Testimony of Stacey L. Bowers

U.S. Public Markets Built for the 21st Century: Exploring Reforms to Make Our Public Markets Attractive to Small and Emerging Companies Raising Capital

Committee on Financial Services, Subcommittee on Capital Markets

March 9, 2023

Chairman Wagner, Ranking Member Sherman, and members of the Subcommittee, thank you for the opportunity to speak with you today. I am a Professor of the Practice of Law and Director of the Corporate and Commercial Law Program at the University of Denver Sturm College of Law. I am also Of Counsel at 3Pillars Law, PLLC, where I assist companies seeking to raise capital. I speak to you today as both an academic and a practitioner who represents clients in the capital markets.

The U.S. capital markets are the bedrock of a healthy economy, funneling capital into businesses, which in turn create jobs and return money to millions of investors. Unfortunately, because of policy decisions by Congress and regulators, our markets today are also creating enormous risks for investors.

Rather than funneling investors' precious savings into funding the best companies and opportunities from around the world, too often, billions of dollars of investors' monies are wasted on ill-advised business ideas, unaccountable companies, and outright fraudulent schemes. If I was testifying a few years ago, we would be talking about Theranos or WeWork. Now, we have hundreds of companies to choose from, not the least of which is FTX.

Those companies wasted billions of dollars of investors' capital that could have been put to better uses, such as by funding better, perhaps smaller, and more diverse businesses.

Our historically strong capital markets were created by the federal securities laws. These laws explicitly conditioned the ability of companies to raise money from the public with the requirement that issuers provide investors with access to full and fair information.

As noted by Congress in 1933 regarding the Great Depression "Whatever may be the full catalogue of the forces that brought to pass the present depression, not least among these has been this wanton misdirection of the capital resources of the Nation. The irresponsibility which fostered this tragic distribution of securities derived in the main from the abnormal profits possible from the business of selling securities. Despite the fact that the business demands the assumption of responsibilities of a character fully equivalent to those of trusteeship, compelling full and fair disclosure not only of the character of the security but of the charges made in connection with its distribution, the literature on the faith of which the public was urged to invest its savings was too often deliberately misleading and illusive."[1]

For decades following the implementation of the federal securities laws, the public markets were the primary way for companies to raise capital to thrive and grow. The number of public companies exploded, as did their valuations and returns for investors. The U.S. became the dominant capital market, attracting both companies and investors from around the world.[2]

Private offerings were, for decades, generally limited to offerings with few offerees,[3] and conditioned upon the offerees receiving the same type of information that they might get from a registration statement in a public offering.[4] The law didn't distinguish between wealthy investors and ordinary people.

After decades of deregulation by Congress and the Securities and Exchange Commission, a company may now raise an unlimited amount of money from an effectively unlimited number of investors without making any mandatory disclosures at all or with limited disclosures. The regulations have also created a number of arbitrary distinctions about investors' status as accredited or non-accredited based on their perceived wealth, income, or legal status.

We have seen the capital markets evolve to exploit these regulatory changes. The private markets, which were once tiny, have come to represent the vast majority of capital raised in a given year.[5] At the same time, the number of companies raising capital in the public markets has continued to decline.[6] Massive deregulations designed to relieve the perceived burdens on public companies in efforts to entice them into the public markets have been ineffective at stopping the trend of companies turning to the private markets to raise capital.

The proposed legislation that is being considered as part of this hearing, like the other deregulatory efforts over the past several years, will undoubtedly fail to spur more robust public markets. In particular, the legislation seems to presume that simply reducing the disclosures and accountability of public offerings would increase the number and size of companies entering these markets in lieu of the private markets.

---

[1] H.R. Rep No. 85, at 2-3 (1933).

[2] 2022 SIFMA Capital Markets Fact Book, at 7 and 31, *available at* https://www.sifma.org/wp-content/uploads/2022/07/CM-Fact-Book-2022-SIFMA.pdf.

[3] Securities Release No. 33-285 (January 24, 1935).

