WKSI category merits expansion so that it overlaps with eligibility for short-form registration.

First, since the introduction of the WKSI definition nearly two decades ago, the automatic shelf registration process and other benefits available to WKSI issuers have significantly improved capital formation and market efficiency without compromising investor protection. When initially proposing the WKSI category, the SEC acknowledged that a much lower float test for WKSI status

could be appropriate. The last two decades of experience have demonstrated that to be the case.

Second, for the last three decades, companies with a public float of $75 million have been able to engage in short-form registration of securities using the integrated disclosure system based on those companies' periodic reporting. When proposing the short-form registration process, the SEC identified the $75 million public float threshold as the level at which a company's securities efficiently reflect available information about the company.

As a result, WKSI status should now be extended to all companies that otherwise satisfy the WKSI definition and have a public float of $75 million, rather than the current, arbitrarily high requirement of $700 million.

3. Adopt clarifications to eliminate needless inefficiencies remaining after the JOBS Act reforms.

(a) Streamline and clarify the EGC public filing condition to require public filing 10 days before the effective date of the IPO registration statement.

Congress should update the public filing condition for EGC IPO registration statements to require public filing at least 10 days before effectiveness of the registration statement. The current requirement for an EGC to publicly file its confidential IPO registration statement at least 15 days before conducting a road show is inefficient and subject to uncertain interpretations.

The update we propose would enhance efficiency, promote certainty, and builds on the SEC's recognition that modern "communications technology, including the Internet, provides a powerful, versatile, and cost-effective medium to communicate quickly and broadly." An EGC is permitted to begin SEC registration on a confidential basis if the EGC publicly files its previously confidential registration statement at least 15 days before conducting a road show.

This provision was intended to facilitate public review of the registration statement between the first public filing and the IPO pricing. However, experience has shown that 15 days is more than

ample time for that purpose. Moreover, the application of the current requirement can sometimes be unclear based on uncertainty surrounding the definition of a road show.

This proposed change would enhance efficiency by reducing the minimum time before pricing and provide greater predictability by referring to the date of effectiveness, which is more precise than conducting a road show, which is sometimes unclear. The updated public filing condition would require that an EGC must publicly file its registration statement, the nonpublic draft registration statement and all draft amendments at least 10 days before the effective date of the registration statement.

(b) Update the confidential review process for draft registration statements to conform to the updated EGC process.

Congress should update the process for voluntary confidential submission of non-EGC registration statements to conform to the updated requirement for EGCs. The updated confidential registration process for all IPOs, initial listings, and follow-on offerings would conform to the updated EGC process described above.

This change would facilitate capital formation and conform practice for non-EGCs to maintain consistency in the registration process if the changes to the EGC process are made. As updated, the confidential registration process would require that any issuer must publicly file its registration statement, the nonpublic draft registration statement and all draft amendments for (i) an IPO or an initial listing, at least 10 days before the effective date of the registration statement; and (ii) a follow-on offering (before the end of the twelfth month after the effective date of its IPO), at least 48 hours before the effective date of the registration statement.

(c) Update the on-ramp to include spin-off transactions.

Congress should update the EGC financial statement accommodation to clarify that the same accommodation applies to both IPOs and spin-off transactions. This would correct the aberrational effect on a spin-off of an EGC, which currently does

not benefit from the two-year financial statement accommodation now applicable only to IPO registration.

The EGC financial statement requirements should be comparable for both an IPO and a spin-off. Equalizing the requirements in both scenarios will promote efficiency and capital formation without compromising investor protection. As updated, the EGC financial statement requirements would clarify that an EGC may present two years, rather than three years, of audited financial statements in either an IPO or a spin-off.

(d) Clarify EGC financial statement obligations to prevent aberrational results.

Congress should update the EGC financial statement accommodation to clarify that an EGC need not provide financial statements for a period earlier than the two years of audited financial statements required in its IPO registration statement. In some instances, misinterpretations have arisen concerning the accommodation allowing an EGC to provide only two years of audited financial statements in its IPO registration statement, and not for any earlier period. This has arisen occasionally, for example, in the case of acquired company financial statements and for follow-on offerings involving an EGC that lost its EGC status during IPO registration.

This change would increase efficiency by ensuring that EGCs can consistently rely on the scaled disclosure accommodation by eliminating aberrational results that have sometimes required burdensome and unnecessary financial statement obligations. Absent this clarification, in some scenarios EGC issuers have needed to provide audited financial statements for financial periods preceding the earliest period in their IPO registration statements. The proposed update would clearly establish that an EGC need not, under any circumstances, provide financial statements for any period preceding the earliest period required to be presented in the IPO registration statement.

The updated requirements would provide that an EGC, as well as any issuer that went public using EGC disclosure accommodations, is not required to provide target company financial statements or pro forma financial information for any

period before the earliest period that the EGC presents in its IPO registration statement, including (i) for significant acquisitions, target company financial statements for any earlier period; and (ii) for follow-on offerings, financial statements for any earlier period by an issuer that went public using EGC disclosure accommodations.

(e) Remove aberrations in the market capitalization test for target company financial statements.

Congress should clarify that a company's market capitalization, for purposes of testing the significance of an acquisition or disposition, may include the value of all shares. When using a market capitalization test to determine whether an acquisition is significant enough to require target company financial statements, current requirements fail to account for the acquirer's full market capitalization by excluding from the calculation some classes of the acquirer's stock.

The significance test is designed to use market capitalization, or aggregate worldwide market value, to ensure that the evaluation of significance for acquisitions and dispositions compares measures that are consistent with fair value. Consistent with that objective, the test should include the market value of preferred stock (whether traded or convertible into common stock) and non-traded common shares that are exchangeable into traded common shares.

