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Subcommittee on Capital Markets

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Chairman Wagner, Ranking Member Sherman and Members of the Subcommittee, thank you for inviting me to appear before you today. I appreciate the opportunity to discuss how our securities laws may be improved in order to increase investor access and to promote capital formation, thereby fostering economic growth and job creation.

As context for my observations today, I have been a securities lawyer for over thirty years now and am a partner at Mayer Brown in New York.[1]

I began practicing in the early 1990s, when initial public offerings (IPOs), including IPOs by smaller companies, were plentiful. This gave me the opportunity to work on many IPOs for companies of all sizes. It also was a time at which the financing trajectory for companies was well understood and predictable. A successful emerging private company generally sought venture capital financing after having received initial funding from friends, family and angel investors. Within five to seven years of its inception, a growth company sought a liquidity event and that liquidity event was, more often than not, a traditional IPO. Historically, an IPO allowed a company to raise a significant amount of capital—more capital than it could then raise through any other means. An IPO and listing a class of equity securities on a U.S. securities exchange was regarded as an achievement for founders and for the company's venture and institutional investors. During this period, there also was an infrastructure that supported smaller public companies. There were equity research analysts whose role resembled that of "gatekeepers," without whose support IPOs could not take place, and who provided post-IPO coverage on the securities of these companies, and there were market makers that provided liquidity in these securities. There also were institutional investors that invested in the securities of small and midcap companies.

Over time, however, the market has evolved. Exempt offerings and hybrid offerings have become more significant with the increased use of shelf registration statements, the promulgation by the Securities and Exchange Commission (SEC) of various safe harbors, and the shortening of the Rule 144 holding period.[2] I played a role in this evolution by introducing hybrid securities

[1] My comments today and the views I express are my own, and not those of Mayer Brown, nor attributable to any client or to any association of which I am a member.
[2] I have written about many of these changes in my books, including, among others, *Corporate Finance and the Securities Laws*, published by Wolters Kluwer (seventh ed. 2023, updated 2024), co-authored with Joseph

offering formats like the private investment in public equity, or PIPE, transaction, the registered direct offering, the at-the-market offering, and, eventually, during the financial crisis, the confidentially marketed public offering—all of which have, in certain important respects, blurred the lines between private (or exempt) offerings and public offerings.

At the same time, the private markets have become much larger due, in part, to the growth of hedge funds, private credit funds, private equity funds, sovereign wealth funds, and family offices.[3] Venture capital investors are no longer the only available or the best available source of capital for private companies seeking to fund their growth.

This shift away from IPOs and from the public markets occurred due to the confluence of these market structure changes and increased regulation, including the Sarbanes-Oxley Act and the Dodd-Frank Act, which increased the costs associated with being a public company. In recent years, more prescriptive and burdensome disclosure requirements should be added to the list of factors to blame. Often, the more recently adopted disclosure requirements have not taken into account the bedrock principle of our disclosure-based securities framework—materiality. Instead, many recently proposed or newly adopted disclosure requirements have been premised on seeking information that likely would not meet the materiality standard—that there be a substantial likelihood that a reasonable shareholder would consider it important in deciding whether to purchase a security, or that the omission of such information would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available. Furthermore, as these newer disclosure requirements have been adopted, fewer allowances have been made for foreign private issuers (FPIs), which traditionally were granted disclosure accommodations, and for smaller reporting companies, which have long benefitted from scaled disclosure requirements.

What's the upshot of all of this? There are fewer U.S. public companies now than there were in the 1990s. Based on statistics from the SEC's Office of the Advocate for Small Business Capital Formation, there were 3,636 U.S. public companies in 2024 compared to 7,414 in 1997. Institutional investors have fewer public companies in which to invest, and a significant percentage of our public companies are tech-focused.

The overall number of IPOs has declined based on historic levels. In 2022, there were 89 IPOs, which raised over $7.8 billion in aggregate proceeds; in 2023, there were 119 IPOs, which raised over $19.3 billion in aggregate proceeds; and in 2024, there were 160 IPOs, which raised over $29 billion in aggregate proceeds.[4] By contrast, the average number of IPOs per annum in the period from 1990 to 1999 was 529. This number fell to 205 during the period from 2000 to 2009. It is important to understand that the nature of the companies seeking to undertake IPOs

McLaughlin; and *Exempt and Hybrid Securities Offerings*, published by Practising Law Institute (2009, second ed. 2011, updated 2014, third ed. 2017, fourth ed. 2022).

[3] Assets in global private markets totaled $14.7 trillion in the second quarter of 2024, over five times as much as in 2007, according to Preqin, a financial data provider. See, for example, "The Boom in Private Markets Has Transformed Finance. Here's How," Bloomberg, June 14, 2022, Dawn Lim and David Brooke. See as well Private Markets – A Growing, Alternative Asset Class ("As of 2023, private markets, excluding venture capital and hedge funds, assets under management (AUM) totaled more than $12.4 trillion globally as of 2023, up from $10.7 trillion at the end of 2022."), available at https://www.spglobal.com/en/research-insights/market-insights/private-markets.