[4] *SEC v. Ralston Purina, Co.*, 346 U.S. 119, 126-127 (1953) ("[t]*he exemption question turns on the knowledge of the offerees,* the issuer's motives, laudable though they may be, fade into irrelevance. The focus of inquiry should be on the need of the offerees for the protections afforded by registration. *The employees here were not shown to have access to the kind of information which registration would disclose.*").

[5] *See*, Securities and Exchange Commission, Office of the Advocate for Small Business Capital Formation, "Annual Report Fiscal Year 2022," Annual Report, at 13, ($2.3 trillion was raised in Rule 506(b) and $148 billion was raised in Rule 506(c) private placements in 2022, whereas $126 billion was raised in initial public offerings and $1.1 trillion was raised in other registered offerings), *available at* https://www.sec.gov/files/2022-oasb-annualreport.pdf.

[6] *See*, Securities and Exchange Commission, Office of the Advocate for Small Business Capital Formation, "Annual Report Fiscal Year 2022," Annual Report, at 13.

It is highly unlikely that reducing information for investors will attract them to the public markets. To the contrary, investors around the world are seeking more comprehensive, reliable, and comparable information. In fact, when companies are looking to raise money in the private markets, what they disclose to which investors is often a key topic of discussion. Further, the proposed legislation would lessen transparency and reliability of information about companies in the U.S. public markets at the same time regulators and policymakers in other countries are strengthening their disclosure requirements.[7]

Separately, given that companies and private funds can often raise all the capital they need from hundreds or even thousands of investors without going public, one has to question why a company or its executives would ever go public. There is a reason that, prior to the disastrous special purpose acquisition company ("SPAC") boom, companies were typically waiting longer than ever before to go public, and were often doing so at extremely high valuations.

Today, a company can often raise the money it needs without having to:

- make public disclosures (and instead make no or selective disclosures);
- subject itself to robust audits, including of its finances and internal controls;
- face SEC and public scrutiny; and
- face potential class action suits by plaintiffs.

Even if Congress were to further reduce the disclosures and accountability for public companies, such as by enacting the legislation before you today, company executives would still find the private markets far more attractive than the public markets to raise capital.

Restoring the public markets should not focus exclusively on potential issuer burdens. It should also focus on the investors. The performance of newly public companies has been abysmal, with almost 87 percent of companies that went public in 2021 trading below their offering prices, down greater than 49 percent on average, with this trend continuing into 2022.[8] For just a sense of how bad it has become, before the Covid-19 pandemic, new public companies underperformed the broader public markets by only 28 percent.[9] However, as of December 2022, a whopping one-fourth of companies that went public in 2020 and 2021 were trading at less than $2 per share – putting them at risk of delisting.[10] Put it together, and investing in an initial public offering ("IPO") has been a disaster for investors over the past years.

---

[7] IFLR, Changes to Information Disclosure Rules in China's Security Market (September 29, 2022), *available at* https://www.iflr.com/article/2aost4262ro4h7gtxciyo/sponsored/changes-to-information-disclosure-rules-in-chinas-security-market.

[8] Corrie Driebusch, Wall Street Journal (online), IPO Stocks Have Tumbled, Hobbling Demand for New Listings (September 26, 2022).

[9] Chris Matthews, MarketWatch, Investors Beware: The Typical IPO Stock Is a Dud, Says Goldman Sachs (September 5, 2019), *available at* https://www.marketwatch.com/story/investors-beware-the-typical-ipo-stock-is-a-dud-says-goldman-sachs-2019-09-05.

[10] Dow Jones Institutional News, Markets: Deflated IPO Stocks Haunt New-Issue Market (December 19, 2022).

Further reducing transparency and accountability of public companies is not going to entice more investors to the public markets, if anything it is instead likely to drive them away.

