HEALTHY MARKETS
TRANSPARENCY & TRUST

September 30, 2019

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

Re: Concept Release on Harmonization of Securities Offering Exemptions, File No. S-07-08-19

Dear Secretary:

The Healthy Markets Association[1] appreciates the opportunity to offer our views on the Concept Release on Harmonization of Securities Offerings.[2]

Over the past several years, Congress and the Commission have created new exemptions and expanded existing exemptions from the securities regulatory framework. These changes have siphoned off trillions of dollars in capital from the well-regulated public markets and into the far-less-regulated "private" markets.[3] Now, after Congress and the Commission have so significantly weakened the federal regulatory framework, the Concept Release suggests that these numerous disparate exemptions are somehow underutilized or simply too difficult for issuers to navigate.[4] The Concept Release proposes several efforts to address these perceived concerns.

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[1] The Healthy Markets Association is an investor-focused not-for-profit coalition working to educate market participants and promote data-driven reforms to market structure challenges. Our members, who range from a few billion to hundreds of billions of dollars in assets under management, have come together behind one basic principle: Informed investors and policymakers are essential for healthy capital markets. To learn more about Healthy Markets, please see our website at http://www.healthymarkets.org.
[2] *Concept Release on Harmonization of Securities Offerings*, SEC, Sec. Act Rel. No. 33-10649, Jun. 18, 2019, *available at* https://www.sec.gov/rules/concept/2019/33-10649.pdf ("Concept Release").
[3] For the purposes of this comment, "private" offerings are those made in reliance on an exemption or exception to the general registration requirement of the Securities Act of 1933. Further, we refer to "private" companies as those that have not made a registered offering and are not subject to the ongoing reporting obligations or other elements of the Securities Exchange Act of 1934 ("Exchange Act"). We colloquially refer to "public" companies as those that have engaged in a registered offering or are otherwise subject to the ongoing reporting and other obligations of the Exchange Act. Surprisingly, not a single sentence of the 211-page Concept Release acknowledges, much less addresses, this reality.
[4] Concept Release at 6 ("Smaller companies with more limited resources, which may be more likely to need to rely on these exemptions given the costs associated with conducting a registered offering and becoming a reporting company, may find it particularly difficult to manage this complexity."). We question what factors the Commission is using to make any assessments about the appropriate level of usage for any exemption.

The Concept Release's proposals to expand exemptions and exceptions to disclosure requirements are particularly puzzling because the Commission explains on its website that

> Only through the steady flow of timely, comprehensive, and accurate information can people make sound investment decisions. The result of this information flow is a far more active, efficient, and transparent capital market that facilitates the capital formation to our nation's economy.[5]

The Concept Release offers no credible evidence -- much less reasonable analysis -- to support its seemingly new determination that less information and disclosure would better "facilitate" capital formation.[6] When adopting the federal securities laws, Congress clearly made the opposite determination.[7] Further, the available evidence suggests that instead of promoting efficient allocations of capital and protecting investors, the proposals outlined by the Concept Release will increase the number of companies and amount of capital in the private markets on one hand, while further eroding the number and quality of public companies on the other.[8]

Rather than continuing to engage in regulatory reform by anecdote, we urge the Commission to collect greater information about the private markets, and engage in multi-faceted efforts to promote the public markets.

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[5] SEC, What We Do, *available at* https://www.sec.gov/Article/whatwedo.html (last viewed Sept. 30, 2019).

[6] Based on the lack of relevant data and lack of analysis contained in the Concept Release, we fail to see how any proposal offered would satisfy the Commission's burdens under the Administrative Procedures Act. 5 U.S.C. § 706(2)(A), (E); see 15 U.S.C. § 78y(a)(4). As the Commission should by now be acutely aware, "[t]o satisfy the "arbitrary and capricious" standard, 'the agency must examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'" *Susquehanna Int'l Group, LLP, et al. v. SEC*, 866 F.3d 442 (D.C. Cir. 2017) (quoting *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)). It's as if the Commission is proposing to remove a requirement that cars include seatbelts on the premise that the requirement imposes a burden on car manufacturers. While those manufacturer costs may be non-trivial, any rational discussion of the seat belt requirement must include the indisputable safety benefits of seatbelt use. The Commission fails to do that.

[7] *See, e.g.*, H.R. Rep. 73-85, at 3 (1933).

[8] As described in greater detail below, the net result of the proposed changes would be to further expand the private markets at the expense of the public markets. We find these proposals facially inconsistent with Chairman Clayton's testimony during his nomination hearing, in which he opined that "[a]ll Americans should have the opportunity to participate in, and benefit from, our capital markets on a fair basis." Testimony of Jay Clayton, Hearing before the U.S. Senate Cmte on Banking, Housing and Urban Affairs, 115 Cong. (2017), *available at* https://www.banking.senate.gov/imo/media/doc/Clayton%20Testimony%203-23-17.pdf. The public markets regulatory regime expressly mandates that investors have information and are treated fairly. However, in the private markets, there are no disclosure obligations and discrimination is permitted and commonplace.

In the pages that follow, we offer an overview of our concerns with the current state of securities regulation, and then offer recommendations to address these concerns. In particular, we recommend the Commission:

- pause the creation and expansion of exemptions and exceptions from the federal securities laws;
- collect and analyze more information about private offerings and private companies, and explore the relationship between the public and private markets;
- curtail or eliminate some of the obvious failures of past efforts to spur capital formation, such as Regulation A+; and
- take steps to curtail the existing exemptions and seek to pull the huge new swath of massive, widely held "private" companies into the light of the SEC disclosure regime.

Background on the Importance of the Federal Securities Laws and the Rise of Exemptions and Exceptions

In the aftermath of the Great Crash, Congress adopted the Securities Act of 1933 to require the registration of public offerings of securities. The goal was to ensure that investors buying a security had key information about the company, its financials, and its governance so that they could properly value the security, and thus help ensure the efficient allocation of capital to drive not just individual companies, but the entire economy, forward.[9] The Securities Exchange Act of 1934 complements the Securities Act by requiring sufficiently large, widely-held, public companies to meet ongoing reporting obligations, comply with certain governance standards, and more.

The regulatory regime provided by the registration and ongoing reporting obligations of the Securities Act and the Exchange Act performs essentially two critical, but distinct functions:

1. It ensures that key information about securities, including issuer governance, operations, and financials are widely available, so that market participants can accurately assess the value of the securities and allocate capital efficiently; and

2. It levels the playing field between investors and issuers, as well as between different types of investors, by ensuring that all investors -- not just those with market power or access -- have access to key information in a timely manner.

[9] H.R. Rep. 73-85 (1933).

Central to both functions, however, is the underlying commitment that investors and the public receive the information that would be "indispensable to any accurate judgment upon the value of the security."[10]

The Commission and courts have long defended the securities regulatory regime from overly broad exemptions and exceptions. For example, while the Securities Act itself exempted offerings that were not "public," courts have ruled that "'exempted transactions' must be narrowly viewed since the Securities Act of 1933 is remedial legislation entitled to a broad construction."[11] Similarly, in 1962, the Commission adopted guidance to combat "an increasing tendency to rely upon the exemption for offerings of speculative issues to unrelated and uninformed persons."[12]

Historically, offerings to even a very small number of outsiders were deemed to be sufficiently "public" offerings so as to trigger the registration requirements,[13] a fact that became increasingly criticized in the late 1970s as an unnecessary burden on small businesses.[14] At the time, "exempt" offerings of securities were largely immaterial to the overall capital markets.

Nevertheless, beginning in the late 1970s, but really gaining steam in the 1980s (with the adoption of Regulation D),[15] Congress and the SEC began to dramatically expand the scope and nature of exemptions from the securities laws. These now include Rule 506 offerings, Rule 504 offerings, Rule 144A offerings, Crowdfunding, Reg A offerings, and more.

After years of deregulation, the number and volume of "private" offerings has grown dramatically, from what was once just a fraction of the overall markets to now more than 60%. At the same time, there are now fewer than half the number of public companies as there were in the mid-1990s, and fewer than there were in the 1970s. Now, it is not the

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[10] H.R. Rep. 73-85, at 3.

[11] *SEC v. Continental Tobacco Co.*, 463 F.2d 137 (5th Cir. 1972) (citing *Hill York Corporation v. American International Franchises, Inc.*, 448 F.2d 680, 690. (5th Cir., 1971)).

[12] Nonpublic Offering Exemption, SEC, Sec. Act Rel. No. 33-4552 (Nov. 6, 1962).