The proposed change would eliminate aberrations that result from contrary interpretations. As updated, the new requirements would clarify that a company testing the significance of an acquisition or disposition may include in its market capitalization the value of all of the acquirer's outstanding classes of stock, including preferred stock and non-traded common shares that are convertible into or exchangeable for traded common shares (based on trading value, conversion value or exchange value, as applicable).

(f) For any private company transitioning to public company status, permit the auditor to comply with SEC and PCAOB independence rules for the most recent year and AICPA or home-country independence for prior periods.

Congress should update the SEC and PCAOB auditor independence requirements to provide that the auditor of a private company that is transitioning to public company status (via IPO, spin-off or otherwise) must comply with SEC and PCAOB independence rules for the latest fiscal year, as long as the auditor is independent under AICPA or home-country standards for earlier periods. Requiring a private company's auditor to comply with SEC and PCAOB auditor independence rules for all prior years, rather than only the most recent year, can unnecessarily require hiring a different auditor to re-audit earlier periods even though the original auditor was actually independent under then-applicable standards.

As updated, this would allow the auditor of a private company that is transitioning to public company status (via IPO, spin-off or otherwise) to comply with SEC and PCAOB independence rules for the latest fiscal year, as long as the auditor is independent under AICPA or home-country standards for earlier periods. In scenarios where the auditor is independent under AICPA or home-country standards for earlier periods but the SEC and PCAOB independence rules imposes additional requirements, the auditor should be required to comply with SEC and PCAOB independence requirements only for the most recent year.

The more demanding SEC and PCAOB standards should not apply to earlier periods where the auditor has complied with the relevant auditor independence rules that applied to the private company. Under this balanced approach, the auditor must still satisfy SEC/PCAOB independence requirements for the most recent audited year while AICPA or home-country independence standards would suffice for all earlier years.

(g) Expand the protection for research reports to cover all securities of all issuers.

Congress should update the provision for research reports about EGC common equity to cover all securities of an EGC or any other issuer. This would expand the availability of the provision designed

to promote publication of research reports about EGCs by deeming the reports a non-offer.

The current provision offers limited protection of research reports in the context of an EGC's proposed offering of its common equity securities. After a decade of marketplace experience, the provision governing EGC research reports has proved wholly successful. Research analysts remain subject to robust regulation, including SEC Regulation AC certification and conflict disclosure requirements, FINRA conduct and communications rules and antifraud requirements. Based on this success, the research report provision warrants expansion. As expanded, the research report provision in Section 2(a)(3) of the Securities Act would cover research reports about any issuer that undertakes a proposed public offering of securities.

(h) Exclude QIBs and institutional accredited investors from the record holder count for mandatory Exchange Act registration.

Congress should update the mandatory Exchange Act registration threshold to exclude qualified institutional buyers (QIBs) and institutional accredited investors. The update in the JOBS Act to increase the record holder threshold should not include large institutional investors, such as QIBs or institutional accredited investors. Section 12(g) of the Exchange Act currently requires every issuer with more than $10 million in total assets and a class of equity security held of record by 2,000 or more persons (or 500 or more unaccredited investors) to register that class of equity security under the Exchange Act. In the decade since the JOBS Act raised this threshold, experience has shown that institutional investors can be excluded from the record holder count. As updated, Section 12(g) would provide that the registration threshold of 2,000 or more holders of record shall exclude QIBs and institutional accredited investors.

☆

Joel H. Trotter

Joel H. Trotter is a partner of Latham & Watkins LLP, ranked as the #1 capital markets law firm in the world by Bloomberg and Deal Point Data. He serves as co-chair of the firm's National Office, a centralized team of former SEC senior officials and experienced capital markets lawyers located in Washington, D.C. The firm's capital markets practice draws exceptional support from the National Office, providing an unparalleled ability to deliver sophisticated advice in real time on the toughest securities and listing issues clients face.

Mr. Trotter is the former global co-chair of the firm's public company representation practice and previously served for 10 years as co-chair of the Corporate Department in the firm's Washington, D.C. office. His practice focuses on capital markets transactions, securities regulation, mergers and acquisitions, and corporate governance. He represents issuers and underwriters in the public offering process and other SEC-related matters.

As a member of the IPO Task Force's leadership, and as one of two lawyers to serve on the Task Force, Mr. Trotter served as a principal author of the IPO-related provisions of the JOBS Act of 2012, enacted by a nearly unanimous Congress and signed by President Obama to reform the IPO process for emerging growth companies.

Law360 named Mr. Trotter one of the 10 Most Admired Securities Attorneys from over 1,000 nominations, noting his "deep expertise and excellent judgment" on strategic matters, for which he is "one of the firm's go-to sources for advice." Who's Who Legal recognized Mr. Trotter as a leading lawyer who is "adept at handling complex issues for major corporate clients." The Legal 500 US recommended Mr. Trotter for Corporate Governance (Tier 1), and Law Business Research named him to the International Who's Who of Capital Markets Lawyers.

Mr. Trotter received his law and undergraduate degrees from the University of Virginia, where he served as an editor of the *Virginia Law Review*, was named an Echols Scholar and was elected to the Raven Society.

Testimony before the U.S. House Committee on Financial Services
Subcommittee on Capital Markets

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

.....

Henry Ward
CEO & Co-Founder, Carta, Inc.

April 19, 2023

Chairman Wagner, Ranking Member Sherman, and members of the Committee, thank you for the opportunity to appear before you today as an advocate for the venture ecosystem and the private markets that support it. My name is Henry Ward, and I am the CEO and co-founder of Carta—a privately held financial technology company that sits at the nexus of the innovation economy.

