September 24, 2019

Secretary
Securities and Exchange Commission
100 F Street, NE, Washington, DC 20549-1090

RE: SEC Concept Release on Harmonization of Securities Offering Exemptions (File No.: S7-08-19)

Dear Secretary:

Smaller companies make extraordinary and significant contributions to the U.S. economy, but they do not share the same opportunities as larger companies when seeking public capital. Investors seeking to invest in smaller companies are also divergent from large company investors. The smaller the company, the lower the level of ownership by institutional investors and the higher the level of investment by private individuals. Institutional investors create more liquid markets and act as intermediaries for creating and trading much of the available capital in the modern U.S. equity markets. The public markets are characterized by high-volume trading utilizing electronic communications networks which are hosted by existing stock exchanges. The recent trend for small company capital raising is to shy away from the public markets and make use of offering exemptions, dramatically increasing the funds for the initial offering of private market capital investment.

Small IPOs have been on a downward trajectory for almost two decades. This decline of small IPOs (IPOs raising less than $50 million in gross proceeds) has been well documented in the public press and the empirical academic literature. The Dream Exchange's analysis counting on Dealogic data shows that during the year of 2017 there were only five completed small IPOs. In a related vein, Davidoff and Rose (2016) show that in 1997, there were 169 exchange-listed IPOs for companies with a market capitalization at the IPO stage of less than $75 million, whereas in 2012, there were only seven such IPOs. Further, counting on data from the Securities Data Corporation (Floros and Shastri, 2009), documents that penny stock IPOs almost disappeared by 2006.

The dearth of small IPOs is an exacerbated version of the overall low IPO activity documented in recent years. Doidge, Karolyi and Stulz (2013) report that from the 1990s to the 2000s, capital raised through IPOs outside of the U.S. increased by 65%, while capital raised within the U.S. fell by 8%. They also note that the fall in the U.S. share of worldwide small-firm IPOs is the most dramatic one. Gao, Ritter and Zhu (2013) attribute the decline in small-firm IPOs to the efficiency with which small firms get acquired, rather than grow using their own funds obtained from public offerings.

Vermeulen (2018) argues that there is a growing need to develop a pre-IPO market for high-tech firms that cannot achieve their funding goals and meet the liquidity needs of founders, early stage investors and employees who have to patiently wait for their private firm to bear the proprietary costs and access the public markets in order for them to cash out. According to Cecala and Floros (2019), there is a need to allow small-cap businesses to increase private secondary trading of securities prior to listing on main U.S. stock exchanges—that will allow them, under certain circumstances (e.g., disclosure, use of proceeds, governance, financing schemes), to raise capital with sophisticated investors, get fair pricing and relative greater tolerance to develop their projects and eventually upgrade to national stock exchanges.

Overall, venture exchanges are expected to stir innovation, as they will create a venue for the venture capital and early stage investor industry to exit prior to the private firm meeting the demanding listing criteria of main U.S. stock exchanges; while simultaneously increasing firm compliance with securities registration and reporting. In this way early stage investment is expected to be intensified with the expectation of a trusted, regulated venture exchange market and consequently, innovation and entrepreneurship can be expanded and accelerated. Also, proprietary information that public equity issuers hasten to reveal when traded on main U.S. stock exchanges will now be a part of a protected, rule-based securities registration process for venture securities, creating both investor protection and liquidity for early-stage company securities.

Proposed Main Street Growth Act (MSGA) – Creation of New Venture Exchanges and Venture Securities

On May 22, 2019, the MSGA, now titled H.R. 2899 in the 116th Congress, was introduced in the U.S. House and referred to the House Committee on Financial Services. H.R. 2899 was sponsored by Republican Representative Emmer and co-sponsored by Democrat Rep. Vincente Gonzalez. This bi-partisan sponsorship reintroduces this important legislation which was unanimously passed by the US House of Representatives during the 115th Congress in the exact same form and text as the current bill.

The MSGA carefully limits the securities which may qualify under the new law. The MSGA's limitations on securities provides further guidance for the Commission to oversee the future operations of venture exchanges and to guide the creation of the venture security industry and its market structure.