[13] *See, e.g.*, *SEC v. Continental Tobacco Co.*, 463 F.2d 137 (5th Cir. 1972). Building upon the Supreme Court's decision in *Ralston Purina*, the Commission argued in *SEC v. Continental Tobacco Co*. that the "private" offering exemption was not generally available for sales of securities to anyone, but instead required that the offering be made to persons associated with the firm who had key information about the firm. See also, *Nonpublic Offering Exemption*, SEC, Sec. Act Rel. No. 33-4552 (Nov. 6, 1962) (noting that limiting an offering to a small number of investors is insufficient to qualify as a private offering unless there was also "the requisite association with and knowledge of the issuer which make the exemption available."). See also, A. C. Frost and Company v. Coeur D'Alene Mines Corporation, 312 U.S. 38, 40 (1941) (while not voiding the contracts for sale, the Court nevertheless accepted the Utah Supreme Court's prior ruling that an offering to one purchaser was a sufficient "public offering" so as to warrant registration under the Securities Act).

[14] *See, e.g.*, Rutheford B. Campbell, Jr., *The Plight of Small Issuers Under the Securities Act of 1933:Practical Foreclosure from the Capital Market*, Duke L.J. 1139 (1977), *available at* https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=2644&context=dlj.

[15] *Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales*, SEC, 47 Fed. Reg. 11251 (Mar. 16, 1982).

"rule" that is broadly construed, but instead the exemptions to it. This result is impossible to reconcile with the plain language and objectives of the federal securities laws,

The Concept Release contemplates even greater expansion of the private markets, undermining what have long been the most robust public markets in the world.

Concept Release

The Concept Release solicits comment on several exemptions from registration under the Securities Act of 1933.[16] In the release, the Commission asserts that:

> our capital markets would benefit from a comprehensive review of the design and scope of our framework for offerings that are exempt from registration. More specifically, we also believe that issuers and investors could benefit from a framework that is more consistent and addresses gaps and complexities. Therefore, we seek comment on possible ways to simplify, harmonize, and improve the exempt offering framework to promote capital formation and expand investment opportunities while maintaining appropriate investor protections.[17]

Despite offering no evidence that deregulatory efforts "promote capital formation" or "maintain appropriate investor protections", the Concept Release suggests that the Commission should continue to expand its exemptions and exceptions to the federal securities laws.[18] The Commission does not, for example, provide any evidence that capital raised in reliance on one exemption would not be raised in reliance on another exemption or the public markets, if that particular exemption was modified or unavailable. Somewhat shockingly, the Concept Release never contemplates limiting the availability of exemptions or otherwise seeking to promote the public markets. For example, the Concept Release contemplates expanding the tradability of "private" securities[19] or expanding the pool of potential investors in "private" securities to include even less sophisticated or wealthy investors, such as by modifying the "accredited investor"

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[16] Concept Release, at 1.
[17] *Id.*
[18] The Commission's "white paper" was facially inadequate, as it was based on uninformed estimates and the extremely limited data that was available. The Administrative Procedures Act and Commission Rules dictate that the Commission must provide evidence and a reasoned analysis for any determination to expand the pool of potential "accredited investors." We understand that the Commission has elected to not collect information about "private" offerings and companies that could be useful in making such an analysis. But the Commission's willful decision to not collect relevant information regarding private offerings is not a sufficient excuse to then make further uninformed policy choices. The Commission is obligated to collect and "examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'" In offering the proposals embodied by the Concept Release, the Commission has done none of those things.
[19] *See, e.g.*, Concept Release, at 193, et seq.

definition to greatly expand the number of those who qualify.[20] It does not materially contemplate adding restrictions to the tradability of private securities or constricting the definition of "accredited investors" so as to reduce the number of qualifying investors.

The changes to the securities regulatory regime contemplated by the Concept Release are in nearly exactly the opposite direction of what the Commission should be doing. The size of the private securities markets is already far out of proportion to the public markets, leading to the misallocation of resources across our economy. At the same time, the lack of transparency in these private markets exposes investors and other market participants to unnecessary risks and costs.

Worse, the Concept Release offers no evidence to suggest that any of its proposals "to improve the exempt framework" would spur any new capital formation. Nor does it offer any evidence that these proposals would protect investors, promote fair and efficient markets, or improve the allocation of capital in our economy. Not only has the Commission failed to offer actual data or evidence to support its proposals, the evidence available establishes that past efforts in the same general direction have already contributed to significant negative impacts on the capital markets and market participants.

Impact of the Rise of Private Markets on Issuers and the Broader Economy

We must begin our discussion of the impact of the rise of private markets by acknowledging how little we actually know about them. The Commission does not capture complete information about private offerings or private companies. Nor can state regulators. For example, even in the Concept Release, the Commission merely "estimates" the amounts raised, even though the amounts raised run into the trillions of dollars.

Table 2: Overview of amounts raised in the exempt market in 2018

Exemption	Amounts Reported or Estimated as Raised in 2018
Rule 506(b) of Regulation D	$1,500 billion
Rule 506(c) of Regulation D	$211 billion
Regulation A: Tier 1	$0.061 billion[39]
Regulation A: Tier 2	$0.675 billion[40]
Rule 504 of Regulation D	$2 billion
Regulation Crowdfunding; Section 4(a)(6)	$0.055 billion
Other exempt offerings[41]	$1,200 billion

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[20] *See, e.g.*, Concept Release, at 32-59.
[21] Concept Release, at 19.

Some big picture impacts are easily spotted, however. Private capital raising has surged, and the number of public companies has continued its steady decline.[22] In fact, de-listings have outpaced IPOs for most of the past decade.[23]

That said, unlike in the public markets, neither the Commission nor state regulators typically know to whom private offerings are made, who buys them, how much is sold, or what information and rights are provided. For example, the Concept Release explains, "Form D data and other data available to us on private placements do not allow us to estimate the number of unique accredited investors participating in the exempt offerings."[24]

Growing Private Capital

Increasingly, companies -- both foreign and domestic -- that are looking to sell securities to American investors are continuing to forgo the public markets as simply unnecessary for their capital raising purposes.[25] Put simply, companies are generally no longer required by law to make basic disclosures and give shareholders basic rights in order to raise the capital they need to survive and grow. So they don't.[26]

As Professor Renee Jones recently explained to Congress, "The cumulative impact of these recent changes in the federal securities laws means today's startup companies face few external or internal pressures to pursue IPOs."[27] A state securities administrator similarly explained:

> due in significant part to policy decisions by Congress and the SEC, issuers now have more options to raise money

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[22] Frank Holmes, *The Pool Of Publicly Traded Stocks Is Shrinking. Here's What Investors Can Do*, Forbes, August 13, 2018, *available at* https://www.forbes.com/sites/greatspeculations/2018/08/13/the-pool-of-publicly-traded-stocks-is-shrinking-heres-what-investors-can-do/#5b814b0b2078.

[23] We note that the two primary causes appear to be the rise of private capital raising and mergers and acquisitions activity by often already public companies. In the case of M&A activity, instead of having multiple public companies, you have one. There are certainly concerns to be raised by these circumstances, such as antitrust considerations, but we understand those to be largely outside the scope of the Concept Release.

[24] Concept Release, at 37, n.83.

[25] For example, in April 2019, Saudi Aramco sold more than $12 billion in debt using a Rule 144A offering after postponing an IPO. Interactive Brokers, *Saudi Aramco's Debut Debt Sale Sees Slick Demand*, Seeking Alpha, Apr. 10, 2019, *available at* https://seekingalpha.com/article/4253787-saudi-aramcos-debut-debt-sale-sees-slick-demand; see also, Abhishek Kumar, *Saudi Aramco IPO: Loss For Equities, Gain for Fixed Income?*, State Street Global Advisers, Sept. 5, 2018, *available at* https://www.ssga.com/blog/2018/09/saudi-aramco-ipo.htm.

[26] Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 Hastings L. J. 445 (2017), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2951158.

[27] Testimony of Renee M. Jones, Hearing on Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment, Before the House Financial Services Cmte, Subcmte on Investor Protection, Entrepreneurship, and Capital Markets,116 Cong. 2019, at 8, *available at* https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-wstate-jonesr-20190911.pdf.