[4] Statistics from Wolters Kluwer IPO Vital Signs, excluding SPAC IPOs.

and the IPO market has changed radically from that of the 1990s. Companies are waiting longer to undertake IPOs. The median age of companies when they have undertaken IPOs in recent years is ten years,[5] the median market capitalization for IPO issuers has been approximately $519.8 million, and the average market capitalization has been approximately $1.9 billion.[6] The companies that choose to go public wait much longer to do so, are much larger when they approach the public markets, and, based on my experience, generally, do not seek to go public because they need to raise capital. They have different motivations for doing so, including providing liquidity for their shareholders.

The SEC's Office of the Advocate for Small Business Capital Formation's Annual Report for Fiscal Year 2024 (the "Report" or "SEC Small Business Report") highlights another important and alarming trend—the decline in the number of smaller public companies. The Report notes that since 2022, IPOs by small companies have accounted for 40% of the number of IPOs, but only 4% of the deal value. The Report further notes that small exchange-listed companies account for the majority of the decline in the number of U.S. public companies. There is also a great and growing disparity between large exchange-listed companies and smaller public companies. The aggregate market value of large exchange-listed companies has grown—now to over $52.5 trillion—while the aggregate market cap of small exchange-listed companies has continued its decline to $104 billion.[7] In part, some of these developments are attributable to market structure changes. Yet, as the Report and as other academic research substantiates, smaller and medium-sized public companies are disproportionately impacted by the costs of being public. Also, once public, they benefit less from their "publicness"—by which I mean that once a company completes its IPO, the historic assumption always was that it would be easier to raise capital in the secondary market, there would be liquidity in its stock, there would be research analysts covering the company (thus, contributing to a more liquid market for its stock), and its stock would be valuable, both to employees who receive stock-based compensation awards and to acquisition targets. The historic promise of being public is not being realized for smaller and medium-sized companies. They are bearing the costs without reaping the benefits. This can be addressed as discussed below.

The other glaring change is that, as the public markets have declined in significance, the private markets have grown. For several years now, reliance on funding in the private (or otherwise exempt) markets has outpaced reliance on SEC-registered offerings. Based on data from the SEC's Division of Economic Risk and Analysis (DERA), from July 1, 2023 to June 30, 2024, companies, excluding pooled funds, raised $28 billion in IPOs and $1.2 trillion in other SEC-registered offerings, $170 billion in Rule 506(b) private placements, and $963 billion in other exempt offerings. During the same time period, pooled funds raised $4 billion in IPOs, $4 billion in other registered offerings, $1.7 trillion in Rule 506(b) offerings, $125 billion in Rule 506(c) offerings, and $99 billion in other exempt offerings.

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[5] Initial Public Offerings: Median Age of IPOs Through 2024, Jay Ritter (Jan 5, 2025), available at https://site.warrington.ufl.edu/ritter/files/IPOs-Age.pdf.

[6] Statistics from RBsource filings; IPOVitalSigns.

[7] Office of the Advocate for Small Business Capital Formation, Annual Report Fiscal Year 2024 (Dec. 2024) (referred to as the "SEC Small Business Report"), available at https://www.sec.gov/files/2024-oasb-annual-report.pdf.

There has been a fair bit of concern expressed by certain regulators regarding the growth of the private markets and the opaque character of these markets. Also concerns have been expressed about unicorns (private companies having a valuation of $1 billion or more) and their ubiquity. There are 1,258 unicorns globally, with a total aggregate valuation of $4.3 trillion. In the United States, there are 693 unicorns, or 55.1% of all unicorns.[8] In fact, the prior SEC rulemaking agenda contemplated potential amendments to the Securities Exchange Act of 1934, as amended, (the "Securities Exchange Act") Section 12(g) threshold, as well as to both Regulation D and Form D. These initiatives, and others like them, would appear to have at their root some inherent suspicion regarding the private markets and exempt offerings. As I noted when I previously appeared before this Subcommittee, it would be a grave mistake to look at the private markets as suspect and in need of regulation, and at the public markets by contrast, as more transparent and as the best or the better solution for most or for all companies. This is a false dichotomy. Put simply, regulating the private markets out of existence would not cause institutional investors to expand their support for microcap and small cap stocks. Nor would equity research coverage spring into existence for small cap and midcap companies that would be forced to become SEC-reporting companies before they are ready to do so.

The markets have changed in significant, and in some respects, irreversible, ways. It is important to acknowledge this and not to purport to address these changes with reactionary responses. Over time, as noted earlier, private or "restricted" securities have become more liquid. Additional investors have entered the private markets. Private equity has grown and private equity returns have fairly consistently outperformed the S&P 500. Public companies and public markets have become less attractive by comparison. Similarly, private credit has grown in recent years for many of these same reasons. Private companies are able to raise significant amounts of capital in the private markets.

