Securities Regulation Daily Wrap Up, SECURITIES OFFERINGS—House FSC Republicans promote capital formation bills at markup, (Apr. 27, 2023)

Securities Regulation Daily Wrap Up

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Of the 15 bills introduced, the Expanding Access to Capital Act of 2023 is significant for its numerous provisions that would preempt state regulations for many smaller offerings.

The House Financial Services Committee held a markup for 15 bills, most of which were directed at easing requirements for capital formation, but with one bill that would convert the Consumer Financial Protection Bureau into a 3-2 commission that also would be subject to the regular appropriations process. Of the capital formation bills, the Expanding Access to Capital Act of 2023 stands out for its preemption provisions that, in scope, echo similar provisions contained in the National Securities Markets Improvement Act of 1996, which redistributed regulatory authorities between federal and state securities regulators. All 15 bills were ordered reported.

House FSC Chair Patrick McHenry (R-NC) provided opening remarks in which he made clear, in reference to recent bank failures, that the House FSC may take action to address banks while also moving ahead with a capital formation agenda. “I say all of this to make it abundantly clear to my colleagues and those tuning in to today’s markup: this Committee can walk and chew gum at the same time.” McHenry added: “We are a legislating committee. When crises arise, we look at potential legislative fixes. In that same vein, when there are laws and regulations that can be improved, we provide legislative solutions.”

Ranking Member Maxine Waters (D-Calif) said Democrats could support 12 of the 15 bills, but she balked at supporting what she characterized as “truly toxic bills,” one of which would convert the CFPB from a director-led bureau into a commission, and the second being McHenry’s larger bundle of capital formation and markets provisions contained in the Expanding Access to Capital Act. She also said she would strongly oppose an electronic disclosure bill that would later generate much discussion during the markup.

“Now, I’d love to say that I appreciated how well Mr. McHenry’s and my staff worked together, but shortly after we came to an agreement on a list of bills for this markup, the Chair went back on his word,” said Waters. “I had hoped that our Committee could rise above the partisanship of the House, but I understand that the Chair is beholden to his leadership at the end of the day.”

State preemption. House FSC Chair McHenry introduced the Expanding Access to Capital Act of 2023 (H.R. 2799), a forty-page bill addressing many topics. Key pieces of the bill, however, would preempt state regulators from addressing certain topics, including gig workers, private placement brokers and finders, micro-offerings, some crowdfunding matters, and secondary trading markets.

Earlier this year, the North American Securities Administrators Association (NASAA) issued a report explaining its recommendations for boosting capital markets. By way of background, since the enactment of NSMIA, which allocated many federal and state securities regulatory authorities, the most significant similar development has been the enactment of Section 410 of the Dodd-Frank Act, which allocated responsibility for regulating investment advisers between the SEC and the states, with the SEC handling the largest advisers and states handling smaller advisers. NASAA said this latter arrangement had worked well.

However, NASAA took issue with more recent assessments about the role played by state regulators in secondary trading markets. Citing a recent meeting of the SEC’s Small Business Capital Formation Advisory Committee, NASAA said that state regulators were being unfairly blamed for problems regarding secondary market trading activity for shares issued by companies under the SEC's Regulation A.

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“State regulators were once again made the scapegoat for this problem, even though panelists identified a number of more substantive impediments that would not be cured by preempting state law, such as inefficiencies in share transfer recordkeeping and the common practice of issuers demanding a right of first refusal before shares can be resold,” said NASAA’s report.

Additional provisions contained in the Expanding Access to Capital Act would, among other things:

- Expand who can be an accredited investor.
- Expand companies’ eligibility for well known seasoned issuer (WKSI) status.
- Clarify audit independence requirements for newly public companies.
- Increase the Securities Act Section 3(b)(2)(A) exemption from $50 million to $150 million.

The U.S. Chamber of Commerce submitted a letter in which it was broadly supportive of the larger bundle of bills contained in the Expanding Access to Capital Act and several other bills marked up individually. The Chamber did note some areas where proposed legislation may delay reforms, such as a requirement that the SEC conduct multiple studies of the definition of “small entity” (see discussion below of small business bills).