The collapse of Silicon Valley Bank (SVB) has brought into sharp relief the importance of the venture ecosystem and its interconnectedness to the broader economy. Growth-stage companies and the funds that back them create jobs, provide important products and services, and drive the next chapter of innovation and economic growth. Put simply, the venture ecosystem is America's innovation engine, and it is important that we continue to invest in and support the entrepreneurs, investors, and employees that drive it forward.

This hearing is focused on the important goal of modernizing the policy framework to bolster private markets, expand access, and drive equity ownership. Before I discuss the pillars that drive innovation and opportunity, I would like to share my journey in building Carta.

Building Carta

When I started Carta (then known as eShares) a decade ago, tracking equity ownership in private companies was complicated. Unlike the public markets, there was no single source of truth in the private markets—equity ownership was tracked through a fragmented network of law firm spreadsheets and paper certificates. This made it difficult and costly to make more employees owners and to expand investment opportunities to more investors. So Carta set out to build the infrastructure for the private markets.

Carta built a capitalization table and valuations business to make it easier for companies to issue equity to employees and investors. We built a venture capital business that helps form venture funds and provides fund administration and valuations services to them. And we built Carta Liquidity to help make that private equity ownership

meaningful by making it liquid. We did this with the goal of creating more owners, enabling employees to participate in the success of the company they help build.

This journey was not easy. I went through 60 "nos" to get people to believe in and invest in us. But in January 2014, we opened our doors and onboarded our first customer. We earned $720. As an entrepreneur, you never forget the first time someone paid you for something you built.

We have come a long way. We have grown from a company with seven employees and $720 in revenue to one that employs nearly 2,000 employees and generates over $300 million in revenue.

Today, Carta supports the private market ecosystem at every stage—from idea to IPO. We support more than 35,000 companies and over 2.2 million stakeholders in managing over $2.9 trillion in equity; we provide fund administration services for more than 5,000 funds and special purpose vehicles (SPVs), representing over $110 billion in assets under administration; and to date, Carta Liquidity has helped unlock $13 billion across over 250 secondary transactions.

We are succeeding because of the dedicated employees who share our mission and work tirelessly to achieve it. And we are succeeding because private markets provided us the resources and time to build it.

In building Carta, we came to realize policy is part of that infrastructure. It can drive innovation or bind its growth. It can incentivize entrepreneurship, expand investment, and facilitate the experimentation that leads to new opportunities and outcomes. Policy affects nearly every aspect of the innovation ecosystem. Carta invests in public policy, and I am here today because we want policymakers to continue to shape a framework that supports this ecosystem as an engine of innovation.

Private markets are the engine for innovation and growth

Startups are the engine of our economy, and the private markets are where they build and grow. Some of our most transformative companies—Apple, Airbnb, Uber—would not exist if the private markets and venture capital did not exist. And these companies operate across sectors. Moderna is a venture-backed company that was instrumental in helping fight COVID-19; Watershed is working to help companies track and control carbon emissions; and there are countless more companies launching every year to build solutions for important global challenges.

Venture capital model

What makes the venture ecosystem so important is not only what it has—and continues to—create, but the structure that drives it. Startups are often unable to access bank loans or traditional financing. Instead they turn to venture capital, which in exchange for

equity ownership—and a piece of uncapped potential—provides capital. This private capital enables entrepreneurs to transform a concept into a company.

The venture funding structure is key to innovation. Private markets provide long-term capital with greater risk tolerance. The projects that will drive the next chapter of innovation take time to develop and commercialize. These are the types of initiatives we want as a country. And private market investment, which is patient capital and aligned through the equity ownership model, enables companies to pursue such projects.

To be certain, some projects and companies will fall short and fail. That is the nature of building something—it is hard. It also creates uncertainty and volatility. These long-term projects do not often provide signal each day, much less financial results. Companies incorporate milestones and accountability, ship items quickly to gain market feedback, and adapt. They do everything possible to make progress and realize success, but it is not always a straight line. It took Carta nearly two years to build our venture fund business. During that time we saw it falter and flounder, but today it is a key driver of our growth. The private market regulatory framework allows innovators to focus on reaching their destination, and we should support this goal.

Public market dynamics

Private markets are unique in supporting this long-term funding dynamic amidst uncertainty. This is less true in our public markets today. There are a number of reasons a company may decide not to go public, including increased regulatory burdens and higher costs. Additionally, despite the allure of broader liquidity in public markets, for some companies, the stock can be thinly traded and the issuer can actually struggle with sufficient liquidity. These are serious hurdles.

But another issue, and perhaps the bigger issue, is a duration-of-capital problem. The typical duration in venture capital investment is ten years because it takes time to build and scale. Public markets, which operate on a quarter-to-quarter basis, do not have the patience to see these projects through. Even though large public companies have more resources, they are not optimized to solve niche problems or those that do not yield financial results quickly.

To succeed in the public markets, companies need a predictable, highly repeatable business model. If management makes a prediction and does not execute against that prediction, the public markets are hostile—they punish volatility. Innovation is premised on building something new, which is unpredictable. That process requires learning, iterating, and improving. Companies that are still in the building stage and have volatility in growing their businesses—companies like Carta—would not flourish under the current public market structure. Not only will the company not flourish, but neither will the ideas and innovations they are attempting to bring to market.

Despite that, the public markets are critical: they enable companies to raise capital, access liquidity, and create more investment opportunities for retail investors—these are

worthy goals. But the solution to increasing the number of public companies should not come at the expense of successful private companies, the private markets, and ultimately, American innovation. The answer to creating more public companies is not to make private markets more hostile, but to make private markets work better. Doing so makes it easier to start and grow companies, creating a bigger pipeline of companies that can go public. Forcing companies to go public before they are ready is not good for the company, it is not good for the investor, and it is not good for the broader economy and U.S. competitiveness.

