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Regarding JOBS Act 4.0

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On the 10th anniversary of the JOBS Act, Senate Banking Committee Republicans under Sen. Toomey's leadership, released a discussion draft of new legislation, called JOBS Act 4.0. I am pleased to submit this feedback on the discussion draft of JOBS Act 4.0.[1]

The JOBS Act 4.0 discussion draft would considerably improve the regulatory environment for entrepreneurs seeking to raise capital. In all, it contains 29 discrete pieces of legislation, many of which have also been introduced as stand-alone legislation. The package, considered as a whole, can be expected to have a positive impact on entrepreneurs, investors and the economy comparable to that of the original JOBS Act. I have elsewhere discussed in detail the very positive effects that this legislation would be expected to have.[2] The focus of this submission is ways that the draft legislation could be improved.

I would also like to commend the process used to develop and improve this legislation. On February 2, 2021, U.S. Senate Banking Committee Ranking Member Pat Toomey's issued request for proposals.[3] Then, in collaboration with other members of the committee, the discussion draft and the associated independent legislation was developed. Now additional public input is being sought to improve the legislative language. This contrasts sharply with the typical process in recent Congresses where legislation that has not been subject to committee or public review is included in massive omnibus legislation or some other large, unrelated bill such as the National Defense Authorization Act. The deliberative process employed to develop JOBS Act 4.0 will result in better legislation.

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[1] "Banking Republicans Roll Out Capital Formation Legislation to Mark 10th Anniversary of JOBS Act: The JOBS Act 4.0 Will Accelerate Economic Growth and Spur New Business Creation," April 4, 2022 https://www.banking.senate.gov/newsroom/minority/banking-republicans-roll-out-capital-formation-legislation-to-mark-10th-anniversary-of-jobs-act. For the legislative language of the discussion draft, see "Jumpstart our Business Startups Act of 2022" https://www.banking.senate.gov/imo/media/doc/the_jobs_act_4.0discussiondraft.pdf.

[2] David R. Burton, Testimony before the Committee on Banking, Housing and Urban Affairs on "Entrepreneurial Capital Formation," April 5, 2022 https://www.banking.senate.gov/imo/media/doc/Burton%20Testimony%204-5-22.pdf; "JOBS Act 4.0: Improving the Regulatory Environment for Entrepreneurial Capital Formation," *Crowdfund Insider*, May 16, 2022 https://www.crowdfundinsider.com/2022/05/191037-jobs-act-4-0-improving-the-regulatory-environment-for-entrepreneurial-capital-formation/.

[3] "Toomey Requests Proposals to Foster Economic Growth and Capital Formation," Press Release, February 2, 2021 https://www.toomey.senate.gov/newsroom/press-releases/toomey-requests-proposals-to-foster-economic-growth-and-capital-formation. See also "Proposals to Foster Economic Growth and Capital Formation," Submission of David R. Burton and Norbert J. Michel, March 18th, 2021 https://www.banking.senate.gov/imo/media/doc/David%20Burton%20and%20Norbert%20Michel%20-%202021-3-18.pdf.

Suggested Modifications to JOBS Act 4.0 Discussion Draft

Sec. 102. Definition of emerging growth company

Section 102 of the discussion draft (relating to the definition of an emerging growth company or EGC) could be improved in two ways. First, EGC status should be made indefinite rather than limiting it to 10 years. Second, and more importantly, the Securities Act and the Securities Exchange Act should be amended so that EGCs (and smaller reporting companies) are exempt from (1) climate change or greenhouse gas emissions reporting, (2) diversity, equity, and inclusion reporting and (3) human capital management reporting (all of which are in the SEC regulatory pipeline). These rules will impose massive costs and exempting EGCs and smaller reporting companies from these requirements is an entirely appropriate aspect of a scaled disclosure regime. Of course, it would be preferable to simply define materiality so that such reporting is not required of any issuer.[4]

