March 18, 2021

The Honorable Patrick Toomey
Ranking Member
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, DC 20510

Re: Request for Proposals to Foster Economic Growth and Capital Formation

Dear Senator Toomey:

The American Securities Association (ASA)[1] appreciates your leadership in soliciting legislative proposals to foster economic growth and capital formation. As our economy recovers from the pandemic, Congress has an opportunity to work on a bipartisan basis to help small businesses access the capital they need to grow and create jobs. We believe policymakers should focus on businesses looking for early-stage investors to companies that have already gone public or are considering an initial public offering (IPO).

In 2018, the ASA was part of an inter-organizational effort to produce over twenty recommendations for Congress and the Securities and Exchange Commission (SEC) to improve the public company model in the United States (IPO Report).[2] The ASA has long been concerned about the decline in the number of public companies, and the regulatory hurdles that make it challenging for young companies to access the public markets. While some of the recommendations included in the IPO Report have been implemented, there are several unresolved items we believe Congress and the SEC should prioritize.

Congress has a history of working across party lines to advance capital formation reforms. The 2012 Jumpstart our Business Startups (JOBS) Act has been a success for both public and private businesses as well as investors, and in 2018 the House of Representatives passed the JOBS and Investor Confidence Act by an overwhelming bipartisan margin.[3] The partisan divides that define many issues generally do not exist when it comes to capital formation.

[1] The ASA is a trade association that represents the retail and institutional capital markets interests of regional financial services firms who provide Main Street businesses with access to capital and advise hardworking Americans how to create and preserve wealth. The ASA's mission is to promote trust and confidence among investors, facilitate capital formation, and support efficient and competitively balanced capital markets. This mission advances financial independence, stimulates job creation, and increases prosperity. The ASA has a geographically diverse membership of almost one hundred members that spans the Heartland, Southwest, Southeast, Atlantic, and Pacific Northwest regions of the United States.

[2] Expanding the On-Ramp: Recommendations to Help More Companies Go and Stay Public, available at: https://www.centerforcapitalmarkets.com/wp-content/uploads/2018/05/CCMC_IPO-Report_v17.pdf

[3] S. 488, 115th Congress

One of the economic bright spots since the onset of the pandemic has been a surge in business startups. A recent study found that Americans created 4.4 million businesses last year, an increase of 24% over 2019.[4] While this data shows that the American entrepreneurial spirit is alive and well, these new businesses will need capital if they are to survive and contribute to the next wave of American growth and innovation.

We also believe that access to capital must be balanced with adequate investor protections. Creating regulatory loopholes that allow bad actors or questionable businesses to dupe investors will only cause harm to the most vulnerable in our country and undermine confidence in America's capital markets.

As Congress considers legislation, the ASA makes the following recommendations:

Improve Research Coverage for Pre-IPO and Small Public Companies

One of the more troubling developments in the public markets over the last two decades has been the collapse in research and analyst coverage of small issuers. Recent data shows that as many as two-thirds of companies with a market cap under $100 million have no research coverage at all.[5] Thus, numerous companies have been orphaned. While the shift towards index investing and away from individual stock selection may play a role in declining coverage, there are several regulatory issues that have contributed to this decline which should be addressed.

The ASA has in the past called for the SEC to conduct a holistic review of this decline that will lead to policy recommendations that will help to increase analyst coverage of small public companies.

Potential reforms include:

- **Broker-dealers should be permitted to receive hard-dollar payments for research from clients without having to register as investment advisers.** Since the implementation of the EU's Markets in Financial Instruments Directive, there has already been a steep decline in the number of research analysts employed as well as the number of companies covered. There has also been a trend towards coverage of larger, more established companies at the expense of smaller ones, which further exacerbates the difficulties that small companies have in accessing the capital markets.[6] In addition to

[4] Surge in start-ups is a surprise in the pandemic economy, New York Times (February 17th, 2021) Citing research from the Peterson Institute for International Economics, available at https://www.nytimes.com/2021/02/17/business/pandemic-entrepreneurs.html
[5] CapitalIQ as of June 9th, 2017
[6] See e.g. Research Analysts' Existential Crisis Enters MiFID II Era (Bloomberg) January 3, 2019, available at https://www.bloomberg.com/news/articles/2019-01-03/the-research-analyst-s-existential-crisis-enters-mifid-ii-era;

depriving money managers of valuable research, the continued decline of company-specific information in the marketplace can further accelerate the trend toward automated and passive investment strategies. While the SEC has issued limited no-action relief to allow broker-dealers to receive hard dollar payments for research, a permanent solution is necessary so that the drop in research coverage is not further exacerbated.