> through private securities offerings than at any other time in our history. It's also easier for companies to avoid ongoing reporting obligations as a "public" company, meaning that these companies can stay private longer. In fact, whole new business models have been created to allow for, as one company calls it, "Private markets for the Public."[28]

Facebook's CEO made the point very clearly nearly a decade ago: "If you don't need that capital [from an IPO], then all the pressures are different, and the motivations [to go public] are not there in the same way."[29] Since then, the trend of staying private longer and growing larger in the private markets has accelerated. For example, at the time Facebook made its IPO, it was already held by thousands of shareholders and had billions of dollars in revenues.[30] Facebook was considered a rarity at the time. Today, there are nearly 500 so-called "unicorns" – companies that attain valuations of $1 billion or more in private markets – including 21 with valuations of more than $10 billion.[31]

Several businesses have developed to ease trading and promote access to shares of these so-called "private" companies.[32] The demand by executives and early funders to

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[28] Testimony of Michael S. Pieciak, NASAA Past-President and Vermont Commissioner of Financial Regulation, Hearing on Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment, Before the House Financial Services Cmte, Subcmte on Investor Protection, Entrepreneurship, and Capital Markets,116 Cong. 2019, at 5, *available at* https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-wstate-pieciakm-20190911.pdf (citing EquityZen, Private Markets for the Public, Mar. 18, 2019, ("Investors that previously couldn't access late-stage private companies due to investment minimums can now invest in private growth companies.") (last viewed Sept. 11, 2019).

[29] Jessica E. Vascellaro, *Facebook CEO in No Rush to "Friend" Wall Street,* Wall St. J., Mar. 4, 2010, available at https://www.wsj.com/articles/SB10001424052748703787304575075942803630712 (quoting Mark Zuckerberg).

[30] Steven Davidoff Solomon, *Facebook May Be Forced to Go Public Amid Market Gloom*, N.Y. Times, Nov. 29, 2011, *available at* https://dealbook.nytimes.com/2011/11/29/facebook-may-be-forced-to-go-public-amid-market-gloom/ (explaining that "Facebook will almost certainly have to go public during this time whether it wants to or not — and whether or not it can get a valuation of $100 billion or more in doing so. And it's partly Facebook's fault — it just has too many shareholders.").

[31]CrunchBase Unicorn Leaderboards, TechCrunch, *available at* https://techcrunch.com/unicorn-leaderboard/ (viewed Sept. 6, 2019).

[32] SharesPost Financial Corporation, *Buying or Selling Private Company Shares*, *available at* lhttps://sharespost.com/buying-or-selling-private-company-shares/?utm_source=google&utm_medium=cpc&utm_campaign=MT%20-%20Second%20Market&utm_content=second%20market%20nasdaq&utm_term=second%20market%20nasdaq&device=c&cmpgnid=126653668&adgrpid=25765210228&kw=second%20market%20nasdaq&adid=237304523185&MT=e&site=&sepos=1t1&campid=126653668&adgid=25765210228&adtype=&merchant_id=&product_channel=&product_id=&product_country=&product_language=&product_partition_id=&store_code=&loc_interest_ms=&loc_physical_ms=9058761&network=g&gclid=EAIaIQobChMI9qregJvn5AIVg4CfCh0sDgnGEAAYASAAEgJdlPD_BwE (last viewed Sept. 23, 2019); see also Nasdaq, Private Company Solutions, *available at* https://www.nasdaq.com/solutions/private-company-solutions?channel=PPC&source=Google&ppc-campaignid=1757343278&sfid=7011R0000016jBbQAI&gclid=EAIaIQobChMIuZjsv53n5AIVg4CfCh3G_ggPEAAYASAAEgIARvD_BwE (noting that "Nasdaq Private Market's liquidity solutions create pathways to secondary capital for shareholders and investors. This solution helps: Private Companies, Founders, Law

utilize these venues to sell their private shares, and for investors to access them, has grown significantly as increasingly large companies have stayed private. At the same time, the relaxation of Section 12(g) thresholds through the JOBS Act has permitted companies to stay private longer -- despite thousands of shareholders and billion dollar valuations. In fact, Facebook was ultimately thrust into the public markets because it had triggered the earlier, stricter version of Section 12(g)'s registration requirement and attendant disclosure obligations.[33] In this way, Section 12(g) acted as a backstop to ensure that large, widely-held companies would have to make basic disclosures about their governance, operations, and finances. Both as a result of creative structuring of investments[34] and the raising of the Section 12(g) triggers in the JOBS Act, this important backstop has been effectively removed.[35]

Allocations of Capital for the Economy

It should go without saying that in order to efficiently value securities, investors need information about them. Conversely, the less information that is available about securities, the less efficiently they may be priced -- leading to misallocations of capital and resources.

While the federal regulatory regime demands significant public disclosures by public companies about their governance, operations, and financials, the same requirements do not generally apply to private securities. Put another way, the "exemptions" contemplated by the Concept Release relieving companies of the requirements to disclose that information. For example, as the Commission notes in the Concept Release:

> Issuers in [Rule 506] offerings are not required to provide any substantive disclosure and are permitted to sell securities to an unlimited number of accredited investors

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Firms") (last viewed Sept. 23, 2019); see also EquityZen Inc, *available at* https://equityzen.com/ (last viewed Sept. 23, 2019).

[33] Steven Davidoff Solomon, *Facebook May be Forced to Go Public Amid Market Gloom*, N.Y. Times, Nov. 29, 2011, *available at* https://dealbook.nytimes.com/2011/11/29/facebook-may-be-forced-to-go-public-amid-market-gloom/.

[34] The calculation of shareholders of record for the purposes of Section 12(g) is complex and allows for easy evasion. Importantly, it does not simply count the number of beneficial owners. For example, EquityZen allows for investors to access private companies, but does so using a fund. This could lead to the numerous investors being classified as a single investor for the purposes of the calculation.

[35] Testimony of Renee Jones, Hearing on Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment, Before the House Financial Services Cmte, Subcmte on Investor Protection, Entrepreneurship, and Capital Markets, at 8, 116 Cong. 2019, *available at* https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-wstate-jonesr-20190911.pdf ("As such, new Section 12(g) has essentially eliminated the prospect of mandatory registration. The cumulative impact of these recent changes in the federal securities laws means today's startup companies face few external or internal pressures to pursue IPOs. These persistent unicorns present new risks for startup investors, employees and the broader society.").

> with no limit on the amount of money that can be raised from each investor or in total.[36]

This statement by the Commission would be deeply troubling to the drafters of the Securities Act of 1933, who explained:

> Whatever may be the full catalogue of the forces that brought to pass the present depression, not least among these has been this wanton misdirection of the capital resources of the Nation …
>
> The bill closes the channels of such commerce to security issuers unless and until a full disclosure of the character of such securities has been made.[37]

Without basic information about securities, it is impossible for even the most sophisticated investors to efficiently value them. Perhaps the best and most recent example of this is Uber Technologies, which made its IPO in May of this year. Just months before its public offering, but before full information was provided, press reports suggested that the company could be valued as high as $120 billion.[38] By this time, of course, the company had engaged in numerous rounds of "private" fundraising, raising billions of dollars from a large number of investors. Yet, once more complete information was released to the markets pursuant to its S-1 filings and various other communications, the company was valued at $82 billion at the time of its IPO. As of September 6, still less than three months after its IPO, the company was trading at a market capitalization of less than $55 billion.

The company hasn't lost more than half of its users or revenues in this short period or otherwise suffered a catastrophic setback. Rather, market participants were simply given more comprehensive, comparable, and reliable information about the company. That information allowed them to better analyze the company, its prospects, and ultimately its value. That's precisely what the public capital markets regulations are intended to do -- provide more (and more accurate) information to everyone so that they can properly assess the value and allocate resources efficiently to drive our economy forward. Incomplete information in private capital markets potentially misallocated $65 billion in investors' capital -- for just one company.

The situation with WeWork is similarly illustrative. SoftBank, one of the most sophisticated private investment firms in the world, invested in WeWork with a valuation

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[36] Concept Release, at 33.

[37] H. Rep. 73-85 (1933), at 2-3.

[38] Trefis Team, *How Uber Could Justify A $120 Billion Valuation*, Forbes, Dec. 3, 2018, *available at* https://www.forbes.com/sites/greatspeculations/2018/12/03/how-uber-could-justify-a-120-billion-valuation/#76b4aaf97f9b.

of $47 billion *earlier this year*.[39] In preparation of a potential IPO, the office space company began disclosing key governance and financial information. Once the marketplace had the benefit of this more complete information, the targeted valuation for the IPO fell precipitously (to around $10 billion), and the IPO has been delayed indefinitely.[40] Again, nothing materially changed about the company to reduce its value by over 75% over the course of a few months. Rather, the primary change was simply the public's access to additional information. These two companies are unfortunately not outliers.[41]

These episodes illustrate that even the largest, most sophisticated investors in private companies are not able to bargain for necessary information from founders and corporate insiders, and market mechanisms that would allow for efficient price discovery don't adequately exist outside of registration.

Far from anomalous, there have long been measured discrepancies between the valuations of securities about which less information is known than those about which more information is known. This discrepancy can be illustrated by examining the performance of companies making the transition from the private markets to the public markets. Not surprisingly, these companies have chronically under-performed for years.