The proposed climate change rule alone has been estimated by the SEC to increase the costs of being a public company by an astounding 165 percent, by $6.38 billion in the aggregate from $3.86 billion to $10.24 billion.[5] And this is a massive underestimate because huge swaths of the costs imposed by scope 3 are not counted. In other words, the proposed climate change rule will nearly triple the costs of being a public company. With one regulation, the Commission is considering adding more costs on issuers than all of the regulations promulgated in the previous nine decades. It is difficult to conceive of a more destructive policy and, if promulgated, it will dwarf the positive impact of this legislation. The DEI and human capital management reporting requirements in the SEC regulatory pipeline will just make the problem worse. The SEC climate change, DEI, and human capital management rules can be expected to radically reduce the number of IPOs and to cause a large number of "going private" transactions among small and medium-sized issuers. This, in turn, will limit the investment choices for millions of Americans. Making the proposed changes to section 102 would substantially mitigate the damage that these rules will cause.

Sec. 104. Reporting Requirements Reduction Act of 2022 (S. 3919)

This bill,[6] introduced by Sen. Tillis, would allow any issuer currently required to file quarterly reports to elect to file semi-annually. I have mixed feelings with respect to this bill. It would obviously reduce the frequency of reporting for electing issuers and therefore reduce costs. However, a well-functioning capital market requires timely information for securities to be priced properly. I am concerned that only reporting twice annually may reduce the efficiency, liquidity

[4] For details, see sections III(f)-(h) "Proposals to Foster Economic Growth and Capital Formation," Submission of David R. Burton and Norbert J. Michel, March 18th, 2021 https://www.banking.senate.gov/imo/media/doc/David%20Burton%20and%20Norbert%20Michel%20-%202021-3-18.pdf.

[5] "The Enhancement and Standardization of Climate-Related Disclosures for Investors," Securities and Exchange Commission, Proposed Rule, *Federal Register*, Vol. 87, No. 69, April 11, 2022, pp. 21334-21473 https://www.govinfo.gov/content/pkg/FR-2022-04-11/pdf/2022-06342.pdf at Paperwork Reduction Act Table 4, p. 21461.

[6] S. 3919, 117th Congress https://www.congress.gov/bill/117th-congress/senate-bill/3919/text.

and fairness of securities markets. However, Form 8-K current event reporting may be sufficient to compensate for the reduction in the frequency of periodic reporting (notably 10-Qs).

Appropriate mandatory disclosure requirements can promote capital formation, the efficient allocation of capital and the maintenance of a robust, public, and liquid secondary market for securities.[7] The reasons for this are that (1) the issuer is in the best position to accurately and cost-effectively produce information about the issuer;[8] (2) information disclosure promotes better allocation of scarce capital resources or has other positive externalities;[9] (3) the cost of capital may decline because investors will demand a lower risk premium;[10] (4) disclosure makes it

[7] Robert A. Prentice, "The Economic Value of Securities Regulation," *Cardozo Law Review*, Vol. 28, No. 1 (2006), pp. 333–389, http://cardozolawreview.com/Joomla1.5/content/28-1/cross.website.pdf; Bernard S. Black, "The Legal and Institutional Preconditions for Strong Securities Markets," *UCLA Law Review*, Vol. 48 (2001), pp. 781–855, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=182169; and Luca Enriques and Sergio Gilotta, "Disclosure and Financial Market Regulation," Oxford Legal Studies Research Paper No. 68, 2014, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2423768.

[8] Marcel Kahan, "Securities Laws and the Social Cost of 'Inaccurate' Stock Prices," *Duke Law Journal*, Vol. 41, No. 5 (1992), pp. 977–1044, http://scholarship.law.duke.edu/dlj/vol41/iss5/1/; John C. Coffee Jr., "Market Failure and the Economic Case for a Mandatory Disclosure System," *Virginia Law Review*, Vol. 70 (1984), pp. 717–753; and Joel Seligman, "The Historical Need for a Mandatory Corporate Disclosure System," *Journal of Corporation Law*, Vol. 9, No. 1 (1983), p. 1.