I. Public Offerings

The U.S. capital markets are the largest in the world, providing approximately 69 percent of equity financing and 6.5 percent of debt financing for non-financial corporations, with loans encompassing only 10.1 percent of such financing.[11] This sets the U.S. apart from many other countries where loan financing accounts for 20 percent or more of the capital provided to non-financial corporations.[12]

During 2021, there were 1,391 public offerings in the U.S.,[13] an increase of 20.2 percent over 2020 and 57 percent over 2019, as well as a record high in the number of public offerings.[14] These offerings in 2021 generated $436.2 billion,[15] a significant portion of which simply exists for corporate insiders and early investors. While the majority of those IPOs were for special SPACs, which had essentially no substantive disclosure obligations because they were for empty pools of capital, there were still many "conventional" IPOs. Of those, 93 percent were so-called emerging growth companies ("EGCs"), which have lesser disclosure and accountability obligations than non-EGCs.[16]

Put another way, in 2021, a tiny fraction of the money raised by companies in the public markets was done using the full set of public company offering and disclosure rules to ensure transparency for investors.

II. Emerging Growth Companies

EGCs are companies that have total annual gross revenues of less than $1.235 billion during the most recent fiscal year and have not sold common equity pursuant to a registration statement prior to December 9, 2011.[17] A company continues to be an EGC until its annual gross revenues equal or exceed $1.235 billion, it has issued more than $1.0 billion in non-convertible debt over the past three years, it becomes a large accelerated filer, or on the last day of the fiscal year following the fifth anniversary of the date it first sold common equity pursuant to an effective registration statement.[18]

---

[11] 2022 SIFMA Capital Markets Fact Book, at 6, *available at* https://www.sifma.org/wp-content/uploads/2022/07/CM-Fact-Book-2022-SIFMA.pdf.
[12] 2022 SIMFA, at 6 (loan financing is 20 percent in the UK, 25.8 percent in Japan, and 71.8 percent in China).
[13] This number includes initial public offerings, secondary offerings, and offerings of preferred stock.
[14] 2022 SIFMA, at 50, (there were 1,157 public offerings and 886 public offerings in 2019 and 2020, respectively).
[15] 2022 SIFMA, at 50, (there was $228.1 and $390.4 billion raised in public offerings 2019 and 2020, respectively).
[16] IPO Report: 2022, WilmerHale, (February 28, 2022), at 3, *available at* file:///Users/sloubowers/Downloads/2022-WilmerHale-IPO-Report%20(4).pdf.
[17] 15 U.S.C. §77b(19).
[18] 15 U.S.C. §77b(19).

A. EGC Statistics

As of November 15, 2021, there were 3,092 companies that identified as EGCs and filed audited financial statements, which reflects a 59 percent increase from the prior period ended November 15, 2020, when 1,940 companies identified as EGCs.[19] Of the 1,577 newly identified EGCs,[20] approximately 40 percent were SPACs.[21] Additionally, 60 percent, or 1,862 EGCs, were listed on a U.S. national securities exchange[22] and had a combined market capitalization of $2.2 trillion, an increase of 81 percent over the prior period.[23]

Of the 3,092 EGCs identified as of November 15, 2021, 1,604 reported being a shell company or having no revenue in their 1934 Exchange Act periodic reporting filings.[24] Further, 50 percent of the EGCs that provided a management report on the company's internal controls over financial reporting, indicated at least one material weakness.[25] Additionally, 61 percent of the non-exchange-listed EGCs and 25 percent of the exchange-listed EGCs had an audit report that included a going concern paragraph, meaning the company's auditors did not foresee the EGC continuing to operate into the foreseeable future (or for the next twelve months).[26]

Exchange-listed and non-exchange-listed EGCs reported significantly less revenue as compared to non-EGC listed companies, with EGC revenue ranging from negative $9.4 million to $1.7 billion, with an average of $66 million in revenue.[27] In particular, 1,733 exchange-listed EGCs had revenue of less than $399 million.[28] The number of all EGCs reporting no revenue increased from 38 percent in the prior period to 51 percent in the current period due in large part to SPACs.[29]

B. EGC Reduced Compliance Requirements

EGCs were created as part of the JOBS Act passed in April 2012 with the underlying purpose of reducing the regulatory burden associated with entering the public markets as a smaller

---

[19] PCAOB, Characteristics of Emerging Growth Companies and Their Audit Forms (November 15, 2021), at 1, *available at* https://assets.pcaobus.org/pcaob-dev/docs/default-source/economicandriskanalysis/projectsother/documents/white-paper-on-characteristics-of-emerging-growth-companies-as-of-nov-15-2021.pdf?sfvrsn=3be9c6f2_3.