Capital access drives the innovation engine

To build and thrive, companies need capital. Private market capital has grown exponentially over the past decade. This growth, however, has not been uniform: the majority of capital raised is concentrated in a handful of places, namely Silicon Valley, New York, and Boston. To put a finer point on it, according to Carta data, in 2022, seven of the top 15 counties by total invested capital were in California, and companies in the San Francisco area raised nearly half of the combined total of every other U.S. county.[1] venture-backed jobs, on the other hand, are more broadly distributed, with 63% outside the top three states.[2]

Capital has become more mobile, but proximity still matters. For the earliest stages, investors tend to fund companies in their region: the average distance between the lead seed investor and portfolio company headquarters is less than 100 miles.[3] There are innovators with transformative ideas across the country, but they may lack connections to networks of potential investors, or the available capital options may be too expensive or not optimal for the business model. Women and minority entrepreneurs also face more challenges in attracting startup capital. For example, women-backed startups received just over two percent of venture-backed investments in 2022[4] despite the fact nearly half of new businesses were run by women.[5] Black founders received around one percent of venture capital dollars over the last year.[6]

These funding disparities have become more challenging as economic conditions have tightened. Funding rounds are lower, take longer, and are gravitating back to traditional

---

[1] Carta, State of Private Markets: Q4 and 2022 in review (Feb. 2023), *available at* https://carta.com/blog/state-of-private-markets-q4-2022/#industry-data.
[2] Gregory W. Brown, et al., An Analysis of Employment Dynamics at Venture-Backed Companies Between 1990-2020 (2022), *available at* https://nvca.org/wp-content/uploads/2022/02/Employment-Dynamics-at-Venture-Backed-Companies_FINAL.pdf.
[3] U.S. Securities and Exchange Commission, Office of the Advocate for Small Business Capital Formation, Annual Report Fiscal Year 2022, *available at* https://www.sec.gov/files/2022-oasb-annual-report.pdf.
[4] Pitchbook, US VC female founders dashboard (Apr. 2023), *available at* https://pitchbook.com/news/articles/the-vc-female-founders-dashboard.
[5] World Economic Forum, Here's what women's entrepreneurship looks like around the world, July 2022), *available at* https://www.weforum.org/agenda/2022/07/women-entrepreneurs-gusto-gender/.
[6] *See* BLCK VC, State of Black Venture (2023), *available at* https://www.blckvc.org/sbvr2023.

geographic hubs.[7] These regressions may be further exacerbated by SVB's failure, as it displaces a financial pillar of the ecosystem and also, as the Committee knows, has cascading effects to other banks, lenders, and capital allocators.

The venture ecosystem is the engine of America; it should not be limited to coastal regions. It should be accessible to more. Policies that help drive capital to emerging ecosystems, broaden local networks, and promote increased opportunities for underrepresented founders and capital allocators will help create more economic opportunity and a more inclusive ecosystem.

Carta supports policy proposals that:

> *Empower emerging fund managers.* Emerging managers play a key role supporting startups across the country, particularly for companies seeking smaller, early-stage financing. These smaller funds are more likely to participate in earlier rounds and invest in a more diverse pool of entrepreneurs located in their geographic area, which are also likely to be run by women and people of color. Venture funds are generally limited to making direct investments in private companies, but modest improvements can be made to help drive more capital into the ecosystem in more regions. Policy changes that could help incentivize established venture funds to invest in regional funds could help unlock a significant source of capital for growing entrepreneurial ecosystems. Further, permitting investments acquired through secondaries could help provide more liquidity for founders, employees, and early-stage investors to exit and redeploy capital, and provide an avenue for new investors to gain exposure to startups that have shown maturation and scale.
>
> Additionally, expanding the size and investor limits for venture capital funds could help smaller funds reach more investors with smaller check sizes, developing more localized networks.
>
> *Preserve the ability for communities to support their innovators.* Particularly at the earliest stages, many founders turn to their local communities for support to get their ideas off the ground. Policy should bolster these local funding networks, rather than constrain them. Recently, there has been discussion around increasing the 40-year old accredited investor financial thresholds to reflect inflation. Financial means are not a proxy for investor savvy, but in today's regulatory regime, they are the standard. Significant increases to these thresholds could have a detrimental impact on funds and founders trying to raise capital, particularly in lower cost of living areas, and particularly among minority communities.

[7] *See* Pitchbook, NVCA Venture Monitor Q1 2023, *available at* https://files.pitchbook.com/website/files/pdf/Q1_2023_PitchBook-NVCA_Venture_Monitor.pdf;

Increasing access to opportunity

A policy framework that expands investment opportunities will not only drive innovation, but also wealth creation for more people. However, in the private markets, these opportunities are largely reserved for institutional or wealthy investors. Most individuals are generally prohibited from participating in the private markets by narrow accreditation standards largely based on wealth and income thresholds.

The United States is built on the premise that the only barrier to opportunity is one's willingness to work for it. This country does not preclude opportunities based on circumstance or socioeconomic background. Through work and determination, anyone has the opportunity to do almost anything—go to college, build a company, even run for president—except for when it comes to investing in the private markets. With few exceptions, unless an individual investor is wealthy, this country's most innovative and transformative companies are off limits.

This is particularly important because it means the public markets are often the only available option for investing. As the number of public companies has declined, so has the number of investment opportunities. Consequently, most investors are unable to take advantage of diversification options. Under the current framework, these investors are also missing out on the growth curve, as companies that do go public are waiting to do so later in their lifecycle and at a flatter growth trajectory. Limited alpha and limited opportunities are not ideal outcomes.

Democratizing access to private market investment opportunities while preserving important investor protections and the character of the ecosystem can broaden economic opportunity.