The MSGA narrowly defines venture securities as follows:

''IN GENERAL.—The term 'venture security' means—

> (I) securities of an early-stage growth company that are classified as exempt from registration pursuant to section 3(b) of the Securities Act of 1933; and
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> (II) securities of an emerging growth company; provided the emerging growth company's initial public offering occurs after enactment of this Act."

The narrow definition of venture securities helps remove uncertainty as to the character of the newly created securities as they are well-known, existing security groups (as defined above in (I) and (II)).

Emerging Growth Company Securities as Venture Securities

The term "emerging growth company" or EGC, is a public company issuer under the Securities Act of 1933 ("Securities Act") and as such, no discussion is needed regarding the issuer's informational disclosures or reporting requirements. An EGC is currently obligated to comply with ***all*** federal securities regulations and no reduction in investor protection is created by including an EGC as a venture security. However, a dedicated venture exchange marketplace for the EGC can help reduce the cost of the "going public" transaction by increased competition among venture exchanges, as well as generate interest from dedicated stock exchanges in EGC transactions which are underserved by the current exchange market structure.

Regulation A/Section 3(b) Securities as Venture Securities

The MSGA's narrow definition of venture securities further includes certain, formerly exempted Section 3(b) securities which may now be traded as venture securities so long as the issuer complies with the existing requirements for the exempted securities.[1] The MSGA is very explicit about the treatment of these securities and the issuer's compliance with disclosure obligations for initial issues and ongoing disclosures, and reporting to permit secondary trading. These activities will now be regulated as part of the venture exchange market structure.

Significant changes to Section 3(b), generally referred to as Regulation A+, went into effect on June 19, 2015 as part of the JOBS Act in an attempt to stimulate liquidity for small companies. The Commission carefully created modifications to enhance liquidity and increase issuer disclosure and reporting of these securities. Before the 2015 modifications to Section 3(b), Regulation A was an exemption from the registration requirements of the Securities Act for nonpublic companies seeking to raise smaller amounts of capital.

The inclusion of Section 3(b) securities in the definition of "venture security" accomplishes the alignment and enhancement with the Commission's carefully crafted protections as modified under the JOBS Act. The creation of venture exchange market structure will increase the "harmony" between the necessity for investor protection and the gradient increase in exempt security compliance with public company registration. As mandated by the JOBS Act, the Commission increased the amount that can be raised by an issuer under the Section 3(b) exemption from $5 million to $50 million and created two offering categories or Tiers: Tier 1 for offerings up to $20 million and Tier 2 for offerings up to $50 million. The Commission created new investor protections, such as requiring audited financial statements in offering materials, ongoing reporting

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[1] The MSGA provides the following constraints:

> ''(3) TREATMENT OF CERTAIN EXEMPTED SECURITIES. — A security that is ordinarily classified as exempt from registration pursuant to section 3(b) of the Securities Act of 1933 shall be exempt from section 12(a) of this title to the extent such securities are traded on a venture exchange, if the issuer of such security is in compliance with —
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> ***(A) all disclosure obligations of such section 3(b) and the regulations issued under such section; and***
>
> ***(B) ongoing disclosure obligations of the applicable venture exchange that are similar to those provided by an issuer under tier 2 of Regulation A*** (17 C.F.R. 230.251 et seq)."
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> (emphasis added.) H.R. 2899, 116th United States Congress.

requirements and an investment cap for non-accredited investors, and a unique offering and disclosure regime specifically designed with smaller startup companies in mind, including limitations on affiliate security holders and pricing disclosures as well as "best price" protections for convertible securities. The new rules modernize the qualification, communications and offering processes, and incorporate many features currently enjoyed by issuers in registered offerings, such as allowing for confidential submissions. Venture securities offerings will be obligated to comply with the carefully studied protections previously created by the Commission.

Venture Exchange Market Structure

Under the MSGA, venture exchange rules must incorporate compliance with registration and qualifications for venture securities as discussed above. In addition, venture exchange rules must disseminate last sale and quote information on fair and reasonable terms and not discriminate against buyers/sellers. Essentially, the exchange market structure obligates venture exchanges to submit self-regulatory rules, under the oversight of the Commission, and to assure parity and fairness in the quote-providing of venture securities without preferential treatment to any buyer or seller. A venture exchange may determine the increment to be used for quoting and trading venture securities on the venture exchange and choose to carry out periodic auctions for the sale of a venture security instead of providing continuous trading. Although venture exchanges are a voluntary marketplace, the careful construction of exchange rules, as approved by the Commission, will create a new layer of oversight for the issuance and trading of small company securities in the very same way that large company securities are registered and listed on national exchanges.