[20] *See*, PCAOB, at 8, (425 EGCs from the period ended November 15, 2020 did not self-identfy as an EGC in the current period or file an audit report in the 18 months preceding the current period).

[21] PCAOB, at 1.

[22] *See*, PCAOB, p. 10, (this reflects a 38 percent increase in exchange listed EGCs as from November 15, 2016 to November 15, 2021).

[23] PCAOB, at 1.

[24] PCAOB, at 1.

[25] PCAOB, at 1.

[26] PCAOB, at 1.

[27] PCAOB, at 13.

[28] PCAOB, at 13 and 14.

[29] PCAOB, at 15.

company. Companies that meet the EGC requirements are subject to reduced disclosure and compliance obligations.

In particular, an EGC is only required to provide two years of audited financial statements in its IPO, versus the three years required of non-EGC companies.[30] This creates a framework where a small company that inherently has a greater risk of failure, often due to its limited revenues or assets, provides less financial disclosures than a large financially stable company.

Further exacerbating this lack of financial information transparency, is that an EGC is not required to provide the auditor attestation required by Section 404(b) of the Sarbanes-Oxley Act of 2002, which requires the auditor to examine and attest to the company's internal controls.[31] The auditor's attestation of internal controls serves as a check on the company's financial reporting. By waiving this requirement, investors lose yet another level of protection from potentially inaccurate or fraudulent financial disclosures.

Additionally, an EGC: (i) can opt out of and defer compliance with changes in accounting standards issued after April 5, 2012, (ii) does not have to comply with the PCAOB requirements regarding audit firm rotation or auditor discussion and analysis reports, (iii) does not have to provide full blown executive compensation disclosure as required by Sections 402(a)-(k) of the Sarbanes-Oxley Act of 2002, (iv) does not have to hold say-on-pay or say-on-golden parachute votes, and (v) does not have to include the pay versus performance disclosures required by Section 14 and 14A of the 1934 Exchange Act.[32]

III. The Proposed Legislation

While the proposed legislation on today's agenda appears intended to make the public markets more attractive to smaller companies, it does so by reducing information available to investors and reducing those companies' accountability to their investors and the public. While expanding access to the public markets for smaller companies is a laudable goal, simply removing companies' disclosure obligations without even acknowledging the impacts on investors will not work. Investors who have options are going to invest where they have access to the necessary information to make informed decisions. If that is not the U.S., then it will be elsewhere.

Investors from around the world have historically come to invest in the U.S. capital markets because they could rely upon our robust financial regulatory apparatus, including SEC oversight of public companies' disclosures. Other countries and markets around the world, including China and Europe, have increasingly sought to improve their global competitiveness by raising their disclosure and accountability standards for public companies.[33] The proposed legislation

---

[30] Westlaw, PLC US Capital Markets & Corporate Governance, Emerging Growth Company Status and Smaller Reporting Company Status: Comparison Chart.
[31] Sarbanes-Oxley Act of 2002, §404(b).
[32] Westlaw, Emerging Growth Company Status and Smaller Reporting Company Status: Comparison Chart.
[33] IFLR, Changes to Information Disclosure Rules in China's Security Market (September 29, 2022), *available at* https://www.iflr.com/article/2aost4262ro4h7gtxciyo/sponsored/changes-to-information-disclosure-rules-in-chinas-

would generally appear to go in the opposite direction, and could materially weaken an area of international competitiveness in our public markets. Below, I address some of the specific proposals.

A. H.R. 9410 and H.R. 9411

Both of the proposed pieces of legislation would lower the quality of financial disclosure for investors without any evidence of meaningful benefit to the capital raising process.