Carta supports policy proposals that:

> *Modernize the accredited investor definition.* The accredited investor standard determines access to private market investment opportunities primarily based on personal wealth and income. Financial metrics, however, do not necessarily equate financial sophistication. Limiting access to investment opportunities and the potential for diversification to the economically privileged is not a desired outcome. In fact, it is discriminatory. It is important for individuals to understand the risks of investing and their ability to withstand loss with respect to any investment—public, private, real estate, crypto—and I believe education is a necessary component. But the government should not deny an individual access to opportunity on the basis of their financial status.
>
> The SEC expanded the accredited investor definition to include sophistication on-ramps for certain credentialed investment professionals. This important step untethered the designation from wealth-based means for the first time. More can be done, however, to expand additional pathways for individuals to qualify as accredited through nonfinancial means, including by expanding the list of

professional designations, certifications, and education requirements to qualify and through sophistication tests.

Permit structured access to private market investments. Another path to increasing access to private market investment opportunities is through professionally managed funds. Giving retail investors access to the private markets through pooled investment vehicles provides a number of important protections. These funds are managed by sophisticated individuals who are regulated and owe fiduciary duties to their investors. Investors would also be able to achieve greater portfolio diversification and would benefit from investing alongside institutional investors and their diligence.

Clarify the ability to invest in private funds through retirement accounts. Another way to expand participation in private markets is through retirement funds. On a risk-adjusted basis, private companies do better than public companies,[8] which is why you see such big investments and high returns in private equity and venture capital. Private market investments, however, are less liquid and can be locked up for years. Pairing longer duration capital—such as that in retirement accounts—with longer-term investments addresses the liquidity mismatch. Too often, this is backward in the retirement space. Professionally managed retirement plans, such as 401(k) investments, also include the benefits of a regulated fiduciary and diversification.

Ownership drives innovation

Carta's founding mission is to create more owners, and equity ownership is at the core of the private markets. In this testimony, I outlined the importance of expanding investor access to ensure more people could become owners in private companies, whether through modernizing the accredited investor definition, structured access, or retirement accounts. This will give more investors access to growth-stage potential that increases their wealth. And importantly, their investments will expand the pool of capital for innovative companies and entrepreneurs.

For Carta, ownership is also about employee ownership. We strive to incentivize and make it easier for employers to issue equity to more employees. Ownership is a critical component to wealth creation, driving economic opportunity, and narrowing the wealth gap. It also aligns incentives across the enterprise, creating accountability and commitment to these longer-term projects that drive innovation and a company's success. Ownership enables employees to benefit from the upside they helped create.

---

[8] *See* Cambridge Associates, US PE/VC Benchmark Commentary: First Half 2022 (Jan. 2023), *available at* https://www.cambridgeassociates.com/insight/us-pe-vc-benchmark-commentary-first-half-2022/; McKinsey & Co., Private Markets Rally to New Heights, McKinsey Global Private Markets Review 2022 (Mar. 2022), *available at* https://www.mckinsey.com/~/media/mckinsey/industries/private%20equity%20and%20principal%20investors/our%20insights/mckinseys%20private%20markets%20annual%20review/2022/mckinseys-private-markets-annual-review-private-markets-rally-to-new-heights-vf.pdf.

Carta is filled with employees who have contributed to Carta's growth and who benefit from the financial appreciation of their equity stakes in our company. They use this money to buy first homes, support their families, invest in other companies, and in their own futures. This drives the innovation cycle forward. And Carta is just one of the many companies whose employees benefit from that ownership.

For these reasons, employee ownership is critical to the employee, the company, and the broader community. Carta is working with partners in the private market ecosystem to expand the employee ownership model beyond venture-backed startups. We hope to shift employee equity ownership from being a perk to being an expectation.

***

Thank you for the opportunity to tell Carta's story and advocate for the innovation ecosystem. Carta is proud to provide the infrastructure to support our innovators: the founders, investors, and employees who drive the innovation economy. Policy is part of that infrastructure—it affects nearly every aspect of the ecosystem and can drive innovation or bind its growth. This is why it is so important to make sure we have the right framework in place to ensure American innovation remains at the forefront, and that the American economy maintains its competitive edge. I appreciate all the work that Congress is doing on that front, and we want to work with you to do that.

I look forward to your questions

April 19, 2023

The Honorable Ann Wagner
Chairwoman
Subcommittee on Capital Markets
U.S. House of Representatives
Washington, DC 20515

The Honorable Brad Sherman
Ranking Member
Subcommittee on Capital Markets
U.S. House of Representatives
Washington, DC 20515

Re: April 19th Subcommittee on Capital Markets Hearing Entitled "A Roadmap for Growth: Reforms to Encourage Capital Formation and Investment Opportunities for All Americans"

Dear Chairwoman Wagner and Ranking Member Sherman:

The American Securities Association (ASA)[1] appreciates the ongoing work of the Financial Services Committee to consider and advance legislation that would reform our nation's securities laws, help businesses raise capital and create jobs, and allow more investors the opportunity to share in the growth of successful enterprises. We previously submitted our views on capital formation legislation for the February 8th and March 9th Subcommittee on Capital Markets hearings.[2][3]

The ASA wishes to provide our perspective on legislation that will be discussed as part of the April 19th hearing:

Legislation the ASA Supports

H.R.__, to except quotations of Rule 144A fixed-income securities from certain regulatory requirements

Rule 15c2-11 was adopted in 2020 to address fraudulent behavior typically associated with trading in the over the counter (OTC) market by ensuring issuers quoted in the OTC market make current financial information publicly available. However, prior to the 2020 amendments,

[1] The ASA is a trade association that represents the retail and institutional capital markets interests of regional financial services firms who provide Main Street businesses with access to capital and advise hardworking Americans how to create and preserve wealth. The ASA's mission is to promote trust and confidence among investors, facilitate capital formation, and support efficient and competitively balanced capital markets. This mission advances financial independence, stimulates job creation, and increases prosperity. The ASA has a geographically diverse membership of almost one hundred members that spans the Heartland, Southwest, Southeast, Atlantic, and Pacific Northwest regions of the United States.
[2] https://www.americansecurities.org/post/asa-commends-capital-markets-subcommittee-for-prioritizing-capital-formation
[3] https://www.americansecurities.org/post/asa-welcomes-house-financial-services-ipo-legislation

there has been limited, if any, application of this rule to fixed income markets, and for good reason.