Most private investments are limited to accredited investors. At present, according to the SEC Small Business Report, only 19% of U.S. households qualify as accredited investors. Companies generally want to limit the number of their holders that are non-accredited investors. In practice, for various regulatory reasons, most opportunities tend to be limited to an even more select audience: institutional accredited investors, investors considered institutional accounts (as defined under the FINRA rules), qualified institutional buyers (QIBs), qualified purchasers (QPs) and qualified clients. These are fairly high but also inconsistent thresholds. Retail investors may have some exposure to private investment opportunities indirectly through their investments in mutual funds. However, many registered funds are limited in their ability to invest in private funds and/or in the securities of private companies. Certain registered funds also may not offer their interests to investors that are not qualified clients or may be required to limit their offerings, to the extent they do invest in private securities, to accredited investors. In other cases, registered funds may be required to set a high minimum investment amount that necessitates that the investor have significant wealth in order to participate in the proposed offering. As a result, some of the concern regarding an inability to, or disparities in the ability to, request the information that would be necessary to make an informed investment decision in the context of private placements is, quite frankly, misplaced.

[8] Data from CB Insights.

As discussed further below, in reviewing the proposed bills under consideration, the definition of "accredited investor" is central to Regulation D and also important to various other securities exemptions. It has been based on the notion of identifying those persons "whose financial sophistication and ability to sustain the risk of loss of investment or ability to fend for themselves render the protections of the Securities Act's registration process unnecessary."[9] In 2020, the SEC amended this definition. It may be appropriate to amend the definition once again in order to allow additional categories of persons an opportunity to participate in the private markets. In light of the evolution of the markets, also providing access to the private markets to a broader cross-section of persons through registered funds, which are highly regulated and offer investor protections, would, in my judgment, constitute a reasonable and welcome approach.

In many respects, avoiding drastic policy pendulum swings would best serve the market, promote capital formation and help to preserve the U.S. capital markets as the envy of the world. There are quite a number of measures that can be taken in order to make it easier and more attractive for smaller and midcap companies to become public companies. A number of the bills under consideration by the Subcommittee reflect this approach. The SEC Small Business Report provides useful recommendations for revitalizing U.S. public markets for smaller and midcap companies, and contains important data regarding smaller reporting companies and the challenges that they face given current regulatory requirements and market dynamics.[10] Similarly, the SEC Staff has built on the successes of the Jumpstart Our Business Startups (JOBS) Act of 2012 by, for example, extending certain accommodations to issuers that are not emerging growth companies ("EGCs"). To the extent that various bills under consideration incorporate into statute a number of these positions, the additional certainty is useful. Alleviating the burdens associated with becoming a public company and transitioning from EGC status also should help quite a number of companies considering the public markets. As noted earlier, reviewing and assessing the regulatory burdens imposed on public companies is an important priority, and a number of the bills would do so. Striking the right balance and reaching some new equilibrium between "private" and "public" given the changed market environment, and allowing broader access to the private markets while being mindful of investor protection concerns is a challenge. A number of the bills under consideration that would expand the accredited investor definition to include additional categories of persons, with certain protections, would, in my judgment, constitute a path forward. Building on a number of the measures under consideration to modernize the regulatory framework for registered funds would be another important step in the right direction. Below, I offer some thoughts on individual bills and some further suggestions on measures that would supplement these.

Legislative Proposals

Given the number of bills under consideration by the Subcommittee, below I review a number of these in more detail by category.[11]

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[9] Regulation D Revisions; Exemption for Certain Employee Benefit Plans, Release No. 33-6683 (Jan. 16, 1987), 52 Fed Reg 3015 at 3017.

[10] See note 7.

[11] The H.R. numbers and titles noted in the headings of this section reflect the H.R. numbers and titles of the 119th Congress to the extent any are available. The discussion drafts posted at this February 26, 2025 hearing are substantially similar in content to the H.R. bills referenced in this testimony.

Accredited Investor Definition

There are various bills under consideration that would revise the accredited investor definition. As discussed above, the definition always has been intended to identify individuals that possess the financial sophistication and the ability to fend for themselves, such that the protections associated with registration under the Securities Act of 1933, as amended, (the "Securities Act") are not needed. Currently, for individuals, we rely on an imperfect proxy to ascertain this, which is based on the wealth tests. The 2020 amendments to the definition added criteria based on experience or skills.

H.R. __, *the Fair Investment Opportunities for Professional Experts Act* is consistent with this historic approach in that it would expand the definition by including individuals with certain licenses or other qualifications—which licenses and qualifications would be determined by SEC rulemaking. H.R. __, the Accredited Investor Definition Review Act would require that the SEC review the certifications and credentials that qualify an individual as an accredited investor every five years. H.R. __, the Equal Opportunity for All Investors Act would expand the accredited investor definition by including investors that had been certified through an impartial exam established by the SEC and administered by FINRA. These expansions are appealing, although in practice they may be difficult to operate and for broker-dealers and others to address.

