A review of Capital Formation Challenges
(As discussed on March 8, 2021)

Revitalize: Since the launch of our Revitalize Blueprint in May 2017, which provided ideas to reinvigorate the capital markets, we have seen many positive developments emerge from the hard work of Congress and the Securities Exchange Commission (SEC):

- Adoption of reforms to improve the transparency, accuracy, and engagement of proxy advisory firms when they provide voting advice.
- Approval of changes allowing companies to avoid placing repetitive, unsuccessful proposals in their proxies.
- Several JOBS Act provisions were expanded, including allowing all companies seeking to go public to file confidentially and have testing the water conversations.
- The universe of companies that qualify as Smaller Reporting Companies was expanded, reducing compliance costs and promoting capital formation.
- The SEC adopted scaled disclosure requirements for certain new and smaller issuers.
- Simplified M&A accounting disclosures were adopted.
- Several updates to Regulation S-K simplified and improved disclosure.
- Harmonization and modification of the categories of accelerated and large accelerated filers.

Proxy Advisory Reform: The SEC's action in 2020 to update the procedures and resubmission thresholds for shareholder proposals and actions to require transparency about the methodologies and conflicts of proxy advisory firms, as well as mechanisms to mitigate errors by these firms, was among the most impactful rules finalized by the SEC in the past several years. The rules were the result of at least five years of legislative activity, SEC guidance, public comment, and rule development. The rules phase-in over the next several proxy seasons and should be allowed to stay in place and show their full intended effects.

Issuer Choice: One issue from our Revitalize effort where there was engagement from the SEC and Congress was the idea of Issuer Choice about the trading of their shares in the secondary markets. One of the unintended consequences of current market structure is that small and medium growth companies (and investors in them) are not receiving a proportional share of the benefits. The relatively high volatility and low transaction volume of smaller issuers is exacerbated by an inflexible one-size-fits-all construct that spreads already-thin trading across too many venues. In fact, thoughtful market reforms will broadly benefit companies of all sizes. Modern markets can and must be flexible markets. We need to move past the rigid, one-size-fits-all thinking of the past and leverage technology to solve emerging problems and benefit all market participants. Nasdaq recommends permitting issuers to choose to trade in an environment with consolidated liquidity. By creating a market for smaller issuers that is voluntary for issuers to join and that is largely exempt from the UTP obligations—subject to key exclusions—we can concentrate liquidity to reduce volatility and improve the trading experience. Eliminating UTP for small and medium growth companies would allow liquidity to develop, and for supply and demand to find one another. When coupled with disclosure reform for these companies this change would make the public markets substantially more appealing to these smaller companies and enable investors to share in their growth.

Quarterly Reporting Flexibility and Making the Form 10-Q Optional: In today's market, between detailed, annual Form 10-K disclosures, companies provide key data via an earnings press release each quarter. For virtually all investors, the press release is the quarterly report. Yet companies are then required to file a formal Form 10-Q document with the SEC, which is complex, time-consuming, and provides little additional actionable information that cannot be found in the press release. By establishing simple guidelines, the press release can replace the 10-Q entirely for issuers that prefer to report information quarterly, aligning regulatory and shareholder interests, and significantly decreasing corporate reporting red tape without reducing the key disclosure that investors rely upon. Detailed disclosures would continue to be available through the annual Form 10-K process.

Furthermore, while for many large companies quarterly reporting remains the ideal vehicle for regular disclosure, some companies looking to encourage long-termism and reduce costs would benefit from the flexibility to provide reports semiannually, as has been done in the United Kingdom. Companies would be able to update key metrics for any material changes between mandated reports using the tools readily available to communicate directly with shareholders.

Private Markets: *Liquidity*: As a company stays private longer, liquidity becomes an issue for companies waiting for their appropriate time to go public. It is important for pre-IPO private companies to be able to effectively access available capital. For these companies, the business strategy, much of their financial situation, product characteristics, and other items that public companies routinely disclose to the public, need to be wrapped in discreteness from emerging competitors. This makes interaction with investors a point of opportunity, but also a critical chance for leakage. In fact, many companies avoid adding too many individual accredited investors to their ownership to try and control for this difficulty. For this reason, the information about companies currently available to accredited investors can appear limited, lack consistency, and not provide the protections of the securities laws aimed at the average investor.

3C1 and 3C7 Funds: These funds were envisioned to allow pools of capital to come together comprised of 3C1 funds with up to 99 accredited investors and 3C7 pools with an unlimited number of qualified purchasers, which includes most institutional and private funds. Thus, 3C7 are more prolifically able to invest because they can represent exponentially larger pools of cash without the information leakage issue of the 3C1 fund. The 99 accredited investor limit can actually curtail 3C1 funds almost exponentially in their financial heft compared to the 3C7 fund, given the more limited check size of accredited investors in a 3C1 fund, limiting ability of these funds to make multiple significant investments in the same company, where a 3C7 fund of qualified purchasers with typically greater amounts of deployable capital may be able to support the company through several rounds of funding along the path to growth and potential exit to the capital markets. Companies can see 3C7 funds as better long-term partners.

Congress and the SEC might consider reforms to 3C1 funds so that they can operate with more impact in these markets. A reexamination of these funds and reconsideration of investment products and vehicles is needed.