Since 2010, stock prices of companies making their IPOs has trailed the Russell 3000 by a whopping 28 percentage points over their first three years of trading.[42] This year has been particularly troubling, as the largest and most well-known issuers who have gone public have been particularly poor, including Uber, Lyft, SmileDirectClub, Chewy, Slack, and now, Peloton. These disappointing statistics will deter, not attract, capital to US public capital markets.

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[39] Alison Griswold, *Softbank, WeWork's biggest investor, has lost its appetite for a WeWork IPO,* Quartz, Sept. 10, 2019, *available at* https://qz.com/1706065/softbank-wants-wework-to-shelve-its-ipo-plans/ (noting that SoftBank had invested $10 billion into the office space company, including $2 billion in investments in early 2019).

[40] Gillian Tan, Liana Baker, and Michelle Davis, *WeWork Postpones Long-Awaited IPO, Sending Its Bonds Falling*, Bloomberg, Sept. 16, 2019, *available at* https://www.bloomberg.com/news/articles/2019-09-16/wework-is-said-to-likely-delay-ipo-after-valuation-plummets?srnd=premium.

[41] *See, e.g.*, SmileDirectClub, which priced its IPO at $23 per share in early September 2019, and closed on September 24 (less than two weeks after its IPO) at a price of $15.68; see also, Lyft Inc., which priced its IPO at $72 per share in March 2019, and closed on September 24 (less than six months after its IPO) at a price of under $42 per share. This disappointing performance is far out of step with the broader public markets.

[42] Chris Mathews, *Investors beware: The typical IPO stock is a dud, says Goldman Sachs*, MarketWatch, Sept. 5, 2019, *available at* https://www.marketwatch.com/story/investors-beware-the-typical-ipo-stock-is-a-dud-says-goldman-sachs-2019-09-05.

Collectively, these facts establish a systemic market failure in the private markets that is made possible and enabled by a regulatory failure. The widespread dysfunction in the private markets is directly undermining the public markets.

The financial regulatory regime no longer sufficiently mandates adequate disclosure of enough companies, and is leading to the misdirection of hundreds of billions of dollars in investor capital. Restoring the federal securities regulatory regime to perform as Congress initially intended -- without the proliferation of exemptions and other loopholes -- would help remedy this situation.

Private Issuers and Executives Lack Accountability to Shareholders and Regulators

Private companies, in general, provide significantly less information to their shareholders and the public than is required of public companies. Neither investors in private offerings nor the government have the same type and quality of information about the companies, their financials, or their executives that would be required as part of the registration and ongoing reporting processes for public companies.

Without this information, shareholders and regulators alike are often hard-pressed to identify areas of potential concern with the company, much less press for changes to address them.[43] For example, once it was disclosed as part of its pre-IPO regulatory filings that WeWork's CEO had received nearly $6 million from the company as part of a dubious intellectual property rights transfer, public scrutiny led to the CEO returning the money to the company.[44] Similarly, prior to the IPO ultimately being scuttled, the company amended its Form S-1 filing to reflect that it had cut that same executive's proposed post-IPO voting power in half, from 20 votes per share to 10 votes per share.[45] It was also disclosed that the CEO borrowed corporate funds to buy property that he then leased back to the company. These and other failures have given rise to pressures for the company to replace the CEO.

As Tom Farley, the former President of the New York Stock Exchange, recently succinctly explained on Twitter, the

[43] We find it telling what happens when companies do decide to emerge from the private markets and expose themselves to the transparency required by the public markets. As an initial matter, as companies begin making public disclosures, a myriad of problems are often identified. These may include significant concerns regarding the company's financial condition and prospects, governance, compliance, operations, and more. *See, e.g.*, Ann Schmidt, *Adam Neumann returns $5.9M to WeWork after it paid the CEO for 'We' trademark*, Fox Business, Sept. 5, 2019, *available at* https://www.foxbusiness.com/business-leaders/wework-ceo-adam-neumann-returns-trademark-money (citing the company's amended S-1 filing).

[44] Id.

[45] BBC News, *WeWork founder Adam Neumann's voting power curbed*, Sept. 13, 2019, *available at* https://www.bbc.com/news/business-49692083 (citing We Company's recently filed amended S-1).

> Experiment (sic) of high-growth companies staying private an extra five years was a failure. Uber and WeWork floundered in private markets in last few years and would have benefited from being public
>
> ….
>
> Uber. Public markets would not have tolerated lighting a couple billion on fire in futile China effort. Bad behavior by management would have been dealt with quicker. Focus on unit economics would have happened years ago.
>
> …
>
> WeWork. Wave pools. Kindergarten. Questionable accounting. Self-dealing. Poor unit economics. The public market would have squashed this on first earnings call.[46]

We understand that many companies and their executives complain about the types of changes and disclosure obligations imposed on public companies. But, to be clear, it's not the public market regulatory regime that's creating any perceived "burden" or otherwise impairing the company.[47]

The act of making a disclosure is not a material burden on the issuer or the executive. Rather, the burden is the reaction by shareholders and the public -- be it through forcing governance changes, or operational reforms, or other measures. We don't believe that issuer or executive frustrations at being held accountable by shareholders provide sufficient basis for policymakers to enable them to avoid accountability.

There is also the question of legal liability. False statements in offering disclosures may be give rise to strict liability, which incentivizes companies to ensure their accuracy. In the private markets, however, the negative legal and financial for company misstatements may be significantly reduced. Investor lawsuits serve not only to provide recourse for injured investors, but also strongly discourage issuer misconduct. At the same time, the disclosures required by the public market regulatory regime make it easier to identify issuer or executive misconduct. Put simply, the disclosure framework of the federal securities laws improves issuer conduct and accountability.

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[46] Thomas Farley (@ThomasFarley), Sept. 22, 2019, Tweet Thread (last viewed Sept. 24, 2019).

[47] See, H.R. Rep. 73-85, at 7 ("No honestly conceived and intelligently worked out offering, floated at a fair but not exorbitant profit, will be injured by the revelation of the whole truth which these requirements seek to elicit.").

Regulators and the Public Lose Ability to Oversee Corporate Actions

The disclosures attendant with the public markets are also intended to provide regulators and the public with key insight into the governance, operations, and financials of large, widely-held companies. For example, when adopting the securities laws, Congress explicitly noted that the requirements were

> necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets.[48]

The requirements of the securities laws are not, and never were, simply about "investor protection." In fact, the disclosures mandated of public companies inform decisions in the public interest along several key areas, from responding to climate concerns, to tax policy, to foreign corrupt practices.

Perhaps the best way to illuminate the importance of the public markets is to put it into context of other issues with which the Commission and Congress have been wrestling, including:

- the impacts of so-called ESG factors,[49] -- ranging from environmental concerns to human capital management to international tax practices -- that are typically disclosed by companies in the public markets only;[50]
- the utility and applicability of the proxy process, which generally applies to companies that are in the public markets only;
- the applicability of mandatory investor arbitration provisions, which have historically not existed in the public markets;

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[48] 15 U.S. Code § 78b. Necessity for regulation.

[49] *Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social and Governance Disclosures*, Hearing before the Cmte on Financial Services, Subcmte on Investor Protection, Entrepreneurship and Capital Markets, 116 Cong. (2019), webcast and written statements available at https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=404000.

[50] Id., (Testimony of James Andrus, CalPERS, at 3)("This raises an important point for today's discussion: most of the ESG-related policy dialogue focuses only on the public markets. Moving forward, we encourage you to also consider how important ESG issues like those we are discussing today can be carried into the non-public market space as well.").

- the applicability of the SEC's rules regarding trading practices and general trading oversight, which generally apply to the public markets only; and
- the SEC's funding regime, which relies on transaction fees in the public markets.[51]

But there are countless more benefits to transparency. For example, if a company subject to Exchange Act obligations engages in wrongdoing, it has to tell the public what it did.[52] There may be no other way for US regulators or the public to learn of wrongdoing by the company. There is no similar obligation for private companies.

The disclosure obligations of the federal securities laws thus perform an important public interest function of ensuring that large, widely held companies and other public companies operate with a baseline of public accountability. The Concept Release contemplates reducing this accountability, but offers no justifications for its decision, much less any data or analysis to support its determinations.

Large Capital Misallocations Can Create Systemic Risk

The lack of robust securities regulation over more than two thirds of new capital raises gives rise to significant systemic risks. It's worth remembering that the Great Depression began when lightly regulated securities were offered and sold to investors without sufficient key information -- much like private securities today. Similarly, a significant portion of the mortgage-related products that were the foundation of the financial crisis were made through private offerings.