H.R. __, *Risk Disclosure and Investor Attestation Act* would appear to permit individuals to invest in private issuers once they acknowledge certain risk disclosures that the SEC prescribes. The SEC's Small Business Capital Formation Advisory Committee in 2024 considered the accredited investor definition and made certain recommendations to the SEC regarding the definition. In making its recommendations, the Committee took into account "the importance of facilitating greater access to capital for founders and the tension in regulatory policy between accessibility and government paternalism," among other factors. In so doing, the Committee recommended the inclusion of risk disclosures; however, the furnishing of, and the acknowledgment of receipt of, such disclosures was not intended to be the sole means of qualification. Risk disclosures can be a useful supplement to any of the proposed additional means of qualifying individuals as accredited investors, but it would be inconsistent to accept this as a sole criterion for investor qualification. H.R. __, Investment Opportunity Expansion Act would expand the accredited investor definition to include individuals who invest ten percent or less of the greater of their net assets or annual income in a private offering. While this approach mitigates risk of loss, it fails to take into account financial sophistication, which has long been at the heart of the concept of what constitutes an accredited investor.

H.R. __, *Accredited Investors Include Individuals Receiving Advice from Certain Professionals Act* would expand the definition of accredited investor to include persons who receive individualized advice from a person who is an accredited investor under Rule 501(a)(10), which includes certain persons that hold FINRA licenses; however, this particular provision may, in fact, be expanded by other bills under consideration. In order to address investor protection concerns, while still expanding the pool of persons qualifying as accredited investors, this could be modified to require that the individualized advice be received from persons subject to Regulation Best Interest, or who are registered investment advisers subject to a fiduciary duty.

There are other possibilities that have been contemplated in the SEC's 2019 proposing release relating to the amendments to the accredited investor definition, as well as in the report of the Staff of the SEC on its Review of the "Accredited Investor" Definition under the Dodd-Frank Act that might be helpful to consider in connection with the proposed bills. For example, qualification based on investing experience or experience investing through an angel investment group should be discussed.

Extending the Benefits of the JOBS Act or Otherwise Promoting IPOs

I review in more detail below a number of proposed bills under consideration that would extend a number of the benefits and reforms enacted by the JOBS Act, particularly by expanding the time period that a company can be classified as an EGC.

Since the passage of the JOBS Act in 2012, over ten years ago, significant market practice has developed with respect to the various disclosure-based accommodations available to EGCs, which should allay any investor protection concerns. Over time, and building on the success of the JOBS Act provisions, the SEC Staff in 2017 extended to all issuers the ability to submit confidentially draft registration statements under the Securities Act and the Securities Exchange Act for IPOs and for most securities offerings made within the first twelve months of the issuer having first become an SEC-reporting company.[12] The proposed bills would codify this practice, as well as address the time periods when an EGC or any other issuer that has confidentially submitted a registration statement for SEC review must publicly file its registration statement with the SEC. Codifying these requirements and shortening these time periods will be helpful to market participants.

H.R.___, *the Encouraging Public Offerings Act*, would effectively codify Securities Act Rule 163B and extend the ability to test the waters that is available to EGCs to other issuers. In 2018, the SEC adopted Rule 163B, which permits issuers to test the waters prior to a registered public offering by engaging in oral or written communications with potential investors that are, or that are reasonably believed to be, QIBs or institutional accredited investors without such communications being considered "gun jumping" communications.[13] Given that the broader access to the test-the-waters provisions have existed since 2019, and have not raised any investor protection concerns, it is both reasonable and appropriate to codify this communication safe harbor.

H.R. ___, *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* would codify existing Staff policy with respect to confidential submission of draft registration statements, and also would provide for confidential treatment of such confidentially submitted registration statements.

[12] Draft Registration Statement Processing Procedures Expanded, https://www.sec.gov/corpfin/announcement/draft-registration-statement-processing-procedures-expanded.
[13] Solicitations of Interest Prior to a Registered Public Offering, Release No. 33-10699 (Sept. 26, 2019), https://www.sec.gov/rules/final/2019/33-10699.pdf.

H.R. ___, *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, and for other purposes*: establishes that an EGC, as well as any issuer that relied on the EGC disclosure accommodations (and has since ceased to be an EGC), would not be required to present financial statements or acquired company financial statements (for example, for purposes of Rule 3-05 of Regulation S-X relating to acquired businesses, or Article 11 of Regulation S-X relating to pro forma financial statements) for a period longer than the two years of audited financial statements. This is another important clarification that would provide much-needed certainty to practitioners and to market participants.

