BETTER MARKETS

– FACT SHEET –

The SEC's Proposed Expansion of the Private Markets Would Weaken Investor Protection and Continue to Ignore the Declining Public Markets

On June 1, 2020, Better Markets filed a comment letter on the Securities and Exchange Commission's recently proposed rulemakings to expand exempt offerings in the private market. The Commission proposes a radical expansion to the already complex web of exemptions under the current securities laws and regulations. These rules govern the capital raising activities of companies that want to raise capital through the issuance of securities without providing minimal information about their financial condition or growth prospects.

Taken together, these proposals would expose financially unsophisticated retail investors to the risks of investing in companies that have funding challenges and prefer to not disclose information about their financial condition or growth prospects. These investors often lack the financial sophistication to understand risks associated with investing in dark private markets and/or lack the wherewithal to withstand higher-than-normal probability of investment loss. The new amendments would allow private companies to reduce the information that they provide investors, and companies could now participate in certain types of general solicitation. The proposal would also decrease the protection of U.S. investors from foreign private companies.

The proposal—short on evidence and long on ideology, conjecture, and assumptions—fails to answer some fundamental questions:

1. Are high-growth and/or promising companies having difficulties accessing funding?
2. Are retail investors asking for or need access to exempt offerings?
3. Do high-growth and/or promising companies prefer funding from *retail* investors rather than institutional investors, venture funds, and others that are already amply available?
4. If there are indeed some promising companies that cannot access ~~to~~ needed capital to grow, what are the reasons the smart money is shunning them?
5. Why are these promising companies having challenges raising funds from friends and family, angel investors, local and national banks, and credit unions, as well as from facilities that the Small Business Administration sponsors or other federally backed facilities or state and local government programs?
6. If these high-growth companies and the intermediaries that cater to them prefer funding from retail investors, what are the reasons?
7. How do those who invest in exempt offerings fare? Will *retail* investors do better or worse compared to sophisticated investors investing in the same exempt offerings? Will retail investors fare better investing in exempt offerings versus public offerings?
8. What are the causes that contribute to a company's decision to remain private?
9. How could the SEC encourage more companies to become public issuers?

Better Markets believes this proposal should be rejected for the following reasons:

The Shrinking Number of Public Companies is a Public Policy Challenge Created by Misguided Congressional and SEC Action

Companies that stay private or public companies that go dark deprive investors of investment opportunities in liquid and transparent markets. Since the late 1990s, the number of U.S. companies listed on public exchanges has decreased by more than 50 percent. This proposal would continue this public policy failure, and retail investors will continue to have their investment options diminished. The Commission should focus on expanding the public market and empowering Main Street investors.

The Commission Assumes, Without Providing Data, that Deregulation Will Spur Further Capital Formation, and Ease Viable and Growing Companies' Access to Financing. Instead, Permitting Exempt Offerings to be Sold to Retail Investors May Expose Investors to the Worst of the Worst Companies

Despite data showing that companies which are viable and investment-worthy have no significant challenge finding and raising necessary funding, the Commission, throughout the proposal, seems to suggest that access to capital is curtailed. The fatal flaw in such a suggestion is that the Commission fails to distinguish between investment-worthy companies and those that have little to no prospect of ever returning a profit for their shareholders or making a product or offering a service that their clients want. After being turned away from all the "smart money," this proposal will make it easier for those rejected companies or their intermediaries to take advantage of investors who do not have the wherewithal to be investing in the private dark markets.

The Commission Fails to Show Whether Retail Investors Could Afford or Want to Invest in Exempt Offerings or Would Fare Better When Investing in Exempt Offerings Versus Public Markets

The Commission offers no evidence that investors who are not accredited investors could afford to invest in exempt offerings. The experience with Regulations A+ and crowdfunding is the strongest signal that retail investors are sending that they do not care for exempt offerings. The Commission also offers no evidence how investors (whether institutional, accredited or non-accredited) currently fare when investing in exempt offerings. In fact, given the very nature of the unregistered offerings, the Commission admits that it lacks evidence about their performance. The Commission cannot go forward with this proposal without evidence that shows retail investors want to participate in private markets and that they would fare better in the private market versus the public market.

The Commission's Interpretation of Its Exemptive Authority Would Allow It to Assume the Role of a Legislator and Re-Write Any Law Through Rulemaking

The Commission is proposing to raise the investing and offering limits in crowdfunding, Regulation A, and Rule 504 under Regulation D. As a threshold matter, the Commission lacks the requisite authority to finalize this proposal, and the release makes little effort to demonstrate the existence of any such authority. Congress—after considerable debate and balancing the need for investor protection with access to capital—set maximum allowable thresholds for crowdfunding, Regulation A and D. Congress also created a mechanism for the Commission to periodically raise some of these thresholds to account for inflation. Congress did not grant any further authority anywhere in the JOBS Act. Now the Commission, citing its Section 28 general exemptive authority, is proposing to permanently expand these thresholds, by rule, to levels that utterly change the character of the exemptions.