H.R. 9410 stipulates that the auditor of any issuer that is public company or that has filed a registration statement to become a public company for the last fiscal year prior to becoming public, shall be deemed to be independent if such auditor meets the AICPA requirements applicable to certified public accountants or if a foreign issuer, the applicable requirements of that issuer's country.

This provision would apparently allow companies going public to submit financial statements audited by an accounting firm not registered with the Public Company Accounting Oversight Board ("PCAOB") and not subject to its oversight. As a result, it would have the potential to significantly impair the quality of the financial information provided to investors. Accounting firms not subject to PCAOB oversight are also not subject to PCAOB inspections or standards. Because PCAOB standards and oversight of accounting firms has resulted in improved audit quality, this provision has the potential to lower the quality of audits for companies going public, which will increase the risk for investors that the financial statements are inaccurate. Thus, investors will not be able to trust and rely upon the accuracy of the company's financial disclosures.

H.R. 9411 would effectively apply the reduced financial disclosure requirements associated with EGCs to companies that did not qualify as EGCs. Further, the approach would reduce disclosure and facilitate transactions with at least some SPACs.

SPACs that qualify as EGCs generally must provide two years of financial statements. To the extent they have filed a Form 10-K (something the SEC treats as having occurred with the fling of audited financial statements in an S-4), a target company that does not quality as an EGC must provide three years of financial statements. The legislation would presumably reduce this requirement from three years to two and again reduce the financial information available to investors.[34]

---

security-market; Courthouse News Service, New EU Rules Aim to Protect Investors, Strengthen Markets (January 3, 2018).

[34] PwC Viewpoint, SEC Financial Statement Filing Requirements, January 25, 2021 (updated September 26, 2022), *available at* https://viewpoint.pwc.com/dt/us/en/pwc/in_depths/2021/domestic_spac_mergers/domesticspacmergers/financialstatementfiling.html.

B. H.R. 3448

H.R. 3448 extends the period companies can qualify as EGCs for an additional five years. As a result, an EGC can continue to rely on the reduced compliance and disclosures and can do so for potentially up to ten years from the end of the fiscal year following the anniversary of its IPO.

Considering that 93 percent of conventional IPOs in 2021 were undertaken by EGCs, these companies which are already inherently risky investments due to their smaller status, limited operating history, or identification as a shell entity, may be exempt from (i) providing an auditor attestation report, (ii) complying with audit firm rotation requirements to ensure independence, (iii) providing complete executive compensation disclosure, and (iv) holding say-on-pay and say-on-golden parachute shareholder votes, among other requirements, for potentially 10 years.

While it was already problematic that EGCs could rely on scaled disclosures and the elimination of other requirements for up to five years, to extend that to 10 years only further deprives investors of access to information regarding the EGC.

In particular, allowing EGCs to avoid complying with new and revised accounting standards creates a scenario where an investor cannot compare the financials of an EGC with a non-EGC in the same industry. Statistics indicate that the number of EGCs that opted out of implementing new accounting standards until private companies are required to do so increased significantly in 2017, with approximately 70 percent choosing to wait to implement new standards.[35] Additionally, the number of EGCs opting to include the abbreviated time frame for selected financial information also increased to 70 percent.[36] Further exacerbating these concerns, is the fact that EGCs are not required to provide an auditor attestation report regarding the EGCs internal controls, thus providing assurance to investors that the company implemented and is adhering to internal control standards in order to detect and prevent potential fraud.

Further, by requiring EGCs to only provide compensation data for three named executive officers (instead of the five required for non-EGCs), the EGC can effectively conceal the amount of cash from its operations that is paid to executive officers. As of 2017, more than 80 percent of EGCs only provided compensation disclosures for three or four named executive officers.[37] Lastly, EGCs are permitted to disenfranchise shareholders from having a voice on the compensation that is paid to EGC executive officers with the elimination of the say-on-pay and say-on-golden parachute voting requirements.