[9] Jeffrey Wurgler, "Financial Markets and the Allocation of Capital," *Journal of Financial Economics*, Vol. 58, No. 187 (2000), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1972124&download=yes; R. David Mclean, Tianyu Zhang, and Mengxin Zhao, "Why Does the Law Matter? Investor Protection and its Effects on Investment, Finance, and Growth," *The Journal of Finance*, Vol. 67, No. 1 (2012), pp. 313–350; Ronald A. Dye, "Mandatory versus Voluntary Disclosures: The Cases of Financial and Real Externalities," *The Accounting Review*, Vol. 65, No. 1 (1990), pp. 1–24; Brian J. Bushee and Christian Leuz, "Economic Consequences of SEC Disclosure Regulation: Evidence from the OTC Bulletin Board," *Journal of Accounting and Economics*, Vol. 39, No. 2 (2005), pp. 233–264, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=530963; Joseph A. Franco, "Why Antifraud Provisions Are Not Enough: The Significance of Opportunism, Candor and Signaling in the Economic Case for Mandatory Securities Disclosure," *Columbia Business Law Review*, Vol. 2002, No. 2 (2002), pp. 223–362, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=338560 or http://cblr.columbia.edu/archives/10795; Paul M. Healy and Krishna G. Palepu, "Information Asymmetry, Corporate Disclosure, and The Capital Markets: A Review of the Empirical Disclosure Literature," *Journal of Accounting and Economics*, Vol. 31 (2001), pp. 405–440, http://tippieweb.iowa.uiowa.edu/accounting/mcgladrey/winterpapers/kothari1.pdf; and Anat R. Admati and Paul C. Pfleiderer, "Forcing Firms to Talk: Financial Disclosure Regulation and Externalities," *Review of Financial Studies*, Vol. 13, No. 3 (2000), pp. 479–519, https://faculty-gsb.stanford.edu/admati/documents/Forcingfirmstotalk_research.pdf.

[10] Christine A. Botosan, "Evidence that Greater Disclosure Lowers the Cost of Equity Capital," *Journal of Applied Corporate Finance*, Vol. 12, No. 4 (2000), pp. 60–69, and Charles P. Himmelberg, R. Glenn Hubbard, and Inessa Love, "Investor Protection, Ownership, and the Cost of Capital," World Bank Policy Research Working Paper No. 2834, 2002, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=303969.

easier for shareholders to monitor management;[11] and (5) disclosure makes fraud enforcement easier because evidentiary hurdles are more easily overcome.[12]

On the other hand, mandatory disclosure laws often impose very substantial costs. And clearly this bill is designed to reduce these costs. These costs do not increase linearly with company size. Offering costs are larger as a percentage of the amount raised for small offerings. And continuing disclosure costs are higher as a percentage of revenues or earnings for smaller firms. The costs therefore have a disproportionate adverse impact on small firms. Moreover, the benefits of mandated disclosure are also less for small firms because the number of investors and amount of capital at risk is less. Since the costs are disproportionately high and the benefits lower for smaller firms, disclosure should be scaled so that smaller firms incur lower costs.

These considerations require a balancing by policymakers of competing concerns and are, to some degree, an empirical question.[13] It would seem to me that it might be better to revise section 2 of this bill so that, as part of a scaled disclosure regime, only smaller reporting companies and perhaps EGCs may elect to report less frequently. If it works well, in conjunction with current event reporting on Form 8-K, Congress could revisit the issue and expand the provision to all issuers.

Sec. 107. Venture Exchanges

This bill (S. 3097),[14] introduced by Sen. Kennedy, would create venture exchanges. If amended, it could prove to be a significant step towards promoting liquidity in the secondary market for relatively small issuers and, therefore, help investors in these companies achieve fair value for their securities when they choose to sell them. The Canadian TSX Venture Exchange and the United Kingdom's Alternative Investment Market appear to be working well but have undergone some adjustment over time. These markets appear to have had a positive economic impact in the U.K. and Canada. There are at least a dozen similar but smaller markets in various countries around the world.