H.R. __, *the Helping Startups Continue to Grow Act* would provide the benefits and reforms available to EGCs for an additional five years, provided that such companies continue to meet the other EGC requirements. Once companies cease to qualify as EGCs, they typically face significant additional disclosure and other reporting requirements, which impose substantial costs.[14] Most important from a cost and timing perspective, following loss of EGC status, the company must include with its first annual report on Form 10-K filed thereafter, an auditor's opinion on the effectiveness of internal control over financial reporting (ICFR). This bill is generally consistent with the goal of the JOBS Act's IPO On-Ramp to "right-size" public company regulation. To the extent an issuer continues to qualify as an EGC based on the other prongs of the definition (i.e., revenue, debt issued, etc.), other than the passage of time, it ought to continue to be able to conserve its resources, continue to provide investors the same kind and quality of information it has been providing since its IPO, and not cease being an EGC and thus becoming subject to a much more onerous reporting regime merely because an arbitrary period of time has elapsed. However, the bill also would modify the threshold to qualify as an EGC to $3 billion. This change may merit some further study. Similarly, the bill would remove the disqualification for "large accelerated filers," which prong should be carefully considered, especially when taken together with other proposed measures that would revisit the various definitions of smaller reporting company, accelerated filer and large accelerated filer. These might best be left to SEC rulemaking.

H.R. __, *the Middle Market IPO Underwriting Cost Act* this bill would require the Comptroller General to study and report on the costs encountered by small-sized and medium-sized companies when undertaking IPOs and certain offerings exempt from securities registration requirements. Given the decline in the number of public offerings by small and medium-sized companies, a more in-depth study of the contributing factors would help identify potential policy responses.

Reducing the Burdens for Public Companies and Addressing Public Company Disclosures

Importantly, the proposed bills would also expand the number of companies that could qualify for the well-known seasoned issuer, or WKSI, status. Allowing additional seasoned issuers to qualify as WKSIs would greatly facilitate the ability of many companies to access public markets, especially due to the enhanced flexibility for communications and the ability to file an

[14] These disclosures include enhanced executive compensation disclosures and pay versus performance disclosures. In addition, an issuer will have to hold a say-on-pay vote and a say-on-golden-parachute vote (if shareholders are approving an acquisition, merger or related transaction).

immediately effective shelf registration statement (an option that currently is available to only a small percentage of public companies). As the public markets are more volatile than ever, and the concerns expressed regarding increased reliance on the private markets, it is reasonable to provide experienced SEC-reporting companies that are not delinquent in their public filings and otherwise meet applicable conditions, including a lower public float test, the ability to file an automatically effective shelf registration statement, thereby seizing opportunities to finance when there are "open market windows" to do so. The SEC now has in place a policy of reviewing the filings of registrants every three years so a registrant's filings would remain subject to SEC Staff review on a regular schedule, which would not be altered by the proposed change.

Since WKSIs are seasoned issuers and are generally well-followed companies, WKSIs are subject to the least burdensome offering and communication requirements. Perhaps most importantly, a WKSI may file an automatically effective shelf registration statement and post-effective amendments. A WKSI's automatically effective shelf registration statement also may omit certain information and the specific offering-related details can be provided at the time of a specific transaction, providing the issuer with enhanced flexibility. As companies are increasingly concerned about publicly announcing any follow-on offering and having such an announcement result in shorting activity in their securities or other aberrational trading, being able to time the filing of a shelf registration statement until it is needed will be an important tool. For a company that would like to be able to raise capital in the public markets to fund an acquisition, knowing that it can file an automatically effective shelf registration statement will be meaningful. The alternatives now available in such an instance are far less appealing and much more expensive. A company that does not already have an effective shelf registration statement in place would have to file a new shelf registration statement with the SEC (or a registration statement relating to a particular proposed offering) and subject itself to the possibility of SEC Staff review. During this time, the market may react poorly to the filing of the registration statement. This waiting period, whether to learn if the registration statement will be reviewed, or for the SEC Staff comments if the filing will be reviewed, results in significant uncertainty for a company since it cannot time when it will be able to access the public markets. Of course, the company might choose to finance by conducting a private placement or other exempt offering; however, there will still be a liquidity discount associated with any such offering alternative compared to a public offering. As a result, making an automatically effective shelf registration statement more broadly available will provide greater flexibility to public companies and should lower their cost of capital. A WKSI also has greater flexibility with respect to oral and written communications, such as greater flexibility relating to the use of free writing prospectuses, which is likely to be important to many issuers.

H.R. __, *a bill to expand WKSI Eligibility* the proposed bill under consideration would expand the availability of WKSI status by updating the WKSI definition to apply to all companies that otherwise satisfy the WKSI definition with a public float of $75 million, rather than the current public float of $700 million. While an expansion of the definition is an important priority for the reasons set forth above, the threshold for WKSI status should reflect an appropriate and substantial public float. In light of the importance of conferring WKSI status on issuers, and the various ramifications of doing so, setting this threshold might best be left to SEC rulemaking. This particular threshold might be considered by reference to the definitions of other important terms, such as, "smaller reporting company," "accelerated filer," and "large accelerated filer."

H.R. __, *Smaller Reporting Company, Accelerated Filer, and Large Accelerated Filer Thresholds* would raise the thresholds and remove overlap in the definitions to qualify as a smaller reporting company, accelerated filer, and large accelerated filer. It also exempts certain low-revenue issuers from being required to have their management's assessment of the effectiveness of ICFR attested to, and reported on, by an independent auditor, as required by Section 404(b) of the Sarbanes-Oxley Act.