If 15c2-11 were to be applied to the fixed income markets without first considering the consequences, it could weaken transparency and disrupt these markets, rather than enhance them.

Accordingly, we strongly support this draft bill that would exempt 144A fixed income securities from Rule 15c2-11 because it would mitigate some of the negative consequences from the misapplication of Rule 15c2-11 while protecting investors in the fixed income markets.

H.R.__, to require the Securities and Exchange Commission to revise the definition of an accredited investor to include a natural person that passes an examination established and administered by the Commission

The ASA generally supports expanding the definition of "accredited investor" under SEC Rule 501. For nearly four decades, the only way that most individuals could become accredited – and therefore be eligible to invest in private offerings – would be to meet certain income or net worth thresholds.

In other words, one had to be "wealthy" enough to invest in most private offerings, and those that were not sufficiently wealthy were sidelined from these deals. This has prevented millions of households from being able to invest in promising private funds or businesses and, as the SEC's Office of the Advocate for Small Business Capital Formation recently noted, has been discriminatory towards minorities.[4]

The ASA supports alternative methods to determine accredited investor status, including through examinations administered by the SEC that are designed to assess an individual's financial sophistication, regardless of their wealth or annual income.

Legislation the ASA Opposes

H.R.__, the Middle Market IPO Underwriting Cost Act

This legislation would require the SEC and Financial Industry Regulatory Authority (FINRA) to conduct a study of the costs associated with small and mid-size IPOs, in particular gross spreads paid to underwriters.

This bill is unwarranted and based upon a deeply misguided premise about why more companies are choosing not to go public. The level of gross spreads paid to underwriters is a longstanding

[4] OASB Annual Report at 73

market practice that spans decades and has existed both during periods of high IPO activity and periods when IPOs declined. There is no credible evidence that underwriter fees are somehow misunderstood by companies considering an IPO or serve as a disincentive to go public.

More fundamentally, these fees are a *known, one-time* cost to companies that they factor into their decision as to whether to stay private or go public. In our experience, the biggest disincentives to IPOs are *unknown, ongoing* costs, in particular regulatory and reporting costs that have steadily grown over the years, and which have made the public markets inhospitable to too many businesses.

Businesses are also wary of how special interests have targeted public companies through shareholder resolutions, activist campaigns, and other methods. It would be more appropriate for Congress to focus on the SEC's current regulatory agenda and actions the SEC has taken to tilt the scales in favor of activist investors rather than granting the SEC authority to establish price controls for underwriting fees. We urge all members of the Committee to oppose this legislation going forward.

Conclusion

The ASA appreciates the work of the Committee on capital formation, and we hope to serve as a resource on these legislative initiatives. We look forward to working with all members on these critical issues during the 118th Congress.

Sincerely,

Christopher A. Iacovella
President & Chief Executive Officer
American Securities Association

Biotechnology Innovation Organization
1201 New York Ave., NW
Suite 1300
Washington, DC, 20005
202-962-9200

Biotechnology Innovation Organization
Statement for the Record
U.S. House Committee on Financial Services Subcommittee on Capital Markets
A Roadmap for Growth: Reforms to Encourage Capital Formation and Investment Opportunities for All Americans
April 23, 2023

Introduction

BIO is the world's largest life sciences trade association representing nearly 1,000 biotechnology companies, academic institutions, state biotechnology centers and related organizations across the United States and in more than 30 other nations. BIO members are involved in the research and development of innovative biotechnology products that will help to solve some of society's most pressing challenges, such as managing the environmental and health risks of climate change, sustainably growing nutritious food, improving animal health, enabling manufacturing processes that reduce waste and minimize water use, and advancing the health of our families.

BIO appreciates the opportunity to present these comments to the Committee as it considers reforms to encourage capital formation and investment opportunities for all Americans.

There is a pressing need for reforms that support entrepreneurs, protect investors, and ensure the continued economic dynamism that has catapulted the United States into its current position as the global leader in innovation.

The Importance of Capital Formation in the Life Sciences

The American bioeconomy is a testament to the benefits of free and fair capital markets that allow for entrepreneurial risk-taking. Our capital markets are a key reason why the United States remains the global leader in life sciences research and in the translation of scientific discovery into therapeutics, diagnostics, and cures.

BIO urges the Committee to build on this success with carefully targeted reforms that promote greater access to capital while protecting investors, promoting transparency, and preserving market integrity.

Global competition in the "biotechnology revolution" is accelerating as nations continuously learn from and adapt to American-born innovation, which includes not only our novel ideas and technologies but also dynamic new business models and policies.

The work of biomedical R&D carries with it a very high risk for early investors. A recent study by MIT found that oncology programs have a 3.4% chance of resulting in an FDA approved product,[1] yet billions of dollars of private and public capital from exchanges are invested every year to find treatments and bring them to the patients who need them.

No other investment carries with it such a low rate of success. These low probabilities of success, significant sums of money, and decade-long timelines required to create a new biomedical product has led to the development of a highly specialized ecosystem to price, transfer, and absorb these entrepreneurial risks.[2] These investments require an efficient capital market ecosystem.

