Securities Regulation Daily Wrap Up, TOP STORY—Advisory committee shares how COVID-19 is affecting small businesses, (Apr. 2, 2020)

Securities Regulation Daily Wrap Up

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By Anne Sherry, J.D.

The SEC Small Business Capital Formation Advisory Committee held an ad hoc, remote meeting to discuss the pandemic's impact on small businesses.

At a remote meeting also attended by SEC Chairman Jay Clayton and Commissioners Hester Peirce and Allison Herren Lee, members of the Small Business Capital Formation Advisory Committee shared a mostly grim outlook on the effects of the coronavirus outbreak on small businesses. In her comments, Commissioner Peirce reiterated her support for a micro-offering exemption as a way for entrepreneurs to raise capital. Several committee members welcomed the idea and offered additional ideas for the SEC to consider or pass along to its sister agencies.

Committee members spoke about the immediate effects of the economic crisis such as a pause in M&A deals and the rapid depletion of cash reserves. Karen Mills (MMP Group, Inc.) said that Main Street small businesses have 27 days of cash on hand, on average. Sara Hanks (CrowdCheck, Inc.) said that for restaurants specifically this number is 16 days. There seemed to be widespread agreement that government aid would be critical during the initial phase of the crisis, but committee members reported that their portfolio companies and clients are confused about how to apply for government programs. For example, Mills said that with Small Business Association disaster loans rolling out tomorrow, banks still need to figure out answers to questions such as who is eligible under the affiliate rules.

Sapna Mehta (Rise of the Rest Seed Fund; Revolution) encouraged regulators to offer flexibility. For example, some people have asked about taking equity in lieu of salary, but she sees this as invoking murky issues of deferred compensation. She acknowledged that this may be more on the IRS side than the SEC. Mills observed that large companies tend to hoard their cash in a crisis because the markets are looking at their cash balances, but this can hurt smaller businesses along the supply chain if they don't get paid on time. She asked larger companies, including the government, to pay their bills quickly, warning that it will be very hard to restart the economy if the small businesses don't survive.

Youngro Lee (NextSeed) brought up the idea of reducing the requirements for GAAP financial statements for smaller offerings. Hanks agreed, suggesting that the threshold should be raised to $500,000 on a temporary basis and that the SEC should try to let companies take the money as soon as they hit their offering target rather than having to wait 21 days for disbursement. Hanks stressed that for some companies in this crisis, historical financial statements—whether reviewed or not—are useless. These companies may have raised a lot of money or produced a lot of revenue before, but that's in the past, she said. She concluded, "This is terrible. We will get through it, but it's going to take longer than anyone thinks. Sorry."

Stephen Graham (Fenwick & West LLP) struck a more optimistic tone, saying that for the most part he sees business happening. The crisis presents an opportunity to be creative with respect to ideas such as crowdfunding and micro offerings, Graham said. Brian Levey (Upwork Inc.) also saw potential opportunity in the crisis. He said that regulators should keep in mind that this may be the new normal and analyze how behavior is changing. One example is, as Commissioner Peirce mentioned, the increasing acceptance of remote communication. Online reputation will become more important, Levey said, whereas business previously built trust through face-to-face relationships.

Clayton's take. Chairman Clayton stepped in towards the end of the meeting to address the feedback that members had raised. He acknowledged Mehta's comments on the affiliate issues and equity compensation and assured that SEC staff is in regular contact with counterparts at other agencies, including the SBA and Treasury. Clayton said that he will bring up the issues raised at the meeting. He also agreed with the suggestion that historical financial statements are not as relevant now as they used to be. Instead, investors will need to look at cash flows and projections of business operations.

Clayton then disclaimed his next remarks as representing only his personal views. He acknowledged Hanks's warnings about the severity of the situation and how important it is to help businesses, workers, and everyone else through the crisis. "People do not invest unless they have visibility into the future," Clayton said, which is why he supports the CARES Act, because currently visibility is very limited. While he is not an epidemiologist and cannot predict the timing of the crisis, he opined that small businesses are already struggling to operate under closures as short as 30 days. As an economic regulator, he stressed the need to think and help people communicate in those terms to help move towards the sort of certainty that promotes investment and credit.

Small business advocate. Finally, Martha Legg Miller, Director of the Office of the Advocate for Small Business Capital Formation, discussed the responses that the SEC broadly and her office specifically have taken to help small businesses. The SEC granted emergency relief extending the filing deadline for crowdfunding and Regulation A issuers and extended the comment period for various rules. As for her office, Miller said that they were gearing up to conducting outreach events, including at SXSW, when the crisis hit. They have now begun putting resources online and have shifted to a virtual outreach strategy, the highlight of which are "virtual coffee breaks" that provide a two-way opportunity for engagement. The first of these will be held Friday, April 3, on the topic of online investment capital raising. Additional sessions will follow next week and the week after.

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