At present, the overlap between the definition of a smaller reporting company and an accelerated filer is fairly narrow. However, the SEC's 2020 amendments to these definitions and the choice not to keep the smaller reporting company definition and non-accelerated filer definition aligned have made these rules more challenging for issuers to understand. It would also be very constructive for the SEC to conduct a study regarding the accommodations provided to smaller reporting companies, taking into account how the costs associated with remaining public companies might be reduced for these filers. This would be consistent with the findings in the SEC Small Business Report, and also with the SEC's mission of promoting capital formation while focusing on investor protection concerns. In the same or in a different study, the SEC might review the definitions of non-accelerated filer, accelerated filer and large accelerated filer—all of which are referred to in various of the proposed bills under consideration.

This bill also would exempt certain low-revenue issuers from Section 404(b) of the Sarbanes-Oxley Act. Again, here it is instructive to refer to the SEC Small Business Report, which documents the average internal annual Sarbanes-Oxley Act compliance costs. Many of these costs are disproportionately higher for smaller reporting companies.[15] Academic studies have shown that there is little evidence as to whether an ICFR audit affects ICFR quality or the utility of management internal control reports and the ultimate quality of financial reporting.[16] Yet, the costs associated with the Section 404(b) attestation requirement are significant, and, as indicated in various studies, have not declined over time. Moreover, they are not scaled proportionately for smaller companies so these companies are likely to bear a disproportionately negative impact from the requirement without there being a commensurate proven benefit from a disclosure or investor protection perspective. When the SEC amended the definition of "smaller reporting company," it provided some relief for certain low-revenue companies from Section 404(b) attestation requirements—there has been no evidence that this change resulted in any investor protection concerns.

H.R. __, *the Enhancing Multi-Class Share Disclosures Act* this bill would require issuers with a multi-class stock structure to make certain disclosures in any proxy or consent solicitation material. As a general matter, there have been a number of recommendations from advisory groups and other interested parties relating to additional disclosures relating to dual and multi-share class structures. If the SEC were to prescribe reasonable disclosures relating to information that would be material to investors, it would be helpful.

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[15] Annual Report Office of the Advocate for Small Business Capital Formation Fiscal Year 2024, see note 7.

[16] See, for example, McCallen, Jennifer and Schmardebeck, Roy and Shipman, Jonathan E. and Whited, Robert Lowell, Evidence on the 2020 Exemption of Low-Revenue Issuers from the Internal Control Audit Requirement (May 30, 2022). Available at SSRN: https://ssrn.com/abstract=3420787 or http://dx.doi.org/10.2139/ssrn.3420787.

H.R. __, *Remove Aberrations in the Market Cap Test for Target Company Financial Statements* this draft would codify guidance relating to the determination of a company's market capitalization, in the context of testing the significance of an acquisition or disposition, and determining whether a target company's financial statements are required. This would provide very useful certainty.

Addressing the Private Markets

Exchange Act Section 12(g) Threshold

H.R. __, *a bill to exclude QIBs and IAIs From the Record Holder Count for Mandatory Registration* would modify the Securities Exchange Act Section 12(g) threshold, which triggers public reporting, in order to provide that the 2,000 or more holders of record shall exclude QIBs and institutional accredited investors. Under Section 12(g) of the Exchange Act, as amended by the JOBS Act, the Exchange Act reporting requirements are not triggered if the issuer has fewer than 2,000 holders of record of its equity securities and fewer than 500 holders of record who are not accredited investors. As noted earlier, unfortunately, discussions regarding whether the Section 12(g) threshold should be recalibrated in order to prevent companies from staying private "too long" lack a basis in fact. The JOBS Act modified the Section 12(g) threshold; however, the JOBS Act is not responsible for changing the capital markets and the JOBS Act was not the catalyst for the growth of the private markets. The growth of the private markets and the availability of funding from a multiplicity of private capital sources have contributed to companies staying private longer. Similarly, many other factors, such as the market structure changes to which I alluded earlier and regulatory developments, also have contributed to companies choosing to defer IPOs or to prefer mergers or other strategic alternatives rather than becoming public companies. The public markets are no longer particularly welcoming to smaller public companies. Smaller company IPOs generally do not fare as well as the IPOs undertaken by companies that are larger (by market capitalization at the time of their IPOs). Forcing a company to become subject to SEC reporting will not change market dynamics. Accordingly, institutional investors should not be "counted" toward the 2,000 holder of record prong of the Section 12(g) threshold that would trigger SEC reporting requirements. By excluding these holders from the count, companies would effectively have greater flexibility to remain private. This change would also not affect the information that is available to these investors. QIBs and institutional accredited investors are able to fend for themselves and obtain the information that they require to make informed investment decisions regarding private placements. In connection with making their investments in private companies, institutional investors generally negotiate for themselves information rights, as well as affirmative and negative covenants that allow them to monitor to an extent the activities of the companies. These rights are, from a business perspective, what the investors believe to be adequate to protect the value of their investments. We should rely on private ordering to determine the information companies provide to institutional shareholders.