Venture Exchanges Will Act as a "Stepping Stone" Marketplace to US National Exchanges

Venture exchanges shall use specialized rules to more carefully examine the candidates for listing, following standardized listing criteria which shall increase the oversight of small company securities. Formerly exempt Section 3(b) offerings from currently unsupervised security issuers, and the institutional investors that participate in those exempt offerings, will be protected from increased market regulation necessitated by self-regulated venture exchanges. Firms and investors will be encouraged to participate in this market by the possibility of increased market liquidity in a venture exchange's "publicly quoted" environment.

As academic research has proven, firms that have the long-term goal of an IPO begin the process of regulatory compliance in anticipation of a going public event. The voluntary participation in the venture exchange market structure will act as a "stepping stone" to larger public markets permitting a customized exchange environment dedicated to small firms that desire to take the gradient steps to IPO. In the venture exchange structure, issuers and investors can capitalize on market-based contractual terms, licensed stock exchange governance of intermediation, and increased disclosure with exchange oversight and accountability for the operation of the marketplace. These factors, which form the market structure of venture exchanges under the MSGA, aligns with the data leading to the likelihood that venture exchanges may increase the volume of IPOs and number of public companies.

In an effort to excavate empirical market data, the Dream Exchange conducted a hand-gathered study that analyzes the "going public" activity of reverse mergers to evaluate the likelihood of an increase in the listing status of the newly public small firm—drawing similarities to how a venture exchange small company market might operate to support an increase in IPOs to national exchanges. The study further informs on the type of firm and the regulatory behavior characteristics of firms that will avail themselves of venture exchange markets.

By careful evaluation of the listing status of the companies under the study, we reveal that there is a noticeable (approximately 30% of all small reverse merged firms) that manage to upgrade to U.S. national stock exchanges when they share particular characteristics ("Upgraded Firms"). Earlier scholarly literature focuses on the way reverse merged firms compare to IPOs. Those studies show that reverse merged firms exhibit a shorter survivability, lower operating and stock performance, and higher information asymmetry. Our research zeroes into whether a small company that availed itself of the public markets, public reporting and disclosure requirements and the corporate governance demanded in the public markets is, in fact, serving as a stepping stone to the national exchange marketplace.

The Dream Exchange's analysis focuses on the subsample of firms that could be considered the "success stories" of the reverse merger universe and the most likely listing candidates for a venture exchange. These are the firms that are initially reverse merged and then are successful at getting upgraded to U.S. national stock exchanges. By further differentiation of the characteristics of certain firms, we are able to identify and examine the frequency of submitted SEC filings, where we measured the reverse merged firms' disclosure levels, where we find that Upgraded Firms submit more frequently with the SEC, even when this is voluntary. The voluntary increase in disclosure and regulatory compliance shows their intention to conform to U.S. national stock exchanges' disclosure standards on the journey to an IPO. Lastly, Upgraded Firms exhibit improved governance schemes such as higher board independence statistics and different individuals serving in the role of CEO and Chairman of the Board. These latter statistics hinge upon improved governance schemes for Upgraded Firms, revealing that governance is associated with the valuation of firms.

We conclude that the ability to have a quoted price, information disseminated through trading, and disclosure that is shared with both private and public investors is vital for these small-cap, high-growth firms—all features that are included under the MSGA market structure. It may be the case that many of these firms, in the absence of an exchange venue listing platform, would face a greater cost of capital and difficulties consummating any financing events, which would further impede their efforts to pursue their growth options. We are among other scholarly researchers identifying the determinants of successful companies within lower visibility platforms. The empirical research shows that a necessity for a new market structure that includes venture exchanges, with customized rules for venture securities, will enhance the small company capital markets and increase the small company secondary securities markets' existence, leading to an increase in companies that upgrade to national securities exchanges.

Very truly yours,

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