EGCs, by their nature, are often riskier investments than non-EGC investments. As previously noted, 50 percent of EGCs that provided a management report on internal controls over financial reporting identified at least one material weakness in those controls. Further, a

[35] PwC, Update on Emerging Growth Companies and the JOBS Act.
[36] PwC, Update on Emerging Growth Companies and the JOBS Act.
[37] PwC, Update on Emerging Growth Companies and the JOBS Act.

significant percentage of both exchange-listed and non-exchange-listed EGCs received an audit opinion with a going concern qualification.[38]

What should be evident from this discussion is that there are significant risks and concerns for investors considering an initial investment in or contemplating whether to buy an EGC's securities. As such, investors would be better served by EGC disclosures and reporting that create transparency regarding the company's operations and financial condition and provide the information necessary for investors to adequately assess their investment.

C. H.R. 9412 and H.R. 9413

These proposed pieces of legislation greatly expand the ability for all companies to seek a confidential review of their registration statements.

H.R. 9412 and H.R. 9413 seek to amend the 33 Act to permit all issuers to file an IPO or follow-on offering draft registration statement for confidential review and to amend the 34 Act to permit issuers to file a draft registration statement for confidential review if related to a class of securities under Section 12(b), respectively. Further, the legislation proposes only requiring that such confidential filings be made available 10 days prior the effective date of the issuer's IPO registration statement or 48 hours prior to the effective date for a follow-on offering.

While EGCs have been permitted to file certain registration statements for confidential review, the SEC extended that opportunity in 2017 to all IPOs, follow-on offerings within 12 months of an IPO, and initial registrations of securities under Section 12(b).[39] Unfortunately, this confidential filing process has proven problematic. Rather than having filings be reviewed, considered, and analyzed by private market participants with for-profit incentives, academics, and others (including other regulators), the "confidential" review process assumes that the SEC staff are somehow equipped to identify and address the weaknesses of the increased number of filings that can now be submitted on a confidential basis.

In fact, since these practices have risen in use, the already poor performance of newly public companies has gotten far worse – much to the dismay of investors who depend upon healthy public markets to fund their pensions, college savings, and more.[40]

Rather than curtail the now widespread practice of confidential review of registration statements, however, the proposed legislation drastically expands the parameters initially established by the SEC in a manner that will detrimentally impact all investors. Specifically, it will

---

[38] PCAOB, at 1.
[39] SEC, Draft Registration Statement Processing Procedures Expanded, June 29 2017 (supplemented August 17, 2017 and June 24, 2020), *available at* https://www.sec.gov/corpfin/announcement/draft-registration-statement-processing-procedures-expanded#_ftn1.
[40] Corrie Driebusch, Wall Street Journal (online), IPO Stocks Have Tumbled, Hobbling Demand for New Listings (September 26, 2022); and Dow Jones Institutional News, Markets: Deflated IPO Stocks Haunt New-Issue Market (December 19, 2022).

exacerbate the “fear of missing out” investing by materially limiting access to confidential filings in a timely manner, with the effect of denying investors – particularly those without significant resources, such as smaller investors – the time needed to digest and take the filings into account when making their investment decisions.

An underlying requirement for efficient public markets is that investors have access to the information necessary to assess the risks of a potential investment and to make an informed decision. By shortening the time that such confidential filings become accessible to investors, 10 days before the effective date of an IPO or 48 priors to the effective date of a follow-on offering, the legislation creates a situation where investors will not have adequate time to digest the information before making an investment decision. As such, investors may be deprived of the ability to evaluate all the material information about the company and thus make an investment decision without full and adequate knowledge of all the salient facts.

D. H.R. 294

Similar to the discussion regarding confidential filings, H.R. 294 would expand the ability for any issuer, not just an EGC, to “test the waters” with qualified institutional investors and institutional accredited investors to determine if the issuer should undertake a public offering with such communications not being considered a gun-jumping violation of Section 5 of the Securities Act.

An inherent concern in allowing any company, EGC or otherwise, to test the waters is that such communications are not required to be filed with the SEC.[41] As a result, yet again investors are deprived of access to information that could be material in their assessment of whether to invest in a particular issuer’s public offering.