Regulation A

H.R. __, *Regulation A+ Improvement Act* this proposed bill draft would increase the amount that companies can raise under Regulation A to $150 million and would require the SEC to adjust this amount for inflation regularly. Currently, the Regulation A Tier 2 offering threshold is set at $75 million for a twelve-month period. Based on reports provided by the SEC's DERA, the amounts being raised in such offerings are relatively modest and do not come close to breaching this threshold. Nonetheless, perhaps raising the threshold might make this another pathway to a smaller company IPO alternative. However, this should be considered in connection with the other proposed bill relating to state securities law preemption.

H.R. __, *Restoring Secondary Trading Market Act* this proposed bill would amend the Securities Act in order to preempt state securities laws for off-exchange secondary trading in companies that make available current public information, including information required by Regulation A. It is unclear, as written, whether this would address resales for all Regulation A Tier 2 securities. It may helpful to have the SEC undertake a study of the current resale exemptions available under the Securities Act, and the limitations that these impose on a liquid secondary market developing for the securities of smaller public companies. The SEC addressed resale exemptions in a limited fashion in its Concept Release on the Harmonization of Securities Offering Exemptions but not since and has yet to make any recommendation. In this context, such a study might lead to a definition of "qualified purchasers" that also includes resales of Regulation A securities and that also address other pressing matters such as the issues that arose when state securities regulators in a state recently and seemingly inadvertently took action that paralyzed the institutional debt markets.

Modernizing the Regulation of Funds

As discussed above, modernizing the regulatory framework relating to various fund products, including registered investment companies and business development companies (BDCs) (collectively, "regulated funds") that are subject to requirements of the Investment Company Act of 1940, as amended (the "Investment Company Act"), among other requirements, as well as private funds that operate in reliance on an exemption or an exclusion from the definition of an investment company under the Investment Company Act would promote capital formation and would expand investment opportunities in a controlled manner.

There are various proposed bills under consideration that include the following:

H.R. __, *the Improving Disclosures for Investors Act* that directs the SEC to promulgate rules with respect to the electronic delivery of certain required disclosures to investors. Under the bill, such rules would permit registered investment companies (i.e., mutual funds, closed-end funds, and exchange-traded funds), BDCs, registered broker-dealers, registered advisers, and other SEC-regulated entities to meet their obligations under U.S. securities laws to deliver regulatory documents to investors electronically. This would provide investors with easy access to disclosures, enhance transparency and make it significantly more convenient for investors to review important information in a timely manner. The transition to electronic delivery is expected to reduce the administrative burden on companies and investors, cut costs related to printing and mailing paper documents and increase efficiency. Nonetheless, the SEC would still have the opportunity as part of its rulemaking to address any concerns, such as ensuring the security of electronic communications and obtaining the investor consent to receive documents electronically.

H.R. __, *the Increasing Investor Opportunities Act* that would amend the Investment Company Act to remove an informal SEC staff-level position that places a limit on the amount of assets a closed-end fund may invest in private funds. Closed-end funds should not be subject to a 15% limit on their investments in private securities in light of the already burdensome regulatory framework to which these vehicles are subject. Currently, the only way to address this staff position is for the closed-end fund to limit the offering of its shares to accredited investors with minimum initial purchases of at least $25,000. By allowing closed-end funds to invest a greater portion of their assets in private funds, the proposed bill would expand investor access to the private markets while maintaining the investor protections established under the Investment Company Act.

H.R. __, *the Small Business Investor Capital Access Act* that would amend the Investment Advisers Act of 1940 to increase the exemption from registration threshold for advisers to small private funds to reflect changes in inflation. The Act would require that this threshold be adjusted periodically for inflation, ensuring that it remains relevant over time. By increasing the threshold, smaller investment funds would face fewer regulatory costs.

H.R. __, *the Improving Capital Allocation for Newcomers (ICAN) Act* that would modify the Qualifying Venture Capital Fund Exemption under Section 3(c)(1) of the Investment Company Act by increasing the cap on aggregate capital contributions and uncalled capital commitments from $10 million to $150 million, and also increasing the allowable number of beneficial owners in a qualifying venture capital fund from 250 to 2,000. These changes would enable venture capital funds to raise and manage more capital without triggering the need to register under the Investment Company Act. In addition, it would enable a broader base of investors to participate in venture capital funds, making it easier for funds to scale and attract more capital.

H.R. __, *the Developing and Empowering our Aspiring Leaders (DEAL) Act* that would require the SEC to revise the definition of a qualifying investment, for purposes of the exemption from registration for venture capital fund advisers under the Investment Advisers Act of 1940.