Currently, two key investment areas come to mind: leveraged loans and Bitcoin-related financial products. Leveraged loans are treated as though they are outside of the "securities" regulatory framework. Like the commercial mortgage backed securities of 2007, the details are often not universally known at the time of offering, nor are there necessarily requirements to provide the same information and rights to investors after the initial offering. Nevertheless, many experts and policymakers are already beginning to question whether these products may be giving rise to significant risks.[53] The House

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[51] See SEC, Fast Answers: Section 31 Transaction Fees, *available at* https://www.sec.gov/fast-answers/answerssec31htm.html (last viewed Sept. 24, 2019).

[52] Testimony of Elisabeth de Fontenay, Hearing on Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment, Before the House Financial Services Cmte, Subcmte on Investor Protection, Entrepreneurship, and Capital Markets, 116 Cong. 2019, *available at* https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-wstate-jonesr-20190911.pdf.

[53] *See, e.g.*, Jesse Hamilton, *Leveraged-Loan Peril Demands Action by Mnuchin, Key Senator Says*, Bloomberg, Apr. 11, 2019, *available at* https://www.bloomberg.com/news/articles/2019-04-11/key-senate-democrat-urges-mnuchin-to-step-up-on-leveraged-loans.

Financial Services Committee's Subcommittee on Consumer Protection and Financial Institutions held a hearing on this topic in June.[54]

But these leveraged loans raise an important question. If they were sold with the same types of disclosures that accompany registered offerings, would they be giving rise to the same perceived risks to investors or the economy?

The situation regarding Bitcoin products raises even more questions. The Commission has repeatedly rejected requests to permit Bitcoin ETFs, and the staff has articulated several concerns with the products, including how the ETF is valued and how the markets could be manipulated.[55] An asset management firm that has been attempting to have a Bitcoin ETF product approved for several years recently announced that -- without responding to any of the SEC's articulated concerns -- it plans to start selling the product anyway as a "private" offering to institutional investors.[56] Is this good for our markets or investors?

Impacts on Investing in Public Companies Versus Private Companies for Investors

The shift to the private markets as the primary engine for capital raising has had significant impacts on investors. When compared to private securities, public securities typically offer a number of significant advantages for investors, including:

- Public securities typically are accompanied by more robust accounting and financial practices;
- Information about public companies, including third party research, is much more readily available and fairly distributed (as required by SEC rules);
- Public securities are far more easily and reliably valued;
- Investors in public securities often have far more (and more equal) rights;
- Public securities offer a transparent and efficient method to liquidate shares of common stock;

[54] *Emerging Threats to Stability: Considering the Systemic Risk of Leveraged Lending*, Hearing before the House Financial Services Cmte, Subcmte on Consumer Protection and Financial Institutions, 116 Cong. (2019), *available at* https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=403827.
[55] Letter from Dalia Blass, SEC, to Paul Schott Stevens, ICI, and Timothy Cameron, SIFMA Asset Mgmt Group, Jan. 18, 2018, *available at* https://www.sec.gov/divisions/investment/noaction/2018/cryptocurrency-011818.htm.
[56] Paul Vigna, *Van Eck, SolidX to Offer Limited Version of Bitcoin Exchange-Traded Fund*, Wall St. J., Sept. 3, 2019, *available at* https://www.wsj.com/articles/van-eck-solidx-to-offer-limited-version-of-bitcoin-exchange-traded-fund-11567503003.

- Liquidity risks and trading costs for public securities are often significantly lower than for similarly-situated private securities;
- Public securities are much more easily benchmarked, such as against the S&P 500; and
- Actual net performance tends to be at least as good, if not better, for institutional investors (and is markedly better for less sophisticated investors).

Accounting and Financial Practices

When compared to accounting and auditing for private companies, public company accounting and auditing practices are heavily regulated and policed.[57] In fact, many of the proponents of the exemptions and exceptions to the securities regulatory requirements assert as their justifications a desire to relieve issuers from perceived "overly burdensome" requirements on public companies. However, for investors, these accounting and auditing standards -- and the legal liability that accompanies them -- ensure that companies are providing accurate and comparable financial information that can be relied upon to determine values for the company.

There is a stark contrast between the picture of a company's health that may be painted by audited financials and other, more issuer-friendly, accounting and financial reports. In the public markets, SEC Chairs in both Democratic and Republican Administrations have highlighted risks and concerns with public companies' use of less-stringent, non-GAAP accounting reporting.[58]

Concerns with accounting and financial reporting accuracy may be best highlighted by example. In May 2018, Peloton's CEO and Co-Founder John Foley declared in a CNBC interview that the bike company was "weirdly profitable."[59] We suspect that would-be investors and market participants likely interpreted his comments as suggesting that the company had "net income."[60] It didn't. Now, as the company has made audited financial

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[57] Following the Enron and Worldcom scandals, Congress established the Public Company Accounting Oversight Board to help ensure high quality auditing practices at public companies. No such entity (or effort) exists in the private investment context.

[58] See Remarks by Hon. Mary Jo White, SEC, Before the International Corporate Governance Network Conference, June 27, 2016, *available at* https://www.sec.gov/news/speech/chair-white-icgn-speech.html ("I have had significant concerns about companies taking this flexibility too far and beyond what is intended and allowed by our rules. In too many cases, the non-GAAP information, which is meant to supplement the GAAP information, has become the key message to investors, crowding out and effectively supplanting the GAAP presentation."); and Ken Tysiac, *SEC urges consistency in non-GAAP reporting*, Journal of Accountancy, Dec. 10, 2018, *available at* https://www.journalofaccountancy.com/news/2018/dec/sec-urges-consistency-non-gaap-reporting-201820253.html (citing SEC Chairman Clayton and Chief Accountant Wes Bricker).

[59] John Foley, Interview with CNBC, May 23, 2018, *video available at* https://www.youtube.com/watch?v=kAdp0R8B_rU.

[60] *See generally*, Merriam-Webster, Definition of "profit", *available at* https://www.merriam-webster.com/dictionary/profit.

disclosures in preparation for its anticipated IPO, it is clear that the company was not then, is not now, and is not expected to be profitable anytime soon.[61] Last week, the company priced its IPO at the high-end of its range, for a valuation of $8.1 billion.[62] By the end of the week, the company's market cap had fallen over 10%.

Similarly, in 2016, Forbes and The Real Deal both reported -- based on information leaked by WeWork executives or explicitly provided by its CEO -- that WeWork had been profitable for years.[63] It wasn't. Ultimately, as WeWork prepared for an IPO, it made audited financial disclosures that indicated that not only was it not profitable, it "may be unable to achieve profitability at a company level (as determined in accordance with GAAP) for the foreseeable future."[64]

There are few more important reference points for investors seeking to value a security than a company's profitability and financials. Yet, investors and the public are able to get far more reliable financial information in the public markets than in the private markets.

The Concept Release does not address, much less identify, quantify, or analyze the impacts of its proposals on having robust standards for accounting and financial practices, including the changes' disparate impacts on investors, and its overall impact on the markets. It must.

Access to Key Information and Investment Research

In the public markets, companies provide certain required information about their operations, finances, and governance on a regular basis (e.g., quarterly and annual reports), but also whenever anything particularly significant happens.

In the "private" securities markets, issuers and investors often negotiate the information and rights for the investors both at the time of the offering and thereafter. And there are typically no requirements that information be widely disseminated.[65] Thus, the federal securities laws level the playing field between issuers and investors, as well as between different investors. For example, it is illegal for an executive to selectively disclose

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[61] Jean Eaglesham, *Unicorns' Pre-IPO Profit Claims Get Scrutinized*, Wall St. J., Sept. 22, 2019, *available at* https://www.wsj.com/articles/unicorns-pre-ipo-profit-claims-get-scrutinized-11569172817. Perhaps what the CEO meant by "weirdly", was "un."

[62] Lauern Hirsch and Amelia Lucas, *Peloton slides after opening below IPO price in market debut,* CNBC, Sept. 26, 2019, lhttps://www.cnbc.com/2019/09/26/peloton-pton-ipo-stock-starts-trading-at-27-per-share.html.

[63] See, Jean Eaglesham, *Unicorns' Pre-IPO Profit Claims Get Scrutinized*.

[64] The We Company, Form S-1, at 25, Aug. 14, 2019, *available at* https://www.sec.gov/Archives/edgar/data/1533523/000119312519220499/d781982ds1.htm.