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[11] The interests of shareholders and management are often not coincident and may considerably conflict. Corporate managers often operate firms as much for their own benefit as that of shareholders, and shareholders may have difficulty preventing this in a cost-effective way. This incongruity of interest is often described as the agent-principal problem, or collective-action problem, and is significant in larger firms where ownership and management of the firm are separate, and ownership is widely held. See Michael C. Jensen and William H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure," *Journal of Financial Economics*, Vol. 3, No. 4 (1976), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=94043; Paul G. Mahoney, "Mandatory Disclosure as a Solution to Agency Problems," *University of Chicago Law Review*, Vol. 62, No. 3 (1995), pp. 1047–1112; and Merritt B. Fox, "Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment," *Virginia Law Review*, Vol. 85, No. 7 (1999), pp. 1335–1419.

[12] Requiring certain written affirmative representations in public disclosure documents deters fraud because proving fraud becomes easier if the public, written representations are later found by a trier of fact to be inconsistent with the facts. Periodic reporting (such as 10-Ks, 10-Qs, and 8-Ks) can help police secondary-market manipulation by issuers and insiders.

[13] David R. Burton, "Securities Disclosure Reform," Chapter 5, *Prosperity Unleashed: Smarter Financial Regulation*, Norbert J. Michel, Editor (The Heritage Foundation: 2017) http://thf-reports.s3.amazonaws.com/2017/ProsperityUnleashed.pdf or David R. Burton, "Securities Disclosure Reform," Heritage Foundation Backgrounder No. 3178, February 13, 2017 https://www.heritage.org/sites/default/files/2017-02/BG3178.pdf.

[14] S.3097, 117th Congress https://www.congress.gov/bill/117th-congress/senate-bill/3097/text.

Two modifications appear to me to be absolutely necessary to this version of 'The Main Street Growth Act' if venture exchanges are going to make a meaningful difference. A third is advisable if we want this secondary market to be robust.

For venture exchanges to work well and achieve their promise, securities traded on a venture exchange must be covered securities within the meaning of Securities Act section 18(b) (15 USC 77r(b)). Requiring issuers to comply with every (or virtually every) state blue sky registration and qualification law as a condition of listing a security would be costly. The issuer would have to do this because, unlike in a primary offering, they will not know the residence of people that may buy their security on the venture exchange. In principle, since venture exchanges under the bill are a subset of national securities exchange under proposed Securities Act section 6(m)(2)(A), they would be covered securities under existing Securities Act section 18(b)(1)(A). But proposed Securities Act section 18(d) in the bill (at section 2(b) of the bill) undoes that. This is a potentially devastating provision in the legislation that may well entirely upend the aims of the bill were it to be enacted in its present form. It certainly will make venture exchanges much less attractive to issuers. It should be removed.

Proposed Securities Act section 6 (m)(7) (relating to disclosures to investors trading on venture exchanges) also seems problematic for two reasons. First, it is not clear what kind of disclosures would be necessary. What are 'characteristics unique to venture exchanges' that investors should be worried about? I do not know but I am sure that the SEC will think of something. If Congress has some specific risk factor in mind, it should say what it is rather than leaving it to the SEC to dream something up. My strong suspicion is that there is no *material* difference between the risks of trading securities on a venture exchange, an exchange or an ATS.

Moreover, it is not clear to me how that would be done in practice. Most of these trades will occur electronically. Are we going to require that a broker-dealer provide a special pop-up window on customers' desktop requiring them to read, or at least claim that they have read, a disclosure document every time a customer wants to trade a security that happens to be listed on a venture exchange? This is certainly one way to make venture exchanges less attractive.