H.R. __, *To permit a registered investment company to omit certain fees from the calculation of Acquired Fund Fees and Expenses, and for other purposes* that would allow a registered investment company to exclude from the calculation of acquired fund fees and expenses those incurred indirectly from investment in a BDC. The Acquired Fund Fees and Expenses (AFFE) rule requires funds to add the actual expense that acquired funds incur to their own operating expenses. The change to AFFE was adopted by the SEC in 2006; however, as it applies to BDCs in particular, it double counts the expenses of a BDC investment resulting in an inflated, artificial percentage for the "total annual fund operating expenses" line item in the prospectus fee table. Furthermore, the registration statement requires an "Expense Example" that follows the methodology of the fee table and uses the inflated, artificial percentage in order to calculate the operating expenses for various time periods (1, 3, 5 and 10 years) of a $10,000 investment in the fund. Inclusion of AFFE in the calculation of the Expense Example inflates actual expenses exponentially over these various time periods. This change had as its consequence the exclusion of BDCs from certain broad-based indices and that, in turn, led to institutional investors moving out of their BDC investments. This has meant that BDCs have less capital to deploy. BDCs are an important source of venture debt and growth capital for small and medium-sized private companies in the United States and fill a crucial gap not addressed by bank lenders. This is, therefore, an important change.

Generally, modernization of the rules and regulations related to regulated funds as a means of promoting capital formation would be an area as to which a further SEC study might be mandated. Comments on this topic were solicited by the SEC in connection with the Concept Release on Harmonization of Securities Offering Exemptions, and various SEC advisory committees have considered this as well. Consideration might be given to modernizing the framework relating to BDCs, especially in light of the fact that during the pandemic relief was granted and no investor protection issues were raised. Also, as a result of many years of exemptive and no-action letter relief, there is well-settled guidance relating to the issuance of multi-share classes of equity securities and the ability to enter into affiliate and joint transactions. There has been increased market interest in interval funds, tender offer funds and target date funds, yet the regulations relating to these vehicles has not kept pace with recent developments. These vehicles might well serve as regulated entities that provide a means for allowing broader access to investments in private funds and to investments in the securities of private companies. Such a study would necessarily have to consider the permissibility of various fee structures in order to compensate managers of such vehicles so that, for example, an incentive fee might be charged even when fund interests are offered to persons that are not qualified clients.

In connection with such a study, the SEC might consider allowing BDCs to rely on Rule 18f-3 under the Investment Company Act without the need to obtain exemptive relief from the SEC. Rule 18f-3 already allows mutual funds to adopt flexible pricing and liquidity policies, including the ability to issue multiple classes of shares with different distribution fees, while maintaining a single pricing structure. Extending the applicability of this rule to BDCs would allow them to issue multiple classes of shares with differing voting rights, fees or other rights subject to the same investor protection conditions under the rule's framework.

Additional Recommendations for the Subcommittee's Consideration

In light of the fact there are many factors that contribute to creating an ecosystem that promotes capital formation, the Subcommittee might be well advised to urge the SEC to undertake a study or studies that would review the following areas, each of which, in practice, is important both to companies and to the financial intermediaries that act as placement agents and underwriters in capital-raising transactions:

- a study by the SEC (possibly jointly with FINRA) aimed at streamlining the equity research rules in order to promote capital formation. The combination of the Global Settlement, Regulation AC, and the FINRA rules, together with MiFID issues, makes compliance with the research rules extremely costly for market participants. Many of the rules are overlapping. The Global Settlement no longer serves any useful purpose;

- an SEC review of the disclosure accommodations provided to FPIs that choose to become subject to SEC reporting requirements with a view to encouraging more FPIs to go public in the United States and list their securities on US national securities exchanges;

- an SEC analysis of the offering related communications safe harbors provided under the Securities Act for non-reporting and reporting companies, which have not been substantially updated since Securities Offering Reform in 2005, given the advances in communications since 2005 and in order to promote greater transparency in the public markets, provide investors with access to information and promote capital formation. There are some outdated communications safe harbors that are little-used because they are too prescriptive;

- an SEC assessment of the use of social media and the securities laws since that the SEC's interpretive guidance on this topic dates back to its 2000 release, and there has been a proliferation of social media usage, including by public companies, to communicate with investors; and

- an SEC review of the current resale exemptions available under the Securities Act, and the limitations that these impose on a liquid secondary market developing for the securities of smaller public companies.

Finally, consideration should be given to those rules applicable to smaller public companies and their ability to raise capital, such as their ability to use shelf registration statements and the eligibility requirements and instructions under I.B.6 of Form S-3 relating to primary offerings for cash as these apply to certain smaller public companies (those that have a public float of less than $75 million and are subject to the "baby shelf requirements," which limit their ability to sell securities to only one-third of their public float during the 12 calendar months immediately prior to the sale using Form S-3, excluding any sales prior to the issuer becoming subject to the baby shelf requirements).

Concluding Thoughts

While additional reforms should be considered to address the issues facing smaller public companies, today's proposed measures are a good step in the right direction. It is for these reasons that I support the proposed bills subject to the specific comments and qualifications made in this statement while, of course noting that the SEC's administrative flexibility relating to the implementation of many of the specific measures contemplated here should not be negatively impacted.