[65] While the antifraud provisions of federal and state securities laws may provide some protections, these protections may be remarkably limited based on the timing of disclosures, content, and reliance. Put simply, investors' seeking to recover for losses or regulators seeking to pursue an action arising from a false statement made on a S-1 filing are subject to a fundamentally different legal standard than if they are seeking to enforce their rights relying on traditional fraud statutes.

information to selected research analysts or investors, but not others,[66] a point the SEC has recently reiterated through an enforcement action.[67]

This lack of consistent information and treatment of investors in the private markets raises significant concerns of fairness and efficiency for investors and the markets.[68] This type of discrimination is likely to disproportionately negatively impact smaller, less connected players, such as smaller institutions or so-called “retail” investors.[69]

Further, it is well-understood that reliable, widely available research coverage is essential to robust investment in companies, a point the Commission and Congress have reiterated several times over recent years. The Concept Release would predictably reduce the overall amount of research available and widen the gap between investors.

The lack of regular and significant disclosures by companies in the private markets often stifles third-party investment research, as there is generally no way to access information. It can also severely impair the quality of the research that is available because that research may be based on limited or skewed information. Put simply, there are already significant concerns with the availability of investment research in smaller public companies -- about which key information is actually available. Expanding the private markets -- as the Concept Release contemplates -- would exacerbate this concern.

The Concept Release does not address, much less identify, quantify, or analyze the impacts of its proposals on the loss of information about companies, including its disparate impacts on investors, and its overall impact on the markets. It must.

Investor Rights

In the private markets, investors and issuers may individually negotiate the information and rights afforded to each investor. In fact,

> it’s very common for differential rights in private firms... This is really the opposite of the public markets, where … everyone has the same rights. Everyone has the same information.[70]

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[66] 17 C.F.R. § 243.100, et seq.

[67] *See, e.g., In the Matter of TherapeuticsMD, Inc.*, SEC, Exch. Act Rel. No. 86708 (Aug. 20, 2019), *available at* https://www.sec.gov/litigation/admin/2019/34-86708.pdf.

[68] Testimony of Elisabeth de Fontenay.

[69] Testimony of Elisabeth de Fontenay; see also, Statement of Hon. Alexandria Ocasio Cortez, Id., (beginning at 1:08:30 in the video *available at* https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=404232#Wbcast03222017 (noting that “investors that have sufficient bargaining power” may negotiate for access to audited financial statements or other key information, but that “retail investors are extraordinarily unlikely to get it.”).

[70] Testimony of Elisabeth de Fontenay.

Thus, in the private markets, investor rights -- much as access to key information about the companies themselves -- are left to the bargaining power of the parties. This will naturally favor those with greater economic clout and access over those with less, such as smaller institutions or retail investors.

The Concept Release does not address, much less identify, quantify, or analyze the impacts of these changes in investor rights, including their disparate impacts on investors, and its overall impact on the markets. It must.

Valuation and Pricing

In the public markets, stock prices and valuations are publicly available and widely distributed. While these prices may be subject to significant variations, those variations are based upon widely available information and the judgements of numerous, often diverse market participants. In the private markets, prices are not generally widely available, nor is the information that would reasonably be necessary to make informed determinations about prices -- points that are well-illustrated by WeWork's recent woes.

The Concept Release not address, much less identify, quantify, or analyze the impacts of its proposed changes to the availability of values of companies, including their disparate impacts on investors, and its overall impact on the markets. It must.

Ease of Trading and Costs

From an investor's perspective, trading private securities is much, much riskier and more costly than trading public securities. First, an investor may not even be able to sell a private security. Second, even if an investor can buy or sell, the price at which the investor can trade generally isn't widely available. Compared to public securities, private securities are much more difficult to value. That's because there is much less information available about them, and that information may be selectively disclosed. The investor may have to go back to the investment bank who helped broker the deal or the company itself in order to be given a suggested price. Investors often do not know potential contra-sides of their trades, putting them at distinct disadvantages for negotiating prices.

Many pension funds and other conservative institutional investors have self-imposed limits on how much they can invest in these markets because of the much greater costs and risks.[71] At the same time, many of these investors are also deeply concerned about

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[71] See Arleen Jacobius, Private equity, real assets make gains with funds wanting safety, Pensions & Investments, Feb. 4, 2019, *available at* https://www.pionline.com/article/20190204/PRINT/190209966/private-equity-real-assets-make-gains-with-funds-wanting-safety (“Across *P&I*'s top 200 universe, private equity accounted for 8.7% of the aggregate defined benefit allocation as of Sept. 30, compared with 8% as of Sept. 30, 2017. Public pension plans had the largest average percentage of their portfolios in private equity at 9.3% as of Sept. 30, up from 8.8% in the year-earlier survey. Among corporate plans, private equity was up to 6.2% from 5.7%, and the average exposure among union plans was 5.8%, a slight increase from 5.7% as of Sept. 30, 2017.”).

missing out on the increasing number of quality investment opportunities that are now in the private markets. So, while many of these investors are concerned with the risks, pressured to chase investment opportunities, many of them are increasing their allocations to private market investments and simply absorbing the greater risks and costs.[72] That said, there is growing research to suggest that even sophisticated institutional investors may not outperform in the private markets versus public markets.[73]

But there are also commissions. The explicit costs of making investments in the first instance may be significantly higher than those in public equities. For example, fees for Equity Zen, a leading "private markets" venue that advertises that it is "for the public" explains that its fees for investments are 5% for all investments up to $500,000, 4% for investments between $500,000 and $1 million, and 3% for investments of $1 million and up.[74] By contrast, the commissions charged to a "retail" customer making a $50,000 investment would be in the neighborhood of 0.01%[75] or nothing. Thus, for an investor seeking to make a $50,000 investment in a private stock on Equity Zen, the difference in upfront costs is as much as $2500 -- and that is before any potential maintenance or fund fees, much less costs for selling the investment (which could double the costs).

While the magnitudes of these fees may change somewhat for institutional-sized traders, the difference in transaction costs between private and public securities is still significant. A broker-dealer trading on behalf of an institutional client may charge a commission on a public stock trade of $0.005/share. By way of contrast, the fee assessed on a similar sized private stock acquisition or sale is often orders of magnitude greater. This is just a transaction cost that doesn't go to either the issuer or the investor -- so it does not benefit capital formation or investor returns, but instead goes to the intermediaries.

[72] Arlene Jacobius, *CalPERS not alone on private equity shift*, Pensions & Investments, Apr. 1, 2019, *available at* https://www.pionline.com/article/20190401/PRINT/190409988/calpers-not-alone-on-private-equity-shift.

[73] *See, e.g.*, Robert S. Harris, Tim Jenkinson and Steven N. Kaplan, *How Do Private Equity Investments Perform Compared to Public Equity?*, 14 J. Inv. Mgmt. 14, 15 (2016), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2597259 (finding that, post-2005, returns were about equal between private and public markets investments by institutional investors).

[74] Equity Zen, *FAQ: Are there investment fees*, *available at* https://equityzen.com/faq/ (last visited Sept. 22, 2019). These fees are assessed upfront, but the company doesn't currently charge any annual or ongoing fees thereafter--despite the fact that the investments are technically made through a fund managed by an Equity Zen affiliate. Equity Zen, *FAQ: How are the investments structured*, available at https://equityzen.com/faq/ (last visited Sept. 22, 2019).

[75] ETrade*, *Pricing and Rates*, *available at* https://us.etrade.com/what-we-offer/pricing-and-rates (reflecting online stock, option, and ETF trades for $6.95/trade) (assuming the same dollar equity trade of $50,000 as reflected in the Equity Zen FAQ, the $6.95 trade equates to a 0.01% fee) (last visited Sept. 22, 2019).

The Concept Release not meaningfully identify, quantify, or analyze the impacts of its proposed changes on the ease and costs of trading securities, including their disparate impacts on investors, and its overall impact on the markets. It must.

Benchmarking

One key distinction between public markets and private ones is the ability to benchmark and compare assets, risk profiles, and returns. With less information widely available about securities in the private markets, more guessing and judgment are generally required for any benchmarking or indexing. This makes it extremely difficult to compare investments -- and may allow for inaccurate assessments of fees and overall investment returns.

The Concept Release does not meaningfully identify, quantify, or analyze the impacts of its proposed changes on the ability of investors and other market participants to benchmark and provide reliable indexes of securities, including their disparate impacts on investors, and its overall impact on the markets; it certainly should.

Opportunity and Performance

With most of all capital now raised in the private markets, Chairman Clayton, some members of Congress, and other policymakers have expressed the view that more investors need to have access to the potential "opportunities" in the private markets. This logic is fundamentally flawed, for several reasons.

First, for well over a decade, the returns in private markets are no better than those of the public markets.[76] While a handful of companies have grown exponentially and showered early investors and executives with significant returns, a very large share of private securities perform very poorly.[77] Put simply, the performance of private securities -- particularly as reported by trade associations and others -- has been overstated.