Earlier versions of this legislation identified specific provisions in Regulation NMS that would not apply to venture exchanges.[15] That would seem advisable.[16] It is not necessary to have as comprehensive a list as the early versions of the Main Street Growth Act but not backing off of a consider number of the Regulation NMS requirements will largely defeat the purpose of venture exchanges. Reducing the regulatory burden on these exchanges and on issuers listing on these venture exchanges is the primary point of creating them in the first place. Probably the most important thing to consider is allowing broker-dealers to make markets on venture exchanges so volatility in these thinly traded securities can be limited.

It is unlikely that the SEC will make decisions that are consistent with venture exchanges being an unqualified success. The Commission rarely takes steps to reduce the regulatory burden on issuers or broker-dealers. Congress needs to make the decisions if it wants venture exchanges to work.

See also the discussion below relating to small firm secondary markets (specifically, over-the-counter markets and Regulation D securities secondary markets) under the heading "Suggested Additions to JOBS Act 4.0: Proposals Relating to Substantive Changes to the Securities Laws."

Sec. 108. Intelligent Tick Study

The Intelligent Tick Study Act (S.3947),[17] introduced by Sen. Kennedy, would instruct the Commission to study the impact of tick sizes larger than one cent and authorize the Commission to impose them with respect to emerging growth companies. There may well be something to be learned by having the SEC conduct a rigorous study of the merits of larger tick sizes.

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[15] See section 2 of H.R. 4638, 114th Congress (https://www.congress.gov/bill/114th-congress/house-bill/4638/text?r=10&s=8) at proposed Securities Exchange Act section 6(m)(3):

> "(3) EXEMPTIONS FROM CERTAIN NATIONAL SECURITY EXCHANGE REGULATIONS. — A venture exchange shall not be required to—
>
> > "(A) comply with any of sections 242.600 through 242.612 of title 17, Code of Federal Regulations;
> > "(B) comply with any of sections 242.300 through 242.303 of title 17, Code of Federal Regulations;
> > "(C) submit any data to a securities information processor; or
> > "(D) use decimal pricing.

Note: This bill was reported out of the House Financial Services Committee on June 8, 2016.

[16] For a discussion of these issues, see David R. Burton, "Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens: Venture Exchanges," Testimony before the Capital Markets and Government Sponsored Enterprises Subcommittee of the Committee on Financial Services, May 13, 2015 https://financialservices.house.gov/uploadedfiles/05.13.2015_david_r._burton_testimony.pdf. See also "What Are Venture Exchanges and How Should They Be Regulated," Heritage Foundation Event, May 4, 2015 https://www.youtube.com/watch?v=arCryUroKyY and Daniel Gallagher, "How to Reform Equity Market Structure: Eliminate "Reg NMS" and Build Venture Exchanges," The Heritage Foundation, February 23, 2017 https://www.heritage.org/article/how-reform-equity-market-structure-eliminate-reg-nms-and-build-venture-exchanges.

[17] S.3947, Intelligent Tick Study Act https://www.congress.gov/bill/117th-congress/senate-bill/3947/text?r=1&s=1.

However, authorizing the SEC to *impose* them, based on the evidence available now, is inadvisable. In general, I think it advisable to leave it to issuers or exchanges to decide these issues. I would also note the SEC tick size pilot study[18] and recent academic research that I have seen on the issue[19] do not appear to support the proposition that higher tick sizes have a positive economic impact.

Sec. 305: Improving Crowdfunding Opportunities Act (S.3967).

This constructive bill (S. 3967),[20] introduced by Sen. Moran, would make significant improvements to crowdfunding, particularly the regulation of funding portals. It would broaden blue sky preemption, reverse a badly conceived SEC interpretation of its Regulation CF that treats crowdfunding portals as issuers for liability purposes, limits the Bank Secrecy Act requirements for funding portal requirements since funding portals are prohibited from holding customer funds by law and the funds held by banks are fully subject to AML-CFT Bank Secrecy Act requirements, and explicitly permit impersonal investment advice that does not purport to meet the objectives or needs of a specific individual or account. All of these are very helpful and will improve the attractiveness of crowdfunding.

