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Capital Formation Advisory Committee Meeting

SPEECH

Remarks at the Small Business Capital Formation Advisory Committee Meeting

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Good morning to the members of the Advisory Committee and to the public viewing in-person and online. I regret that I cannot join you in person at this meeting, because you will be discussing two topics — Regulation A and finders — that are near and dear to small issuers and their ability to obtain capital.

I appreciate the Committee’s continued efforts to examine ways to increase the use of Regulation A. In overseeing the capital markets, the Commission should consider regulation as a continuum, where regulatory burdens increase relative to the impact of the offerings. Unfortunately, today, there are effectively only two approaches: either raise capital under Regulation D or register as a public offering. As the Advocate’s report demonstrates, the use of alternatives other than these approaches pales in comparison.

With respect to Regulation A, the current regulatory framework adversely impacts secondary market liquidity. This significantly decreases the attractiveness of investing in a Regulation A offering. Why would an investor participate in a primary offering if he or she does not have an easy ability to eventually re-sell the securities in a secondary offering? This framework creates a “Hotel California” situation^[1] where a person can invest capital in a company any time but never exit.

Requiring the registration of secondary sales from multiple state securities regulators under blue sky laws increases costs and adds complexity to a framework intended for small businesses — and it is not clear whether having multiple layers of review adds any investor protection. As such, we should be thinking of ways to promote secondary market liquidity rather than maintaining structures that restrict it.

Making Regulation A offerings more attractive to investors will improve the ability of small businesses to raise capital. Vibrant markets benefit all participants. Retail investors may benefit from the opportunity to diversify their portfolios by investing in smaller companies for which Regulation A was intended. Exposure to smaller companies may provide differing return characteristics than larger companies. Thus, a better Regulation A framework increases opportunities for all market participants, whether they are seeking or contributing capital.

Turning to the second topic of the day: finders, a topic that has been near the top of the recommendations from the SEC Small Business Forum for many years. Mechanisms for matching users of capital with providers of capital are not as obvious as one might assume — especially for persons seeking to raise relatively modest amounts. In 2020, the Commission attempted to address this issue.[2] The Commission observed that “small businesses frequently encounter challenges connecting with investors in the exempt market, particularly in regions that lack robust capital raising networks.”[3] Finders could be helpful in bridging the gap between capital raises that are too low to attract venture capital funds or broker-dealers, but above the amounts that can be raised through friends and family.[4] This is particularly true in regions that may not have extensive venture capital or angel financing networks. Increasing capital formation opportunities would be beneficial to founders and investors and can foster economic growth and jobs creation.

Let’s be clear: any activity, whether in the form of an exemption or a dramatically scaled down regulatory structure, remains subject to the antifraud provisions of the securities laws. But a person who merely provides a name and contact information to a company seeking capital in exchange for modest transaction-based compensation does not need to be regulated in the same manner as the largest Wall Street brokerage firms. Finders should be subject to an appropriately tailored set of guardrails that reflect their limited involvement in smaller scale private capital market activities. The 2020 Proposal included a number of exemptive conditions; perhaps there are others that should be considered.[5]

The objective is to minimize burdens on legitimate intermediaries while decreasing the likelihood that illegitimate actors will engage in bad acts.^[6] As then-Commissioner Stephen J. Friedman observed forty-five years ago, “all regulation-deregulation decisions involve a trade-off between the abuse-prevention of a prophylactic rule and that rule’s interference with the activities of non-abusers.” In this instance, any framework should open doors to finders who serve as legitimate conduits for investment information flows without imposing disproportionately draconian broker-dealer regulatory standards. I look forward to reviewing the Committee’s recommendations.

Congratulations, Marcia [Dawood], on taking over as the chair of this Committee, and to the other committee members who are assuming new leadership roles. Thank you also to the participants and attendees for joining us today.

[1] “You can check out any time you like, but you can never leave,” the Eagles, “Hotel California” on *Hotel California* (Asylum Records 1977).

[2] Notice of Proposed Exemptive Order Granting Conditional Exemption from the Broker Registration Requirements of Section 15(a) of the Securities Exchange Act of 1934 for Certain Activities of Finders, Release No. 34-90112 (the “2020 Proposal”) (October 7, 2020) available at <https://www.sec.gov/files/rules/exorders/2020/34-90112.pdf> [_ \(https://www.sec.gov/files/rules/exorders/2020/34-90112.pdf\)](https://www.sec.gov/files/rules/exorders/2020/34-90112.pdf).

[3] *Id.* at n. 8.

[4] *Id.* at n. 9.

[5] *Id.* at 18 (such as the finder does not engage in general solicitation; the finder has a reasonable belief that the potential investor is an accredited investor, and the finder is not subject to statutory disqualification).

[6] Remarks to National Association of Manufacturers, Government Regulation and Competition Committee, The Tides Inn, Irvington, VA (Sept. 8, 1980).