Second, there is no evidence that expanding access to even less-sophisticated investors to the markets in general is likely to result in expanding their access to "better"

[76] *See, e.g.*, Ludovic Phalippou & Oliver Gottschalg, *The Performance of Private Equity Funds*, 22 REV. FIN. STUD. 1747 (2009); see also Robert S. Harris, Tim Jenkinson & Steven N. Kaplan, *How Do Private Equity Investments Perform Compared to Public Equity?*, 14 J. INV. MGMT. 14, 15 (2016); Ludovic Phalippou, *Performance of Buyout Funds Revisited?*, 18 REV. FIN. 189, 189 (2014); Ludovic Phalippou & Oliver Gottschalg, *The Performance of Private Equity Funds*, 22 REV. FIN. STUD. 1747, 1747 (2009); Berk A. Sensoy, Yingdi Wang & Michael S. Weibach, *Limited Partner Performance and the Maturing of the Private Equity Industry*, 112 J. FIN. ECON. 320, 341-42 (2014).
[77] Notably, given the high rate of failures and underperformance, many of the most sophisticated private market investors thus seek to hold securities of a wide number of companies, so as to maximize their possibilities of obtaining a "hit." However, the average overall returns tend to be significantly lower than the most successful investments.

investment opportunities. "So the odds that you would get in early in Uber, for example, that you would even have access to the promising startups is extraordinarily remote."[78]

Third, given the issues highlighted above, it's not surprising that private companies provide "considerable risk" over public companies, and "the failure rate is very high" in private companies.[79] Thus, even if it could be shown (and it hasn't been) that some investors earned better returns in the private markets, those excess returns would almost certainly be a reflection of the significantly greater risk absorbed to seek those returns.[80]

Fourth, because of the concerns with information transparency and fees, the price appreciation of private companies would have to considerably out-perform that of public companies in order to overcome the dramatically higher costs. Unfortunately, there is little evidence to suggest that such performance is consistently available, or if so, that it is as readily available to the full panoply of investors.

The Concept Release not meaningfully identify, quantify, or analyze the impacts of its proposed changes on the ability of investors and other market participants to access private offerings, including their disparate impacts on investment performance, and its overall impact on the markets. It must.

Similar Congressional and Commission Efforts to "Promote Capital Formation" Have Harmed Investors and the Markets

Recent experiences with rolling back securities regulations have not worked well. And the available evidence suggests that none of these efforts have materially spurred any new capital investment or jobs.

That doesn't mean to say that issuers won't take advantage of lesser disclosure or governance obligations. They likely will. But there is no evidence that investors or the markets materially benefited from those lesser requirements. For example, pursuant to Title I of the JOBS Act, companies were able to take advantage of a new classification of public company that had lower obligations than a "normal" public company. At the time, members of Congress and the Commission suggested that it would "spur" IPOs. Despite the fact that the vast majority of issuers in IPOs after the law's passage have taken advantage of the designation, there is no material evidence that the IPOs occurred because of the new, lesser regulatory requirements, or that additional capital

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[78] Testimony of Elisabeth de Fontenay.
[79] Testimony of Elisabeth de Fontenay.

[80] Testimony of Elisabeth de Fontenay, at 7, n.9.

was raised. And even if there were such evidence, there is no evidence that such a result would be advantageous for investors, the markets, or the economy overall.

Making it easier for a company to fleece investors may allow the company to raise more capital, but that would clearly be inconsistent with the public interest. Unfortunately, there is substantial evidence that some of these reforms have materially harmed investors. For example, the JOBS Act created, and the SEC has now implemented, so-called Regulation A+, which is essentially an exemption that allows for the public offering and trading of securities with far-lower disclosure obligations than are generally required for registered public offerings. Over one hundred companies have made filings to suggest that they were going to make such an offering. While the majority of Regulation A+ offerings are not sufficiently publicly traded to allow for tracking of their performance, those that have been listed on the NYSE and Nasdaq have performed poorly.[81] As Barron's reported:

> Investment returns are hard to find, mainly because only a few dozen of the 300-odd Reg A+ stocks have gotten so far as to list on the NYSE, NASDAQ, or OTC markets, where you can trade or at least get a price quote. Those include a handful of community banks and one outfit carried high on the recent blockchain froth. Excepting those, the average Reg A+ stock fell 40% in the six months after its mini-IPO and has underperformed the raging bull market surrounding them by nearly 50 percentage points.[82]

Worse, Longfin (the one company that performed "well") has subsequently had its assets frozen in an emergency fraud enforcement lawsuit by the SEC -- just months after its mini-IPO.[83]

The Myth that the Securities Laws Aren't Needed to Apply to Sales to "Sophisticated Investors"

Several decades after the securities laws were passed, the Commission began to create exemptions from the securities regulatory framework. Most of these exemptions hinge, in part, upon the purported "sophistication" of the ultimate investors. Commission rules thus hinge potential exemptions to whether investors meet specific standards, such as whether they are "qualified purchasers," "accredited investors," or "qualified institutional buyers." In each case, the Commission has determined that the purchasers

[81] Bill Alpert, Brett Arends, and Ben Walsh, *Most Mini-IPOs Fail the Market Test*, Barron's, Feb. 13, 2018, *available at* https://www.barrons.com/articles/most-mini-ipos-fail-the-market-test-1518526753.
[82] Id.
[83] Complaint, *SEC v. Longfin Corp. et. al.*, 18 Civ. 2977, Apr. 4, 2018 (S.D.N.Y.), *available at* https://www.sec.gov/litigation/complaints/2018/comp-pr2018-61.pdf.

are sufficiently sophisticated as to not warrant the protections and the benefits of the securities laws.

There are three deeply troubling flaws with this current regulatory approach--much less with the expansion of it that is contemplated under the Concept Release.[84]

First, the "sophisticated investor" construct, which seems to nearly exclusively arise from dicta from a decades-old Supreme Court case,[85] is simply inconsistent with the plain meaning and intent of the original securities laws. In the seminal case *SEC v. Ralston Purina, Co*, the Supreme Court was asked to determine whether the company was exempt from having to register its offering of securities to several of its senior executives on the basis that the offering was not to the "public."[86] The company conceded that if it had offered the securities to all of its employees, it would have been a "public" offering requiring registration.[87] The Court held that the offering was, in fact, a public offering. In exploring what the word "public" should mean in this context, the Court explained that

> manifestly, an offering of securities to all redheaded men, to all residents of Chicago or San Francisco, to all existing stockholders of the General Motors Corporation or the American Telephone & Telegraph Company, is no less 'public,' in every realistic sense of the word, than an unrestricted offering to the world at large. Such an offering, though not open to everyone who may choose to apply, is nonetheless 'public' in character, for the means used to select the particular individuals to whom the offering is to be made bear no sensible relation to the purposes for which the selection is made.[88]

The Court then explained that:

> Since exempt transactions are those as to which "there is no practical need for . . . [the bill's] application," the applicability of § 4(1) should turn on whether the particular class of persons affected need the protection of the Act. An offering to those who are shown to be able to fend for themselves is a transaction "not involving any public offering."[89]

[84] We wish to highlight this section as responding to questions 20-31 of the Concept Release.
[85] *SEC v. Ralston Purina, Co.*, 346 U.S. 119 (1953).
[86] *Ralston Purina* (examining the applicability of Section 4(1) of the Securities Act of 1933).
[87] *Ralston Purina*, at 122.
[88] *Ralston Purina*, at 122-123.
[89] *Ralston Purina*, at 125.

The Commission seems to suggest that this language would end the matter. It doesn't. Rather, the Court continued:

> But, once it is seen that *the exemption question turns on the knowledge of the offerees,* the issuer's motives, laudable though they may be, fade into irrelevance. The focus of inquiry should be on the need of the offerees for the protections afforded by registration. *The employees here were not shown to have access to the kind of information which registration would disclose.* The obvious opportunities for pressure and imposition make it advisable that they be entitled to compliance with § 5.[90]

Put simply, the Court did not hold that the question turned the "sophistication" of the offerees, nor did it even suggest that there is a class of investors with sufficient level of "sophistication" so as to not warrant the benefit of the securities laws -- as the Commission and others have erroneously suggested for years.

Rather, the Court explicitly ruled that the question "turns" on the "knowledge" of the offerees.[91] And as if that weren't sufficiently clear, the Court continued by focusing on whether the investors had "access to the kind of information which registration would disclose."[92] The Court then held that the offering was a public offering, even though it was made to company employees.