Given, however, the complexity and burden that the Senate and then the SEC added to Title III, I believe a more fundamental reform will be necessary for equity crowdfunding to fulfill its promise.[21] Congress needs to amend Title III of JOBS Act (primarily Securities Act 4A but also other provisions) so that it is more like the original House passed JOBS Act Title III[22] or, preferably, Rep. McHenry's original bill.[23] This more ambitious approach would make a much greater difference.

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[18] See, for example, "Assessment of the Plan to Implement a Tick Size Pilot Program," July 3, 2018 (Revised August 2, 2018) https://www.sec.gov/files/TICK%20PILOT%20ASSESSMENT%20FINAL%20Aug%202.pdf.

[19] Robert P. Bartlett III and Justin McCrary, "Subsidizing Liquidity with Wider Ticks: Evidence from the Tick Size Pilot Study," *Journal of Empirical Legal Studies*, Vol.17, No. 2 (June 2020), pp. 262-316.

[20] S. 3967, 117th https://www.congress.gov/bill/117th-congress/senate-bill/3967/text?r=5&s=1.

[21] See discussion above under the JOBS Act heading and David R. Burton, "Improving Entrepreneurs' Access to Capital: Vital for Economic Growth," Heritage Foundation Backgrounder No. 3182, February 14, 2017 https://www.heritage.org/sites/default/files/2017-02/BG3182.pdf; Thaya Brook Knight, "A Walk Through the JOBS Act of 2012: Deregulation in the Wake of Financial Crisis," Cato Institute Policy Analysis 790, May 3, 2016 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2833877#; Comment letter of David R. Burton regarding Crowdfunding, February 3, 2014 http://www.sec.gov/comments/s7-09-13/s70913-192.pdf; Comment letter of Rutheford B Campbell, Jr., regarding Crowdfunding, February 14, 2014 http://www.sec.gov/comments/s7-09-13/s70913-278.pdf; Comment Letter of David R. Burton regarding Concept Release on Harmonization of Securities Offering Exemptions, Micro-Offering Exemption, pp. 50-54 https://www.sec.gov/comments/s7-08-19/s70819-6193328-192495.pdf.

[22] H.R.3606, Jumpstart Our Business Startups Act, 112th Congress (as passed by the House) https://www.congress.gov/bill/112th-congress/house-bill/3606/text/eh#toc-H0DABF03FA4154C06A46D5FB67E47DC97.

[23] H.R.2930, Entrepreneur Access to Capital Act, 112th Congress https://www.congress.gov/bill/112th-congress/house-bill/2930/text/ih.

Sec. 307: Facilitating Main Street Offerings Act (S.3966).

This important bill,[24] introduced by Sen. Moran, is meant to preempt blue sky laws for primary and secondary market for Regulation A Tier 2 securities. This would enable robust secondary markets in Regulation A securities to develop that would make Regulation A securities more liquid and enable investors to achieve better value when they sell their securities. It would also make primary offerings easier because investors buying from the issuer will know that they will be more easily able to sell their securities when they wish to do so. I am concerned, however, that the language in the bill does not do the job it is meant to do. It needs to be improved.

Section 305(a) of the discussion draft amends section 18(b)(4)(A) of the Securities Act of 1933 by adding:

‘‘pursuant to

‘‘(i) section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C.2
78m, 78o(d)); or
‘‘(ii) section 4A(b) or any regulation issued under that section;’’

Section 307 (i.e. The Facilitating Main Street Offerings Act) then adds:

‘‘(iii) all disclosure obligations of section 3(b)(2) of this Act and any regulations issued under that section;’’.