It is no coincidence that the country with the most robust capital formation ecosystem also happens to be the country that produces the most groundbreaking medicines. In fact, the United States produces more new medicines than the rest of the world combined. Our markets are also larger than those of the next nine largest financial markets combined.[3]

In short, robust capital formation yields a robust innovation economy. If we intend to continue being the world's leader in biotechnology innovation, we must enhance our capital formation policies to maintain our competitive advantage.

Private Markets

All innovation journeys begin in the private market. Angel investors provide entrepreneurs with those first dollars needed to take the gigantic leap from the lab to commercialization, which takes more than a decade, billions of dollars, and a high risk of failure.

Angel and venture investors serve a critical function that public markets cannot. They not only provide capital but also invaluable advice, mentorship, and a network that is leveraged to take innovations to the next step. We need more angels, not fewer. We need more dynamic and liquid private markets, not more constrained private markets.

Private capital differs most significantly from public capital in that they have specialized expertise and a higher tolerance for extreme uncertainty and a longer investment horizon. They can invest in a company that is not expected to generate revenues for a decade—as is the case

[1] Lo et al, "Estimation of clinical trial success rates and related parameters," Biostatistics (2018)
[2] https://www.nature.com/articles/s41587-021-00876-w
[3] https://data.worldbank.org/indicator/CM.MKT.LCAP.CD?locations=US

across the biotech ecosystem—and not feel pressured to sell. In fact, the opposite holds true. They invest more time and resources to develop the team and mature the enterprise.

These investors know that biotechnology companies consume cash at a ferocious rate, and they expect the majority of their dollars to go towards scientific progress. These early investors know each portfolio company intimately, and they care about nurturing the growth of the company and its leaders.

BIO supports the "Equal Opportunity for All Investors Act of 2023," which would have the Securities and Exchange Commission establish an examination to qualify an individual as an accredited investor and no longer limit the definition to a wealth criterion.

Across the bioeconomy, private capital tends to be patient capital. It allows for mistakes, for growth, and for the maturity of entrepreneurs from scientists to corporate leaders. All of this is crucial for first-time founders and those seeking to change the world by bending the arc of disease.

However, fundraising is not a binary decision between public or private capital, but rather a continuum where regulatory burdens should grow in tandem with access to the larger pools of capital needed to advance clinical trials.

Both private and public markets are accessed based on company specific needs for financing. After a certain point in the lifecycle of a biotech company, the costs associated with running clinical trials exceed the capital base of private markets and, therefore, entrepreneurs must then take the leap into the largest pool of capital on the planet: U.S. stock exchanges.

Public Markets

It is no secret that fewer companies now pursue an IPO and become public. There are several reasons for that, including the significant increase in costs associated with being a public company. These funds are diverted from a small biotech's core mission of R&D and clinical development, which is the main reason investors fund our members.

Instead, small biotechs must spend a growing percentage of their limited capital raise on regulatory filings and paperwork, quarterly reporting when our cadence of news is more sporadic, and on ancillary services required of public companies, such as those dedicated to ensuring the enterprise and its officers, engage appropriately with non-specialized investors for the first time, and navigating the legal risks that follow volatile periods of stock performance.

BIO urges Congress to adopt rules that reflect the differences between public and private markets in a targeted manner that protects investors, preserves the integrity of markets, and facilities robust capital formation.

The JOBS Act of 2012 (P.L. 112-106), is an example of a successful targeted approach. It ushered in a new era of dynamic capital formation for the biotechnology industry. It represented a recognition by Congress that regulations must fit the purpose for which they were designed and not impose costly burdens that do not benefit markets or investors. We believe that Congress should build on this success and resist the calls to add additional and unnecessary reporting requirements to public markets, Board directorships, and related expenses, both direct and indirect, dedicated to matters that are not material to our business and will not aid investors in making informed decisions.

These are additional costs that threaten to divert scarce funds from science to compliance and require innovators to raise new funds from public markets at a time when these markets are especially tight. Ultimately, the costs to the system are increasingly dedicated to reporting rather than delivering on our promise to change the course of rare diseases. The challenge for policymakers is to ensure that any additional regulatory costs yield substantive benefits for market integrity and investor protection.

A critical bottleneck is that public market regulation is once again becoming a one-size-fits-all, which makes being a public company much more burdensome for smaller businesses. Recent proposed rules by the SEC notably did not fully consider the impact of these new rules on small businesses, as noted by the Small Business Administration's Small Business Advocate.[4]

It is important to recall at this point that despite being public companies, early-stage small biotechs lack an approved product and have no recurring revenues to fund daily operations. They are entirely dependent on capital markets to finance their work.

As is the case with private markets, small biotechs raise money from investors (this time from public equity investors in initial public offerings and follow-on issuances) and enter into partnerships with pharmaceutical companies to advance clinical trials which can cost in the hundreds of millions of dollars. In essence, the biotechnology industry has a fixed pool of money that must be budgeted across years of operating until the next need to raise more money for the next clinical trial.

[4] https://www.sec.gov/comments/s7-10-22/s71022-20131758-302192.pdf

The difference from private markets is that the cost of capital is significantly higher and the cost of being a public company consumes ever greater amounts of budget from one year to the next. This is an especially salient point in context of the last few years, when the industry experienced significant volatility in response to COVID, which was followed by the current multi-year decline.

For context, the entire sector saw speculative inflows as the response to COVID attracted public monies even if companies were not responding to the pandemic but were rather developing cancer therapeutics or treatments for rare diseases.

This epic market swing increased share prices and forced companies to exit the emerging growth company, or EGC, exemption and forced them to comply with new regulatory filing requirements despite the fact that their stock prices collapsed shortly after breaching the thresholds. This loss of EGC status in many cases had nothing to do with the fundamentals of these companies, but with overall market conditions.