Discontinuing the Provision of Audited Financial Statements for Certain Reg D Offerings Would Allow Companies that Already Have Questionable Accounting Practices to Raise Hundreds of Millions from U.S. Retail Investors without Providing Audited Financial Statements

The proposals would permit companies, including foreign companies such as those domesticated in the People's Republic of China, to raise from U.S. investors up to $20 million per issuance without providing audited financial statements. If this proposal and the integration proposal are approved as released, this would potentially allow foreign companies to raise hundreds of millions of dollars from U.S. retail investors without providing audited financial statements. The Commission and U.S. investors are already facing seemingly unsurmountable difficulties in accessing reliable financial information from foreign companies, particularly those based in China. This proposal would further exacerbate that challenge and be harmful to U.S. investors. Providing audited financial statements for the benefit of investors and other market participants by an issuer that could potentially raise hundreds of millions a year in unregistered offerings is not overly burdensome. Additionally, that information allows for a modicum of confidence among investors who can rely on the independent review and opinions of financial auditors. These audited financial statements enable investors to protect themselves and generally increases the confidence of market participants in the unregistered offerings.

Lack of Investor Status Verification Would Allow Issuers to Raise Money from Investors That Have Lost Their Accredited Status Due to Changes in Income or Asset Depreciation

The Commission is proposing to add an item to Rule 506(c) which would allow companies to not verify an accredited investor's status, if the accredited investor had been verified in the past by the issuer or an intermediary and if the investor asserts that she or he remains accredited. This self-assertion could be a check-the-box input. The supposed need to provide issuers or their intermediaries with flexibility tailored to specific facts and circumstances is not supported by any specific data or analysis in the release. The Commission has also failed to strike the right balance between the speculated burden on issuers versus the very real threat that the wrong type of investor may become subject to offerings of unregistered securities. Given the intent to maximize participation and returns, it is only reasonable to expect that issuers and persons acting on their behalf (underwriters, promoters, and unscrupulous or incompetent brokers, especially issuers of risky investments like penny stocks and certain asset-backed securities) will design mechanisms that maximize self-certification. As the Commission knows all too well, these types of materials too often contain hype, wildly optimistic prognoses about the prospects of the issuer, and in many cases, attempt to inappropriately condition the investor so that he or she becomes less critical of the issuer and/or the risks associated with investing in the offered security.

Diluting Integration Doctrine Would Enable Continuous Offering of Unregistered Securities to Financially Unsophisticated Investors, And Would Detrimentally Condition Them Against Risks Associated with Unregistered Securities

The Commission is proposing a general principle of integration that will supposedly simplify the current integration framework. As proposed, this would allow companies to continuously raise needed capital *ad infinitum* without providing information to the growing number of investors at various levels of sophistication. This would short-circuit the integration doctrine, which is designed to prohibit evasion of registration requirements. This change alone would mean hundreds of companies would never have to pursue an IPO and hundreds more would decide to "go dark" and begin offering unregistered securities, instead of register. These outcomes would harm capital formation and investor protection as investors and other market participants would have fewer choices of viable companies to invest in and less information to make informed investment decisions.

The So-Called "Demo Days" Would Significantly Weaken Appropriate Prohibitions Against General Solicitation and Increase the Risk of Affinity Fraud; Both Would Harm Investors

The SEC is proposing to allow "Demo Day" communications to and solicitations from retail investors. In the proposal, an issuer would not have partaken in general solicitation if the communications occur during a seminar or meeting by a college, university, or other institution of higher education, a local government, a nonprofit organization, or an angel investor group, incubator, or accelerator sponsoring the seminar or meeting. Permitting essentially any social group or institution to organize demo days and allow issuers or their affiliates to advertise the existence of that "demo day" while also permitting the issuer or an affiliated intermediary to solicit interest from unlimited number of retail investors about unregistered and yet-to-be-registered securities offering is an end-around of the prohibition on general solicitation. Also, permitting issuers to engage in solicitations at meetings organized by various social or religious groups would increase the risk of affinity fraud. Finally, we believe permitting issuers or their trade associations, such as Chambers of Commerce, to trigger the organizing of demo days by local governments would increase the risk of pay-to-play corruption where the issuer, its affiliated intermediary, or the trade association would promise (explicitly or not) to make a political campaign contribution in return for successful "demo days."

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Better Markets is a public interest 501(c)(3) non-profit based in Washington, DC that advocates for greater transparency, accountability, and oversight in the domestic and global capital and commodity markets, to protect the American Dream of homes, jobs, savings, education, a secure retirement, and a rising standard of living.

Better Markets fights for the economic security, opportunity and prosperity of the American people by working to enact financial reform, to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

By being a counterweight to Wall Street's biggest financial firms through the policymaking and rulemaking process, Better Markets is supporting pragmatic rules and a strong banking and financial system that enables stability, growth and broad-based prosperity. Better Markets also fights to refocus finance on the real economy, empower the buyside and protect investors and consumers.

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