E. H.R. 9605

This bill extends the research report exception to all issuers, potentially creating a false sense of comfort in a potential issuer for investors contemplating an investment.

H.R. 9605 would stipulate that a research report prepared by a broker-dealer regarding an issuer that is the subject of a proposed public offering of securities pursuant to a to be filed, filed, or effective registration statement does not constitute an offer for sale or offer to sell a security, even in the circumstance where the broker-dealer is participating in the issuer’s securities offering.

While it was already problematic that a research report of an EGC was not considered to be an offer, to extend that exception to all issuers opens the door even further for investors to simply rely on the research report to make an investment, which report is unlikely to cover all the material information regarding the potential issuer. While an institutional investor will generally

[41] 17 CFR §230.163B (b)(3).

understand the biases or incomplete nature of a broker-dealer's research report, many other types of investors may not. In particular, an investor may easily assume that a research report prepared by a registered broker-dealer, and even more so by one that is participating in the securities offering, will include all the relevant information that an investor should take into account when assessing an investment decision. However, research reports are only required to contain "information reasonably sufficient upon which to base an investment decision."[42] As such, by stipulating that research reports are not offers pursuant to the securities laws, a broker-dealer can broadly disseminate such report to potential investors and such investors may ultimately make uninformed investment decisions under the false impression that the research report contains all the information that should be taken into account when evaluating the risks of making a particular investment.

F. H.R. 9562

H.R. 9562 proposes to drastically expand the existing lighter rules applicable to well-known seasoned issues ("WKSI"), by expanding the pool of potential qualifying issuers. When the SEC created the WKSI rules, it determined that these issuers would not need to provide the full panoply of disclosures in each offering, in part, because they do so many offerings and make the information available elsewhere.[43] Put simply, the SEC gave large public companies a pass on some of their rules, while continuing to subject other, smaller companies to their full rulebook.

The exemption is often used by banks, many of whom sell complex financial products to investors, such as structured notes, which in many cases have caused significant investor losses.[44] Additionally, the exemption is only meant to be available to companies that stay out of regulatory trouble, however that requirement has also been routinely waived over the years.[45]

But rather than eliminate the exemption, the proposed legislation would expand it. Under the current rule, an issuer qualifies as a WKSI if it has over $700 million in worldwide market value of its voting and non-voting common equity held by non-affiliates or has issued over $1 billion in non-convertible securities over the past three years, other than common equity.[46] The legislation proposes to make any company with $75 million in aggregate market value of its voting and non-voting common equity held by non-affiliates as a WKSI.

---

[42] FINRA Rules, Rule 2241. Research Analysts and Research Reports, *available at* https://www.finra.org/rules-guidance/rulebooks/finra-rules/2241.

[43] Securities Act Release No. 33-8591 (July 19, 2005).

[44] Tom Osborn, Risk.net, Dealers' WKSI Woes: A Case of Rough Justice? (August 22, 2016), *available at* https://www.risk.net/derivatives/structured-products/2468324/dealers-wksi-woes-case-rough-justice; Dow Jones Institutional News, Markets: Deflated IPO Stocks Haunt New-Issue Market (December 19, 2022); and Robin Wigglesworth, Financial Times, Barclays' Galaxy-brain Structured Notes Screw-Up Explained (April 1, 2022).

[45] U.S. Securities and Exchange Commission, Division of Corporation Finance, Revised Statement on Well-Known Seasoned Issuer Waivers (April 24, 2014), *available at* https://www.sec.gov/divisions/corpfin/guidance/wksi-waivers-interp-031214.htm.

[46] 17 CFR §230.405.

WKSIs are governed by fewer gun-jumping regulations and can make oral offers and use free writing prospectuses during the pre-filing of quiet period.[47] Additionally, WKSIs qualify for automatic shelf-registration meaning a Form S-3 filed by a WKSI will be declared effective immediately and is thus not subject to SEC review. Further, the disclosure requirements of Form S-3 are less robust than a filing pursuant to Form S-1. All of these coupled together create an environment where significantly more companies will qualify as WKSIs with a resulting opening of the floodgates for such companies to undertake an automatic shelf registration thus depriving potential investors from ready access to all the material information regarding the issuer and relying on a shelf registration that was not reviewed by the SEC.