Section 18(b)(4)(A) begins “A security is a covered security with respect to a transaction that is exempt from registration under this subchapter …” Then there is a list of exempted transactions (primarily under section 4 of the Securities Act) and some exempted securities under section 3 of the Securities Act. Section 307’s proposed paragraph (iii) has the language “all disclosure obligations of” before “section 3(b)(2) of this Act and any regulations issued under that section.” To the extent it is intentional, this is presumably meant to be a limitation of some sort such that Regulation A securities would sometimes be treated as covered securities and sometimes not. I do not believe that was the intention. The phrase “all disclosure obligations of” is inconsistent with the language used elsewhere in section 18(b)(4)(A) where the transaction or security is simply cited. A court or the SEC is going to wonder why this “limitation” is there and invent a reason. The ambiguity will create confusion for years and presumably some Regulation A offerings made under section 3(b)(2) will not be treated as covered securities.

Ergo, it would be much better for paragraph (iii) to read simply:

‘‘(iii) section 3(b)(2) of this Act and any regulations issued under that section;’’.

I see no reason why the provision should be limited to just subsection (b)(2) and would recommend that paragraph (iii) read as follows:

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[24] S.3966, Facilitating Main Street Offerings Act https://www.congress.gov/bill/117th-congress/senate-bill/3966/text?r=6&s=1.

‘‘(iii) section 3(b) of this Act and any regulations issued under that section;’’.

In my judgment, all securities issued under the small issues exemption should be treated as covered securities. All of these securities are subject to robust disclosure requirements.

Suggested Additions to JOBS Act 4.0 Discussion Draft

Proposals Relating to Substantive Changes to the Securities Laws

1. Congress needs to take steps to improve secondary markets for small firms. First, Congress should improve the regulatory environment for existing non-exchange over-the-counter (OTC) securities traded on alternative trading systems (ATSs), primarily by (a) providing the same reduced blue sky burden that large companies whose securities trade on exchanges currently enjoy, (b) re-establishing the list of marginable OTC securities and (c) removing impediments to market making caused by Regulation SHO. Second, Congress should improve the regulatory environment for secondary sales of private securities (Regulation D and other private securities), primarily by codifying the so-called section 4(a)(1-1/2) exemption and ensuring that platform traded securities are eligible for the exemption. JOBS Act 201(c) and Securities Act section 4(a)(7) and section 4(d) are attempts to address this problem. They need, however, serious improvement and simplification.

2. Congress should codify and broaden the exemption from the section 12(g) holder-of-record limitations for Regulation A securities.[25]

3. Congress should eliminate the income and net worth limitations imposed by Regulation A. These were not imposed by Securities Act section 3(b).

4. Congress should exempt P2P lending from federal and state securities laws.[26]

5. Congress should amend Title III of the JOBS Act to create a category of crowdfunding security called a “crowdfunding debt security” or “peer-to-peer debt security” with lesser continuing reporting obligations. In my original submission, I provided detailed analysis and suggested language.[27]

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[25] For details, see section II(g)(iii) of “Proposals to Foster Economic Growth and Capital Formation,” Submission of David R. Burton and Norbert J. Michel, March 18th, 2021 https://www.banking.senate.gov/imo/media/doc/David%20Burton%20and%20Norbert%20Michel%20-%202021-3-18.pdf.

[26] For details, see section II(h) of “Proposals to Foster Economic Growth and Capital Formation,” Submission of David R. Burton and Norbert J. Michel, March 18th, 2021 https://www.banking.senate.gov/imo/media/doc/David%20Burton%20and%20Norbert%20Michel%20-%202021-3-18.pdf.

[27] See section II(h) of “Proposals to Foster Economic Growth and Capital Formation,” Submission of David R. Burton and Norbert J. Michel, March 18th, 2021 https://www.banking.senate.gov/imo/media/doc/David%20Burton%20and%20Norbert%20Michel%20-%202021-3-18.pdf.

