Public Statement

Statement on Harmonizing, Simplifying and Improving the Exempt Offering Framework; Benefits to Small and Medium-Sized Business and Their Investors

Chairman Jay Clayton

Nov. 2, 2020

Good morning. This is an open meeting of the U.S. Securities and Exchange Commission under the Government in the Sunshine Act.

Today we consider a recommendation from the Division of Corporation Finance that would harmonize, simplify and improve various structural and procedural aspects of our exempt offering framework under the Securities Act of 1933. The recommended amendments reflect a comprehensive, retrospective review of a framework that has, over time, unfortunately become difficult to navigate, for both investors and businesses, particularly smaller and medium-sized businesses. Some have referred to it as a “patchwork” – I will explain this in a bit more detail later. Today’s amendments would rationalize that framework, increase efficiency and facilitate capital formation, while preserving or enhancing important investor protections.

The staff’s recommendation is remarkable in its scope, efficiency and importance. It may seem counterintuitive to praise a 400-page release for its efficiency, but that is what the staff has achieved with this review. It is beyond question that our framework has been in need of an overhaul. Recognizing that an overhaul is needed is the easy part. I commend our staff for taking on the hard part. Taking on the hard part requires deep knowledge of the practical realities our private markets, including that they serve a wide variety of investors and companies. Our staff, with the benefit of Director Hinman’s expertise and leadership, has provided the Commission with a thoughtful path forward that draws on their combined decades of knowledge and experience in this area, including understanding its evolution over the past decades. Director Hinman recently announced he would be leaving the agency before the end of the year, and today’s recommendation is yet another example of the lasting and positive impact his tenure will have on our agency, our capital markets and our Main Street investors.

To better understand today’s recommendation, I suggest you start with a few helpful charts prepared by the staff. A chart summarizing our overall exempt offering framework can be found on page 10 of the release, as well as attached to our press materials. A couple of charts summarizing our approach to the integration of multiple offerings can be found on pages 16 and 63 of the release.

A review of these charts demonstrates the complexity of our current framework and the staff’s undertaking. Our exempt offering framework, which consists of no fewer than 10 different exemptions, was built over time, over fifty

years, through various acts of Congress as well as rulemaking by the Commission. In large part, it was built exemption-by-exemption in response to certain changes in our economy, technology and financial markets. I believe one can view today's actions as analogous to long-overdue deferred maintenance on a home where, over time, a few additions have been added and several rooms have been redecorated during different decades. Each step made sense at the time, but the result is a complex patchwork that does not fit together as well as it should. In the case of our exempt offering framework, we are left with frictions, gaps and other needless inefficiencies.

Turning back to the charts, they clearly show that the staff – applying their deep understanding of the law, as well as their deep understanding of the various market segments and the many types of issuers and investors that rely on this framework – have crafted an overhaul that accomplishes three objectives:

1. remaining true to proven principles for retrospective review and modernization, improving all three components of our mission: investor protection, capital formation and market integrity;
2. addressing the substantial changes in our marketplace, including changes in communications technology and access to capital; and
3. greatly reducing costs, particularly for smaller and medium-sized business as well their investors.

I will discuss each of these objectives in a bit more detail.

On the first objective, serving our tripartite mission, I want to emphasize an important general point. There is no doubt that the Commission can and should strive to fulfill each component of our mission when we modernize our rules. There are, however, some who express the view that there is an inevitable trade-off among these objectives — for example, a trade-off between facilitating capital formation and enhancing investor protection. This zero-sum perspective is inconsistent with the Commission's demonstrated history, Congressional action, market performance, investor returns and investor protection. The JOBS Act, Regulation Crowdfunding, the great work of the Division of Corporation Finance over the past several years to modernize our disclosure framework, and the work — the genius — of the New Deal architects of the Securities Act and the Exchange Act more than 85 years ago, and countless other actions, demonstrate we can move forward and improve all three aspects of mission simultaneously. Moreover, such a zero-sum and anachronistic perspective can impede much-needed progress on a range of emerging issues important to investors, our agency and the economy more generally. Speaking more specifically about the recommendation before the Commission today, a review of the charts shows that serving all three parts of our mission is just what the staff had in mind when crafting these amendments. The release text emphasizes and reinforces this point. To be clear, we are not changing the definition of accredited investor or the types of offerings and circumstances under which investors can participate, or the anti-fraud and other protections they receive in private offerings. We are eliminating costs and providing access, including in areas where individual investors can be more likely to sit side by side with professional investors. Harmonizing requirements across exemptions allows issuers to more easily navigate our framework – and ensure they are complying with our rules, including the important investor protections embedded in each. At the same time, investors benefit from a more harmonized framework through more consistent protections generated by efficiencies — whether that's the revision we've made to make our bad actor provisions consistent across exemptions, the alignment of financial disclosures between Rule 506(b) and Reg A, or the anti-evasion prohibition and other improvements to our integration framework that ensure investors remain protected.