For context, this is one of the main reasons most small biotechs lose the emerging growth company exemption of the JOBS Act, which shields them from spending significant sums of money on reporting that investors have not requested but regulation requires. Public market fluctuations often cause biotechs to cross public float thresholds that trigger additional reporting requirements. This trigger event is not based on company fundamentals, such as finally having product revenues. This is like having a tax system that is based on the number of years working instead of income.

Providing more flexibility to the emerging growth company definition would be a significant help to small companies. Extending the exemption by five years and raising the public float thresholds maintain the spirit of the JOBS Act and will help companies better absorb new regulations. This is especially relevant to the biotechnology sector where R&D timelines can run for a decade or longer.

BIO believes that Congress can build on the past success of the JOBS Act with narrowly targeted changes to the law.

BIO supports the "Helping Startups Continue to Grow Act," which would create a longer runway for young, pre-revenue companies to maintain their Emerging Growth Company status as it would align the exemption length with product cycle timelines.

BIO also supports a draft proposal by Senator Ted Budd (R-NC) to increase reporting thresholds by updating the decades-old public float thresholds that define emerging growth companies. One option is to bring these thresholds in line with actual markets is to adjust the public float thresholds by the amount the equity market has grown since 2012, when the JOBS Act was enacted.

According to the World Federation of Exchanges, the U.S. equity market grew from $18.7 trillion at the end of 2012, when the JOBS Act was enacted, to $40.7 trillion in 2020.[5] Markets have doubled since 2012, which would bring the EGC public float threshold just under the limit that investors already use to define a small company's market capitalization, which is $2 billion. It is time for the SEC to raise the thresholds to be in line with how markets have grown since the legislation became law.

Conclusion

BIO supports transparent and reliable capital markets, both private and public, that allow companies to efficiently "graduate" or transition across funding structures while minimizing overlap in reporting and disclosure burdens. Disclosures and reporting obligations should scale as a company matures and generate revenues.

Small tweaks can mean a big difference for emerging biotechnology entrepreneurs who continue to face a tidal wave of challenges, especially in the current bear market in public equities that have left IPO on-ramps and follow-on issuances shuttered.

We must learn from the past and avoid costly errors that threaten to sacrifice what has been built over the last 80 years. We should not institute rules and regulations that will only concentrate capital further and raise the cost of entrepreneurship to the point that we box out the innovative small businesses that account for the lion's share of innovation in this dynamic industry. Rather, Congress should build upon the successful implementation of the bipartisan JOBS Act of 2012 and take further bipartisan action to help smaller companies grow.

Thank you for this opportunity to present BIO's views.

Nick Shipley
Chief Advocacy Officer
Biotechnology Innovation Organization

[5] https://data.worldbank.org/indicator/CM.MKT.LCAP.CD?locations=US

Questions for the Record from Ranking Member Maxine Waters
Subcommittee Hearing, entitled "A Roadmap for Growth: Reforms to Encourage Capital Formation and Investment Opportunities for All Americans"
Wednesday, April 19, 2023 at 2 pm

Mr. Joel H. Trotter

1. Which of the following options best describes your self-identified race? (you may choose more than one)
    a. White or Caucasian
    b. Black or African American
    c. Hispanic/Latinx
    d. Asian
    e. Middle Eastern/North African
    f. Choose not to answer
2. Which of the following options best describes your gender identity?
    a. Woman
    b. Man
    c. Non-binary
    d. Transgender Man
    e. Transgender Woman
    f. Choose not to answer
    g. Prefer to self-describe (please specify)

Mr. Rodney Sampson

1. Which of the following options best describes your self-identified race? (you may choose more than one)
    a. White or Caucasian
    b. Black or African American
    c. Hispanic/Latinx
    d. Asian
    e. Middle Eastern/North African
    f. Choose not to answer
    g. Prefer to self-describe (please specify)
2. Which of the following options best describes your gender identity?
    a. Woman
    b. Man
    c. Non-binary
    d. Transgender Man
    e. Transgender Woman
    f. Choose not to answer
    g. Prefer to self-describe (please specify)

Mr. Henry Ward

1. Which of the following options best describes your self-identified race? (you may choose more than one)
    a. White or Caucasian
    b. Black or African American
    c. Hispanic/Latinx
    d. Asian
    e. Middle Eastern/North African
    f. Choose not to answer
    g. Prefer to self-describe (please specify)
2. Which of the following options best describes your gender identity?
    h. Woman
    i. Man
    j. Non-binary
    k. Transgender Man
    l. Transgender Woman
    m. Choose not to answer
    n. Prefer to self-describe (please specify)

Mr. Brandon Brooks

1. Which of the following options best describes your self-identified race? (you may choose more than one)
    a. White or Caucasian
    b. Black or African American
    c. Hispanic/Latinx
    d. Asian
    e. Middle Eastern/North African
    f. Choose not to answer
    g. Prefer to self-describe (please specify)
2. Which of the following options best describes your gender identity?
    a. Woman
    b. Man
    c. Non-binary
    d. Transgender Man
    e. Transgender Woman
    f. Choose not to answer
    g. Prefer to self-describe (please specify)

Ms. Melanie Senter Lubin

1. Which of the following options best describes your self-identified race? (you may choose more than one)
    a. White or Caucasian
    b. Black or African American

c. Hispanic/Latinx
d. Asian
e. Middle Eastern/North African
f. Choose not to answer
g. Prefer to self-describe (please specify)

2. Which of the following options best describes your gender identity?
   a. Woman
   b. Man
   c. Non-binary
   d. Transgender Man
   e. Transgender Woman
   f. Choose not to answer
   g. Prefer to self-describe (please specify)