This connection to knowledge and the company was carried through subsequent court cases and by the Commission itself. For example, following *Ralston Purina*, the Commission issued guidance to combat "an increasing tendency to rely upon the exemption for offerings of speculative issues to *unrelated and uninformed persons*."[93]

Second, no matter what the level of sophistication of an investor, an investor needs sufficient information upon which to make reasoned decisions. As the Fifth Circuit has explained:

> there must be sufficient basis of accurate information upon which the sophisticated investor must be able to exercise his skills. Just as a scientist cannot be without his specimens, so the shrewdest investor's acuity will be blunted without specifications about the issuer. For an investor to be invested with exemptive status he must have the required data for judgment.[94]

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[90] *Ralston Purina*, at 126-127 (emphasis added).
[91] *Ralston Purina*, at 126.
[92] *Ralston Purina*, at 127.
[93] *Nonpublic Offering Exemption*, SEC, Sec. Act Rel. No. 33-4552 (Nov. 6, 1962).
[94] *Doran v. Petroleum Management Corp*., 545 F.2d 893 (5th Cir. 1977).

It is impossible to reconcile this basic information requirement with the lack of any information requirements embodied in the Commission's current exemption regime.[95]

At the same time, recent history is replete with examples of even the most sophisticated private market investors making clearly erroneous judgments regarding private securities based on a lack of information.[96]

Further, a review of hundreds of recent regulatory enforcement cases or review of the financial crisis will quickly demonstrate that even the most sophisticated investors have repeatedly proven incapable of protecting themselves and the broader economy from disaster without adequate information.

The Commission has offered no evidence to suggest that any of its different layers of "sophisticated" investors -- be they "qualified purchasers," "accredited investors," or "qualified institutional buyers" -- is less likely to make poor investment decisions or is less likely to be victimized by fraud. Similarly, the Commission has offered no evidence that the persons to whom the Commission is contemplating further expanding this "privilege" are also capable of protecting themselves with no information.

Third, the current reliance of the regulatory regime upon an investor's wealth, income or regulatory status to determine their "sophistication" is misplaced. Wealth and income are poor proxies for "sophistication," a point that House Financial Services Committee Ranking Member Patrick McHenry colorfully illustrated in his remarks at hearing earlier this month.[97] Again, the Commission has offered no evidence that these classes of investors are less likely to suffer investment losses due to poor investment choices or fraud than the average population. And, as described above, even if this were true, it would still be facially inconsistent with other objectives of the securities laws, the Commission's past interpretations, and key relevant case law.

Fourth, the "accredited investor" definition, along with the definitions of "qualified purchasers" and "qualified institutional buyers," impacts the entire ecosystem of capital formation -- not just those who qualify for them.

These thresholds directly impact the information available about a security that is exempt from registration due to reliance on them, and so impacts the ability of market participants to efficiently value that security.

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[95] *See, e.g.*, Concept Release, at 33 ("Issuers in [Rule 506] offerings are not required to provide any substantive disclosure and are permitted to sell securities to an unlimited number of accredited investors with no limit on the amount of money that can be raised from each investor or in total.").

[96] Supra, at 9-12.

[97] Statement of Hon. Patrick McHenry, Hearing on Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment, Before the House Financial Services Cmte Subcmte on Investor Protection, Entrepreneurship, and Capital Markets, 116 Cong. 2019, *available at* https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-wstate-jonesr-20190911.pdf ("Because there is a societal decsion that if you're not a high net worth individual, you're dumb, and that is implicit in securities regulation.").

As the Concept Release explicitly notes, issuers of private offerings need not disclose anything in particular when making a private offering.[98] This means that when a company is able to sell to only "accredited investors," for example, the information necessary to determine the value of the company may very likely not be available. By contrast, when a company is "public," the issuer discloses significant details about its governance, operations, and financials -- all of which inform the efficient valuation of the security. The definitions of "qualified purchaser," "accredited investor," and "qualified institutional buyer" thus directly impact the overall efficiency of the capital markets writ large -- not just the investment risks of any particular qualifying investor.

For example, many of the financial products underpinning the financial crisis (e.g., collateralized debt obligations), were often sold as private offerings that lacked key information.[99] Without adequate information, even sophisticated investors made poor capital allocation decisions, and a worldwide financial crisis was born. Good businesses in both the public and private markets went un- or under-funded. Millions of families and businesses around the world -- not just those who had direct exposure to these securities -- were impacted. Unsurprisingly, following that crisis, several experts called for the elimination or reduction of some exemptions from the federal securities laws, such as Rule 144A.[100]

Expanding the pool of potential investors in private offerings by revising the "qualified purchaser," "accredited investor," or "qualified institutional buyer" definitions will -- to some degree -- result in a decrease in the overall information available about companies. Notably, neither the Commission nor any commenters have attempted to explain, quantify, or justify this net loss of information. Nor have they provided any data or analysis of the impact on investors, issuers, or the economy.

The Commission should work with Congress to abandon the flawed premise that the securities laws should only be applied to some subset of investors. Rather, the securities laws should only be relieved when the information required by them about a company's governance, operations, and financials is otherwise available. If not abandoned, the criteria to meet such standards should be sufficiently high so as to ensure that investors are financially capable of withstanding the maximum possible loss. Accordingly, any such investments should be limited to not more than a *de minimis*

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[98] *See, e.g.*, Concept Release, at 33.

[99] See *Wall Street and the Financial Crisis: Anatomy of a Financial Collapse*, Majority and Minority Staff Report of the Permanent Subcmte on Investigations, Senate Cmte on Homeland Sec. and Gov't Affairs, 112 Cong. (2011), *available at* https://www.hsgac.senate.gov/imo/media/doc/PSI%20REPORT%20-%20Wall%20Street%20&%20the%20Financial%20Crisis-Anatomy%20of%20a%20Financial%20Collapse%20(FINAL%205-10-11).pdf.

[100] *See, e.g.*, Jeff Madrick and Stephen Diamond, *A "Modest Proposal" for Capital Market Reform: Close Down Rule 144A*, HuffingtonPost, (May 25, 2011), *available at* https://www.huffpost.com/entry/a-modest-proposal-for-cap_b_564989?guccounter=1&guce_referrer=aHR0cHM6Ly93d3cuZ29vZ2xlLmNvbS8&guce_referrer_sig=AQAAAMAHB5GFI5wQoB3PCBE-c6j8dzrrR5da90U19J3Mrh3OSymyxsgkmNEuWv3998bR3LbTdAZ0_xLxli6qGVzhIEENPmMTG30s7xQCTQgAvX7upHALYO52bg4WyMGLHMBmyvix9za-iJUd1Emj2Pd4MXwk-WHMTnsBiGl7TfyYxuvI.

portion of an unaffiliated individual's total investable assets (excluding primary residence).

What Should the Commission Do to Enhance the Public Markets?

We urge you to remember that the role of the public markets is to ensure companies that offer securities to the public, or that are large and widely held, provide sufficient information to allow for accurate valuations, and the efficient allocation of capital to drive our economy. Further, as the courts and even the Commission have noted over the years, the exemptions to that regime should be narrowly construed.

We recommend the Commission take a four-pronged approach.

- First, we urge the Commission to pause the creation and expansion of exemptions and exceptions from the federal securities laws.
- Second, we urge the Commission to take efforts to ensure that the Commission and the public have more information about private offerings and private companies. One easy way to ensure market participants and regulators have some of this basic information would be to require significantly more information from those who wish to avail themselves of the existing exemptions, such as by hinging reliance on Regulation D on the filing of a closing Form D that would contain significantly greater information. In addition, the Commission should conduct a comprehensive review of each exemption and how it is used, by whom, and the extent to which it is undermining investors and the public markets.
- Third, we urge the Commission to consider curtailing or eliminating some of the obvious failures of past efforts to spur capital formation. For example, since its creation in the JOBS Act, Regulation A+ has been a disaster for investors. NYSE has become so concerned with the poor quality of these securities that it has stopped accepting them for listing. Nasdaq is also pulling back. Reg A+ should be dramatically revised to raise its requirements or effectively eliminated.
- Fourth, we urge the Commission to consider curtailing the existing exemptions and seek to pull the huge new swath of massive, widely held "private" companies into the light of the SEC disclosure regime. One approach would be to revise Section 12(g) in a way that would require more widely-held companies to meet ongoing reporting and other requirements of the federal securities laws. This approach, which has been suggested by Renee Jones,[101] could be achieved without legislative intervention, would not impact offerings by smaller companies,

[101] Testimony of Renee M. Jones, Hearing on Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment, Before the House Financial Services Cmte, Subcmte on Investor Protection, Entrepreneurship, and Capital Markets, 116 Cong. 2019, *available at* https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-wstate-jonesr-20190911.pdf.

but would instead ensure the public and investors benefit from increased transparency as the companies grow.

Conclusion

Thank you for the opportunity to offer our comments to this Concept Release. Please feel free to contact me with any questions or follow up at [redacted] or by email at [redacted]

Sincerely,

Tyler Gellasch
Executive Director