Turning to the second objective, addressing changes in our marketplace, I want to first focus on an aspect of our markets that has changed significantly in the past several decades but is not likely to be affected by these amendments. Capital raising in our private markets for larger companies has increased significantly in the past twenty five years. This is true for both equity capital and debt, where private market financings range into the billions of dollars. The amendments we are considering today will add important efficiencies to our private offering framework, but I believe they will not, I repeat will not, materially alter the choice of whether to access the public markets or the private markets for larger companies. Today's amendments eliminate frictions and uncertainties that in various cases would be material to smaller and medium-sized companies, but they will not move the needle for large companies choosing between public and private offerings, whether for large debt or equity offerings. As such, there are no trade-offs between our various initiatives to improve our public company regulatory framework

and the actions we are taking today.[1] Also, speaking about this dynamic more generally, you don't make the public company framework more attractive to large companies by making the private market alternatives less so.

I will now focus my discussion on an area of the market where the clarity, cost reductions and efficiencies provided by the amendments will have the most benefit, and that is with smaller and medium-sized businesses. Financing for these types of companies — which many call the lifeblood of our local economies and, accordingly, our economy more generally — has changed dramatically in the past thirty years. For the vast majority of these companies, raising capital in the public markets is not a practical option. While not a hard and fast rule, this is the reality for many companies with values from $50,000 to $50 million or even $100 million or more.

For these companies and their investors, there is no public market-private market choice. The exempt capital markets – the private markets – are their only option. However, these companies generally do not have the resources, expertise and experience to effectively navigate our complex private offering rule sets. These companies and their investors are the ones we intend to benefit from today's amendments, which aim to replace unnecessary complexity and uncertainty with a clearer, more consistent system.

This brings me to the third objective, reducing costs. As just one example, these amendments will eliminate costs relating to paperwork and lawyer hours that as a practical matter serve no mission-oriented purpose, and specifically do not enhance investor protection. Many of these costs are the result of rules that were constructed in an age of different communications and other technologies. Here, the staff has responded to technological change and, to their credit, not only updated processes but used that change to improve procedural safeguards. As one can see with a quick look back the charts, the procedural safeguards of the framework are maintained and updated to reflect the communications and other realities of today.

In the area of modernization, adding efficiency and mission-effectiveness in all three areas of our mission, I note that our efforts to meet the challenges presented by COVID-19 have unquestionably demonstrated that our regulations should not cling to the mails and paper as the default or preferred paradigm for communications. In fact, I believe our electronic communications backbone contributed substantially to market function, market integrity, investor engagement and investor protection during the period of market stress in March and April of this year. To be sure, our rules should accommodate the mails, including providing for use of the mails by those Main Street investors who prefer mail, but we should not slow or constrain our processes to the pace of the mails or the constraints of paper. We are market regulators and the markets moved on to better and more efficient communications methods long ago, as has our society more generally. Our rules should reflect, and be improved by, these developments.

Today's recommendation benefitted from expertise across many offices of the Commission. In particular, I would like to acknowledge members of the staff that contributed to this effort:

- From the Division of Corporation Finance: Bill Hinman, Elizabeth Murphy, Jennifer Zepralka, Steven Hearne, Anthony Barone, Jeb Byrne, Jim Budge, Carol Weiss, Elizabeth Walsh, Michael Coco, Heather Maples, Craig Olinger, Victoria Colbert, and Jasica Desai.
- From the Division of Investment Management: Dalia Blass, Sarah ten Siethoff, Melissa Gainor, Jenny Songer, Larry Pace, and Terri Jordan.
- From the Division of Trading and Markets: Joanne Rutkowski, Tim White, Geeta Dhingra, John Guidroz, Joan Collopy, Mark Wolfe, and Josephine Tao.
- From the Division of Economic and Risk Analysis: S.P. Kothari, Chyhe Becker, Hari Phatak, Marie-Louise Huth, Lauren Moore, Vladimir Ivanov, Daniel Bresler, Andrew Glickman, Chantal Hernandez, Angela Huang, and Morgan Williams.
- From the Office of the General Counsel: Bob Stebbins, Bryant Morris, Shaz Niazi, Dorothy McCuaig, Evan Jacobson, Connor Raso, Natalie Shioji, Cathy Ahn, and Kerry Dingle.
- From the Division of Enforcement: Jonathan Hecht and Jackie Berman-Gorvine.

I will now turn it over to Bill Hinman, Director of the Division of Corporation Finance, for the staff's presentation of their recommendation. S.P. Kothari, our Chief Economist and DERA Director, will then summarize his views on the potential economic effects of the new framework. Following the staff's presentations, I'll ask Commissioner Peirce, Commissioner Roisman, Commissioner Lee, and Commissioner Crenshaw for their remarks.

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[1] Over the past several years the Commission has adopted various rules and procedures to make our public markets relatively more attractive to larger issuers. For example, expanding the JOBS Act accommodations beyond emerging growth companies, updating the required financial disclosures about guarantors and guaranteed securities as well as financial disclosures about acquired and disposed business, and modernizing the auditor independence requirements.