- **Allow investment banking and research analysts to jointly attend "pitch" meetings in order to have open and direct dialogue with EGCs.** Under the JOBS Act, investment banking research and analysts may jointly attend pitch meetings, however analysts are prohibited from engaging in efforts to solicit investment banking business. While the SEC has provided guidance for what analysts may discuss in such meetings, in practice those conversations are limited.[7] Bankers and analysts therefore typically do not jointly attend pitch meetings despite the clear intention of the JOBS Act. The SEC should consider the removal of barriers prohibiting investment banks and analysts (including those from "settling" firms) from jointly attending meetings (including pitches) for EGCs, and expressly expand the permitted content that can be discussed at such meetings so long as no direct or indirect promises of favorable research are given. This would result in more information for investors regarding the operations and investment profile of EGCs.

- **The SEC should produce a holistic report and recommendations to improve research of pre-IPO and small public companies.** The ASA strongly supported the Treasury Department's previous recommendation for such a review and believe that a comprehensive review of SEC and Financial Industry Regulatory Authority (FINRA) rules should be conducted. While there have been rule changes made to encourage pre-IPO research, without a liability safe harbor it is unlikely that we will see a meaningful increase in pre-IPO research. Bipartisan legislation, the Improving Investment Research for Small and Emerging Issuers Act, has already passed the House of Representatives on two occasions and should be considered again by the 117th Congress.[8]

- **The SEC should be required to review the continuing restrictions contained in the 2003 Global Research Settlement with a view toward assessing the continuing need for the Settlement or certain terms thereof**. The Global Research Settlement is now over 17 years old and continues to contain certain provisions that we view as non-substantive in terms of the core purposes of the Settlement. Certain of these provisions impede settling firms' ability to make rational research coverage decisions and are

Why MiFID II Isn't Working as Intended and Investors are Losing as a Result (Melius Research) December 6, 2018, available at http://www.integrity-research.com/mifid-ii-isnt-working-intended-investors-losing-result/

[7] https://www.sec.gov/divisions/marketreg/tmjobsact-researchanalystsfaq.htm

[8] H.R. 2919, 116th Congress

inconsistent with FINRA rules. These impediments and inconsistencies run counter to the SEC's mission of protecting investors and promoting capital formation.[9]

Secondary Market Trading Reforms

Little has been done to improve the secondary market trading environment for small issuers. The SEC has missed several opportunities to implement reforms that have the longstanding support of a broad spectrum of market participants. This failure to act has effectively kicked the can down the road on the market structure debate, preserved the status quo for those who benefit from the current trading regime, and continues to be a disincentive for growing small American businesses to complete an IPO. Congress and the SEC should take this as an opportunity to reset the market structure debate and prioritize reforms that support small business capital formation and market stability.

Potential reforms include:

- **Suspending unlisted trading privileges (UTP) for small issuers with distressed liquidity.** UTP enables securities listed on an exchange to be traded on other national securities exchanges and is automatically extended to securities prior to their listing on an exchange. While UTP makes sense for larger companies with adequate liquidity and significant trading volume, it simultaneously fragments liquidity and increases trading costs for thinly traded stocks, which tend to be smaller issuers. The IPO Report recommended that issuers with distressed liquidity be given the option to suspend their UTP, and Congress has also recently weighed in on this issue. In July 2018, the U.S. House of Representatives passed the "Main Street Growth Act," which would create the legal framework for venture exchanges in the United States. Included in that legislation (which had earlier passed the House Financial Services Committee by a vote of 56-0) was an important provision that would prohibit venture exchanges from extending UTP to issuers that chose to list on a venture exchange.[10]

- **Improve liquidity by introducing more flexible tick sizes.** The IPO Report also recommended that issuers become eligible to determine their own "tick-size" to improve the liquidity of thinly traded or lower priced stocks. The SEC's 2000 decimalization order transitioned the trading of stocks – regardless of stock price or market capitalization – to penny increments. While decimalization may make sense for large capitalization, highly traded stocks, narrow trading spreads can serve as a disincentive for market makers to

[9] See Government Accountability Office, Report to Congressional Committees, Securities Research: Additional Actions Could Improve Regulatory Oversight of Analyst Conflicts of Interest (January 2012) (the **"GAO Report"**), *available at:* https://www.gao.gov/assets/590/587613.pdf.; see also U.S. Department of the Treasury, A Financial System that Creates Economic Opportunities: Capital Markets (October 2017) (the **"Treasury Report"**), *available at:* https://www.treasury.gov/press-center/pressreleases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf.

[10] H.R. 2889 / S. 2306, 116th

trade the shares of EGCs or other small issuers. A 2019 report from Nasdaq, done in collaboration with a diverse group of market participants and academics, proposes a set of six different tick increments.[11] Stocks would be categorized based upon their duration-weighted average quoted spread over a certain period of time. Importantly, a tick increment for a company would not be static as it could transition to a different increment after a data-driven review of how the security trades. In other words, objectivity, not subjectivity will drive the outcome. ASA supports the concepts included in the Nasdaq proposal and we believe it is time for Congress or the SEC to act upon such initiatives.