6. Congress should statutorily define materiality in terms generally consonant with Supreme Court holdings on the issue but should specifically exclude social, ideological, or political objectives unrelated to investors' financial, economic or pecuniary objectives.[28]

7. Congress should amend the Securities Act and the Securities Exchange Act to reflect the principles of the Civil Rights Act by prohibiting securities regulators, including SROs, from promulgating rules or taking other actions that discriminate on the basis of race, color, religion, sex, or national origin of such individual or group. Legal discrimination or quotas on the basis of race or sex should be a relic of the past.[29]

8. Congress should terminate the Consolidated Audit Trail program.[30] This has a particularly adverse impact on small broker-dealers.

Proposals Relating to Studies or Data Improvement

The Securities and Exchange Commission does a singularly poor job of providing useful information to policy makers and the public. Providing better information will enable policy makers to make better decisions. This should be non-controversial. Both Democratic and Republican Commissioners have agreed with me in conversations that this is a problem. Yet, it is never prioritized. Congress needs to act.[31]

1. Congress should require the Division of Economic and Risk Analysis at the SEC to conduct a study mapping and reporting accredited investor data by state and county but permitting the use of core-based statistical areas or metropolitan statistical areas if data masking by the Census Bureau or the IRS Statistics of Income effectively requires their use.

2. Congress should require the SEC to publish better data on securities offerings, securities markets and securities law enforcement and to publish an annual data book of time series data on these matters (as outlined below). The Division of Economic and Risk Analysis (DERA) should publish annual data on:

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[28] For details, see sections III(f)-(h) "Proposals to Foster Economic Growth and Capital Formation," Submission of David R. Burton and Norbert J. Michel, March 18th, 2021 https://www.banking.senate.gov/imo/media/doc/David%20Burton%20and%20Norbert%20Michel%20-%202021-3-18.pdf.

[29] See section III(h) of "Proposals to Foster Economic Growth and Capital Formation," Submission of David R. Burton and Norbert J. Michel, March 18th, 2021 https://www.banking.senate.gov/imo/media/doc/David%20Burton%20and%20Norbert%20Michel%20-%202021-3-18.pdf.

[30] See section III(j) of "Proposals to Foster Economic Growth and Capital Formation," Submission of David R. Burton and Norbert J. Michel, March 18th, 2021 https://www.banking.senate.gov/imo/media/doc/David%20Burton%20and%20Norbert%20Michel%20-%202021-3-18.pdf.

[31] See section III(m) of "Proposals to Foster Economic Growth and Capital Formation," Submission of David R. Burton and Norbert J. Michel, March 18th, 2021 https://www.banking.senate.gov/imo/media/doc/David%20Burton%20and%20Norbert%20Michel%20-%202021-3-18.pdf.

(1) the number of offerings and offering amounts by type (including type of issuer, type of security and exemption used);

(2) ongoing and offering compliance costs by size and type of firm and by exemption used or registered status (e.g. emerging growth company, smaller reporting company, fully reporting company) including both offering costs and the cost of ongoing compliance;

(3) enforcement (by the SEC, state regulators and SROs), including the type and number of violations, the type and number of violators and the amount of money involved;

(4) basic market statistics such as market capitalization by type of issuer and type of security; the number of reporting companies, Regulation A issuers, crowdfunding issuers and the like; trading volumes by exchange or ATS; and

(5) market participants, including the number and, if relevant, size of broker-dealers, registered representatives, exchanges, alternative trading systems, investment companies, registered investment advisors and other information.

This data should be presented in time series over multiple years (including prior years to the extent possible) so that trends can be determined.

3. Congress should require an annual SEC and one-time GAO study that collects and reports data from state regulators on the fees or taxes they collect from issuers. These studies should collect data from at least the years 2017-2021 and classify the fees and taxes collected from issuers by offering type.

4. Congress should require an SEC study reporting the annual costs relating to Sarbanes-Oxley internal control reporting and the amounts paid by issuers each year to accounting firms in connection with compliance.

5. If the SEC promulgates the climate change/greenhouse gas emissions rule it has proposed, a DEI rule or a human capital management rule, Congress should require an SEC study reporting the annual costs of each of those rules.