G. H.R. 9459

H.R. 9459 proposes to exclude qualified institutional buyers and institutional accredited investors from being counted as record holders in the determination of whether an issuer would be required to register its securities and provide periodic reports.

Currently, an issuer is required to register its class of equity securities if it has 2,000 or more record holders.[48] The SEC's process for counting "holders of record" is already outdated as most investors do not hold securities in their own name, but rather through a third party, such as a broker-dealer. If a company has thousands of owners, regardless of whether they are record or beneficial owners, it should be public. The SEC has included on its 2022 agenda a proposal to consider amendments to the "held of record" definition for purposes of Section 12(g) of the Exchange Act, and I would encourage them to do so.[49]

Eliminating some large investors from this record holder calculation would further expand the number of very large, widely held companies from public reporting requirements and investor accountability.

H. H.R. 9570

H.R. 9570 mandates the SEC to promulgate rules regarding electronic delivery of required disclosures and publish proposed rules to address electronic delivery within 180 days of its passage and finalize such rules within 1 year. While implementing a set of rules for those disclosures that a company can provide electronically will ease the burden on public companies, these rules are best left in the SEC's hands to ensure that (i) shareholder participation is not negatively impacted, (ii) the appropriate data included in the electronic filings is tagged so that it is readily searchable, and (iii) there is a smooth transition.

---

[47] 17 CFR §230.163.

[48] 17 CRF §240.12g-1(b)(1).

[49] U.S. Securities and Exchange Commission, Office of Information and Regulatory Affairs, Title: Revisions to the Definition of Securities Held of Record, *available at* https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202210&RIN=3235-AN05.

IV. Conclusion

I think we all agree that we need robust public markets and I hope we can all agree that doing that will require shrinking the large and growing regulatory gap between the public and private markets. But how we accomplish that goal matters. Simply lowering the transparency and accountability of public companies – that is to say, the quality of the public markets – is not the solution to the problem.

Based on my experience, when a company's top executives are considering raising money, they typically walk through a very short decision tree about whether to engage in a public or private offering. While the public markets were once the primary method a company could use to raise all the capital it required, that is no longer the case.

What you will often hear from those executives is that they simply do not need to go public to grow the company. Why subject themselves and the company to disclosure burdens, the prying eyes of auditors, the headaches of SEC comments, the stress of quarterly earnings calls, or the fear of class action plaintiffs' lawyers if they do not have to do that in order to raise capital?

Whether through these bills, or through other similarly oriented legislation, neither Congress nor the SEC would ever be able to lower the public company bar enough to materially alter that calculus.

At the same time, investors who can increasingly invest around the world are going to move to whichever markets provide the most opportunity, transparency, and accountability. For decades, that was the U.S. Given the regulatory changes around the world, however, the U.S. markets are at risk of losing that favored status with investors. Legislation that lowers the transparency and accountability of public companies in the U.S. would exacerbate that potential – likely leading to less investment in the U.S., not more.

If you want to expand and improve the public markets, I urge you to consider legislation to statutorily pull large, widely held companies into the public markets regime and reduce the regulatory gap between the public and private markets. As Commissioner Crenshaw recently noted "… through decades of legal, regulatory, and market developments, private companies now have access to increasing amounts of private capital, inflating their sizes and significance to investors and our economy, and all without the concomitant safeguards built into the public markets."[50] One strong step toward achieving the goal of increasing access to the public markets would be to restore basic, mandatory disclosures and accountability in the private markets.

Thank you for the opportunity to testify, and I look forward to questions.

---

[50] Commissioner Caroline A. Crenshaw, U.S. Securities and Exchange Commission, Speech: Big "Issues" in the Small Business Safe Harbor: Remarks at the 50th Annual Securities Regulation Institute (January 30, 2023), *available at* https://www.sec.gov/news/speech/crenshaw-remarks-securities-regulation-institute-013023.