Scaling Regulatory Requirements for Small Issuers

As noted by the IPO Report, some of the more significant costs that fall on smaller issuers are related not to the IPO process but rather involve the cost of *being* public. The 1930's-era reporting regime is not fully equipped to handle the speed at which information flows today. Moreover, as disclosure and financial reporting requirements have steadily increased over the years, small issuers find that the cost of annual and quarterly reporting can be a major hindrance to going public. While the SEC has made some strides recently in reforming the corporate disclosure regime, there is much more that should be done to help small issuers and their investors navigate these often-burdensome regulations.

Potential reforms include:

- **Allow EGCs to file short-form 10Qs with full negative assurance comfort from auditors on all (from SAS 72 standpoint) financial statements with limited MD&A.** The IPO Task Force of 2011 – whose recommendations informed much of what ultimately became the JOBS Act – noted that 92% of public company CEOs reported the "administrative burden of public reporting" was a major challenge to becoming a public company.[12] Legislation directing the SEC to examine the costs of quarterly reporting for EGCs was included as part of the JOBS and Investor Confidence Act.[13]

- **Explore allowing all issuers the ability to use S-3 shelf registration forms.** Form S-3 is the most simplified and cost-effective form that issuers can file with the SEC. It allows them to pursue follow-on offerings by pulling already filed forms off the "shelf." Unfortunately, EGCs and small issuers remain prohibited from using such forms. The Committee should examine whether S-3 eligibility is appropriate for all issuers.

[11] Intelligent Ticks: A Blueprint for a Better Tomorrow, available at https://www.nasdaq.com/docs/2019/12/16/Intelligent-Ticks.pdf
[12] Rebuilding the IPO On-Ramp: Putting Emerging Companies and the Job Market Back on the Road to Growth – IPO Task Force (October 20th, 2011) Available at https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf?mod=article_inline
[13] H.R. 4076, 116th *Modernizing Disclosures for Investors Act*

Legislation to implement these reforms has been introduced and considered in the House of Representatives for several years.[14]

Transparency in Short Sales

While short selling is a longstanding and necessary market function, it can be subject to certain abuses that harm investors and small companies, such as EGCs. We have three simple recommendations to improve market confidence and help level the playing field for all investors:

- SEC Form 13F should include disclosures of institutional holdings of short positions in the same way it does for long positions (this would not harm short sellers because if they are right, then they will be rewarded for their hard work by entering the short position first);

- Aggregate short interest for each publicly listed company stock should be reported daily, rather than monthly (this information is readily available and calculable today); and

- End the perception "short and distort schemes"[15] continue by prohibiting any person or firm that holds an existing short position in an EGC from covering their short position within a certain period of time after publishing a short report on the company they are short (this would protect free speech while ensuring that no one profits off of misleading information that could harm the reputation and capital raising ability of an EGC).

Avoid Unnecessary Loopholes That Lead to Investor Harm

While provisions of the JOBS Act and other initiatives were informed by evidenced-based analysis and they carefully balanced capital formation needs with investor protections, other recent proposals would create loopholes in the securities laws that would empower bad actors without any benefit to small businesses looking to raise capital.

For example, for several years Congress has considered legislation that would exempt mergers and acquisitions (M&A) brokers from registering as broker-dealers under the securities laws, notwithstanding the fact that they engage in activities of a broker-dealer.[16] Broker-dealers are subjected to an ongoing and robust oversight regime for good reason, and the small business owners that would ostensibly "benefit" from such legislation are able to seek recourse against well capitalized brokers that seek excessive compensation or engage in other abuses. There is no

[14] Accelerating Access to Capital Act – H.R. 4529, 115th
[15] SEC.gov | SEC Charges Hedge Fund Adviser With Short-and-Distort Scheme This is harmful to capital formation as those who engage in this behavior generally target smaller public companies, harming their employees and investors.
[16] H.R. 609, 116th

evidence whatsoever that current regulations associated with M&A transactions are exceedingly costly or have resulted in a market failure. We urge Congress to continue to reject this legislation as it has in the past.

Additionally, in October 2020 the SEC issued a proposed order that would allow "finders" who help small businesses raise capital to avoid broker-dealer registration.[17] Finders would not be subject to the "know your customer" obligations, recordkeeping requirements, minimum capital standards, and other rules that registered broker-dealers are subject to. The SEC also provided no evidence to support its assertion that the exemption "would provide clarity to investors and issuers and establish clear lanes for both registered broker activity and limited activity by finders that would be exempt from registration." In fact, the ASA is not aware of any real demand among small businesses to use unregistered "finders" to help them raise capital.

Creative exemptions from the securities laws masquerading as "capital formation" initiatives should be rejected by policymakers, and Congress should pursue vigorous oversight of the SEC to ensure that the Commission does not independently implement new law that would jeopardize the protection of American investors.

Conclusion

The ASA thanks you for your leadership on these critical issues and we look forward to working with you and all the members of Congress as a capital formation agenda takes shape.

Sincerely,

Christopher A. Iacovella

Christopher A. Iacovella
Chief Executive Officer
American Securities Association

[17] Notice of Proposed Exemptive Order Granting Conditional Exemption from the Broker Registration Requirements of Section 15(a) of the Securities Exchange Act of 1934 for Certain Activities of Finders