Retail Investor Exposure to Private Issuers Through a 40 Act Registered Fund: As an alternative to direct investment, retail investors can gain exposure to the private company risk/reward that occurs earlier in the company lifecycle through professionally managed funds such as public mutual funds. These pools of capital are actively and passively managed by some of the most respected global asset managers and can offer retail investors the benefit of diversification of investments in multiple private issuers, reducing concentration risk of individual investors with limited capital to invest in more than one exempt offering (and potentially limiting information leakage concerns of private issuers). Over the years we have seen increased trends of asset managers (Fidelity, T. Rowe, Wellington, Blackrock, etc.) interested in direct investment in private companies, however, current market practice typically caps mutual fund investment in funds invested in illiquid securities, such as 3C7 funds or other exempt vehicles limited to accredited investors, to 15% of the overall strategy of the mutual fund. This is based on positions communicated by the SEC staff through disclosure comment letters.

Reform might be considered to enable public mutual funds and other 40 Act registered funds to independently evaluate the suitability of exposure to private securities where consistent with the overall fund strategy, rather than a limitation on asset mix not currently codified in the 40 Act or the rules thereunder. Such reform could offer the potential benefit of indirectly expanding retail access to private company strategies through the protection and expertise of SEC registered investment advisers and potential to increase pools of capital accessible to private companies.

Directors & Officers Insurance: The escalating number and costs to companies for securities litigation is becoming a major impediment to companies considering going or staying public. In just the past few years, we have experienced a dramatic hardening of the commercial insurance market, creating significant cost increases. Larger organizations that require higher limits to attract and retain quality directors and officers crucial for their continued success face the very real threat of being unable to secure adequate financial risk transfer. According to Property and Casualty News[1]:

> "U.S. commercial insurance prices again grew significantly in the fourth quarter of 2020, according to leading global advisory, broking and solutions company Willis Towers Watson's Commercial Lines Insurance Pricing Survey (CLIPS). The survey compared prices charged on policies underwritten during the fourth quarter of 2020 with those charged for the same coverage and quarter in 2019 and found the aggregate commercial price change reported by carriers was above 10%, the highest increase in the history of CLIPS.
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> Data for nearly all lines indicated significant price increases in the fourth quarter with the largest increases coming from excess/umbrella liability and directors' and officers' liability."

Nasdaq's own experience as a public company is interesting; we have seen an over 20% increase year over year for our own coverage. And, while the highest increases accrue to the largest companies, the increases for small to medium companies come at a high cost. These increases are a substantial drag on companies' abilities to invest in research & development and other activities that grow value for shareholders. Nasdaq has added this issue to our annual issuer survey and once completed, we will share the findings with your office.

Congress should certainly evaluate the continued effectiveness of the Private Securities Litigation Reform Act that was put in place in 1995 to moderate abuse of long-term shareholders by a state-by-state rampant and unbridled legal environment. Congress could also engage the SEC to study any actions that can be taken at the federal level to mitigate this growing problem.

Capital Formation: The SEC should, on all new rules, draft special provisions or provide justification for why they are not doing so, for small companies. Not all stocks trade the same and more thought needs to be put into how different regulations will affect trading of less liquid stocks.

[1] Property Casualty News Article dated March 8, 2021: https://insurancenewsnet.com/innarticle/commercial-insurance-rates-take-another-hike-in-q4

Importance of Open Capital Markets: In the last Congress, legislation was passed aimed at resolving the standoff with regulators in China over access to audit books and records of U.S. traded companies by the Public Accounting Oversight Board (PCAOB). Since passage of that legislation, aimed to address a long-standing and limited issue, we have detected a growing attractiveness by some to consider new legislative ideas utilizing access to the U.S. capital markets as a legislative tool for foreign policy.

Without commenting on the underlying issues that Congress might rightly wish to address within certain foreign policy relations, it should be fully understood, from a policy point of view, de-listing companies carries severe penalties to *U.S. investors* through market uncertainty prior to any law's application and potential total loss to those investors if a stock ultimately is rendered untradable. America has a tradition of open capital markets and a tie between risk and reward for our investors. Nasdaq urges moderation when choosing the most extreme policy option in our capital markets, slamming the door in the face of its own investors.

Advance Transparency to Aid Investors Access to Alternative Investment Products:
Retail investors need simplicity and everyday tools to find, evaluate, and explore investment products that sit outside the traditional asset space. It can be difficult to become informed about the many options available to them and their needs. The democratization of data is well understood in the area of equities, options, mutual funds, and exchange traded funds (ETFs). However, that world of clarity quickly vanishes when investing in Models, Managed Accounts, and Alternative Investment Products (such as Non-Traded Real Estate Investment Trusts, Fund of Funds, Private Equity, Managed Future Funds, Collective Investment Trusts, and others). By improving access to these opaque, but market-tested assets, investors could grow their wealth while protecting their investments through their preferred investment advisor's guidance.

Background on Nasdaq's existing activity in this arena: The Nasdaq Fund Network (NFN) is one of Nasdaq's longest-standing products and services (founded in 1984). Originally intended to provide transparency for both retail investors and Registered Investment Advisors (RIAs) investing in or researching mutual funds. Nasdaq works directly with issuers and sponsors of investment products across the following products:

• Open End Mutual Fund	• Demand Deposit Account
• Interval Fund	• Tender Offer Fund
• Exchange Traded Fund	• Closed End Fund
• Money Market Fund	• Unit Investment Trust
• Collective Investment Trust	• Separate Account
• Managed Account	• Alternative Investment Products (such as Non-Traded Real Estate Investment Trusts, Fund of Funds, Private Equity, Managed Future Funds, etc.)
• Structured Product	
• Hedge Fund	
• Annuities	

Congress could work with the SEC to encourage standardized transparency of these funds and investment vehicles and help investors and their advisors approach these products in a well-informed manner.