Accredited investors. Several bills would expand the definition of accredited investors. Historically, these individuals have been defined statutorily and by regulations to be presumably sophisticated, often wealthy individuals who, under Supreme Court precedent, are deemed to be able to fend for themselves. Republicans have pushed for a more expansive definition on the theory that early-stage investment opportunities should not be the exclusive domain of the wealthiest. By contrast, Democrats typically urge more guardrails on the theory that less sophisticated investors may find themselves in financial trouble when they deal with complex exempt offerings.

The bills purporting to expand the definition of accredited investor seek to allow more types of individuals with professional or other backgrounds that may give them the experience to deal with complex offerings the chance to participate even if they otherwise would not meet the wealth thresholds under current regulations. One bill would allow individuals to become accredited investors via an examination. In 2020, the Commission issued an order in which it designated some professional licenses (i.e., the Series 7, 65, and 82) as qualifying their holders for accredited investor status.

Small business bills. In addition to requiring the SEC to study and report to congress on the definition of small entities under federal securities laws, the numerous bills addressing small business capital formation aim to lower some costs of going public. For example, one bill would allow emerging growth companies (EGCs) to provide only two years of audited financials.

Two other bills, perhaps demonstrating a degree of bipartisan backing, would make it easier for the SEC’s Advocate for Small Business Capital Formation to operate while also requiring that office to provide educational resources to, and to host events for, underrepresented small businesses (e.g., women- and minority-owned small businesses), rural businesses, and small businesses affected by hurricanes and other types of natural disasters. Previously, Congress had incrementally enacted amendments to the duties of the Advocate for Small Business Capital Formation by requiring the office to consider the unique challenges to minority-owned small businesses, women-owned small businesses, and small businesses affected by hurricanes or other natural disasters. The education and events requirement, if enacted, could bring more resources even closer to those small business within the office’s purview.

Registration and disclosure. Two Republican bills would clarify that the SECs framework for submitting draft registration statements for confidential staff review applies to all issuers. Two Democrat-sponsored bills would require a study of IPO fees and mandate additional disclosures for companies that adopt multi-class share structures.

With respect to multi-class share structures, the Council of Institutional Investors wrote to members of its “general support” for the Enhancing Multi-Class Share Disclosures Act (H.R. 2795), sponsored by Rep. Gregory Meeks (D-NY). The CII noted that multi-class share structures (what the CII called the “founder-knows-best approach”) can bring a premium early in a company’s public existence but that the premium can quickly turn into

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a discount with long term negative consequences for investors. The CII said it recommends that new companies sunset multi-class share structures within seven years unless all of a company's share classes vote on a one-share, one-vote basis to retain the founders' voting advantage.

Another Republican-sponsored bill would reduce the disclosure requirements for a wide swath of entities, including investment companies, registered investment advisers, registered broker-dealers, registered municipal securities dealers, government securities brokers, registered transfer agents, and registered funding portals. These entities would be permitted to deliver regulatory documents via electronic delivery.

Under the electronic disclosure bill, "regulatory documents" would be defined broadly to include Securities Act Section 10(a) prospectuses, summary prospectuses, statements of additional information, annual and semiannual reports, confirmations, proxies, privacy statements, and affiliate marketing notices.

During the markup, the electronic disclosure bill generated some of the most heated debate. Republicans sought to defend the bill as merely creating flexibility for how some entities could provide disclosures. Democrats expressed concerns that persons who cannot or do not use electronic modes of communication might not be able to obtain important disclosure materials. The fate of the bill likely rests on whether it creates an opt-in or opt-out framework.

"H.R. 1807 [the electronic disclosure bill] would allow brokerages and investment advisers to force millions of Americans to access their investment statements and other materials online, even if they don't have access to the internet," said Waters. "I saw how this tactic made it difficult for many business owners to access PPP loans during the pandemic when banks required the applications to be completed online. It is elitism at best, and discriminatory at worst."

Seniors. The National Senior Investor Initiative Act of 2023 (aka the Senior Security Act), sponsored by Rep. Josh Gottheimer (D-NJ), would create within the SEC a new Senior Investor Taskforce. The taskforce would identify challenges that exist for seniors regarding financial investments and identify regulatory changes that may benefit seniors. Both the taskforce and the GAO would have to provide separate reports to Congress. Previous bills on senior investors have varied somewhat in how they define "senior;" the Senior Security Act would apply to persons over the age of 65 years. The taskforce would sunset 10 years after enactment.

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