HEALTHY MARKETS
TRANSPARENCY & TRUST

September 11, 2020

Via electronic mail (CMM.Taskforce@ontario.ca)

Capital Markets Modernization Taskforce

Re: Consultation — Modernizing Ontario's Capital Markets

Dear Messrs. Soliman, Duchesne, and Hall, and Mses. Kennedy and Tripp;

The Healthy Markets Association[1] appreciates the opportunity to offer our comments to the Capital Markets Modernization Taskforce Consultation Report.[2] We appreciate your efforts to comprehensively review and offer recommendations to improve capital markets regulation.

As detailed more fully below, we support the Consultation Report recommendations that would enhance transparency and issuer accountability, as well as those that would promote competition and level the playing field across market participants.[3]

At the same time, we urge you to revise or abandon the numerous proposals included in the Consultation Report that could:

- Reduce transparency, increase risks, and increase costs to investors;
- lead to inefficiencies in the markets and misallocations of capital in the overall economy; and
- inhibit competition by disproportionately favor large market participants over smaller ones.

We also note that many of the recommendations have significant overlap with one another, and so while a recommendation may, by itself, appear to have one effect, when viewed collectively with other recommendations, it may have multiplying or

[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 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] Capital Markets Modernization Taskforce, *Capital Markets Modernization Taskforce Consultation Report,* July 9, 2020, *available at* https://files.ontario.ca/books/mof-capital-markets-modernization-taskforce-report-en-2020-07-09.pdf ("Consultation Report").

[3] Attached as **Exhibit 1** is a more fulsome comment by Healthy Markets in response to a SEC Concept Release, which covers many of the same policy matters contemplated by the Consultation Report.

mitigating effects. For example, one proposal would ease the ability to make public offerings, while another would seem to target the same issuers for expanded exempt securities offerings. We urge the Taskforce to explicitly acknowledge that some of these recommendations may run contrary to one another, and have multiplying or mitigating effects on one another.

Finally, we note that the Consultation Report offers an extremely limited analysis of the issues, including the costs, the benefits, and the impact on different market participants and the market overall. To ensure that these complex policy recommendations are given an appropriate consideration before adoption, we urge the Taskforce to, in its final report, explicitly recommend that the Ontario Securities Commission (OSC) be empowered to engage in robust cost benefit analysis of the issues and exercise its judgment as to whether, to what extent, how, and over what time horizon it may implement the recommendations.

Overall Objectives of Effective Capital Markets Regulation

Effective capital markets regulation:

- ensures that key information about securities, including issuer governance, operations, and financials disseminated on a regular basis and widely available, so that market participants can accurately assess the value of the securities and allocate capital efficiently; and

- levels the playing field between market participants and regulators by ensuring that all investors and the public -- not just those with market power or other advantages -- have access to key information in a timely manner.

Fair and efficient capital markets -- which form the bedrock of a healthy capitalist economy -- require timely, comprehensive, and accurate information for investors, the public, and regulators. By ensuring that information is provided to make informed decisions, effective regulation isn't an inhibitor to capital markets, but is instead the bedrock upon which the markets rely.

The Consultation Report "proposes incorporating the fostering of capital formation and competitive capital markets to the OSC's mandate to encourage economic growth."[4] We understand the temptation to include these factors, as they are critical components of a healthy market ecosystem. However, based upon our experiences in the US, we urge caution in your recommendations to modify the OSC's mission. As applied in the US, these two considerations often result in opposite purposes. We urge you to reject recommending a "capital formation" mandate and propose a "competition" mandate.

In the US, the phrase "capital formation" has been used to justify dozens of efforts to remove disclosures and rights from investors in the public markets on the one hand, and expand exemptions from the federal securities law protections on the other. The

[4] Consultation Report, at 6.

entire focus of these efforts is on collecting capital from investors by an issuer. The capital is only being "formed" for that issuer. Clearly, the investors already had it. But by adopting this issuer-centric framework, then the entirety of discussion often focuses on how regulators can make it easier for issuers to collect capital.

When faced with this question, then the answer is the least amount of burden that will still investors to part with their capital. The restraints are then nearly entirely based upon the risk appetites of investors. These risk appetites may vary significantly based on their levels of expertise and available resources. As the U.S. markets have seen during the Great Crash of 1929, the Dot Com Bubble Crash, the Financial Crisis of 2008-2009, and now today, investors may wittingly or unwittingly take extreme risks that may have disastrous consequences for themselves, but also the economy overall. This risk may be amplified by a lack of transparency, low interest rates, and other factors.

Nevertheless, if the regulatory goal is to strictly make it easier to "form" capital, then the policy solutions are relatively straightforward--reduce the burdens on issuers by expanding exemptions, expanding potential purchasers to exempt securities, reducing disclosures by public companies, and reducing rights of investors in public companies. That is unfortunately much of the Consultation Report would consider recommending.

However, this narrowly scoped, issuer-centric view of the capital markets nearly entirely ignores the important roles of investors. Of course, eliminating disclosures and expanding exemptions dramatically increases risks of fraud and losses for investors. That will have economy-wide impacts on the long-term financial wellbeing of investors in Canada, the US, and abroad. But investors' risks and returns are only parts of our concern.

Investors provide the mechanism through which capital is expected to flow to the best uses. Aside from suffering their own losses, we do not want investors pouring capital down the drain. We all want and need investors to fund good companies and ideas to create jobs and drive our economies forward. But without adequate information and rights, investors simply will not know whether their investments are likely to be fruitful or not. Capitalism relies on investors to make these capital allocation decisions, but the reforms that have already been made in the US under the auspices of capital formation (much of which are proposed in the Consultation Report) deprive them of the ability to do so.

Again, the phrase "capital formation" is a skewed term that has a well-established meaning and history with market participants in the U.S. and Canada, as well as U.S. regulators. That history is unfortunately skewed against investors and more transparent, fair, and efficient markets. That history reflects policies that are contrary to a robust and fair economy.

If the Taskforce is to nevertheless include a recommendation that "capital formation" be included in the OSC's mission, we urge you to explicitly include in that recommendation a recognition that capital formation is not intended to be the exclusively issuer-centric

viewpoint that has taken root in the US dialogues. Rather, "capital formation" should be interpreted to include the role of investors as well, including their needs for information and rights.

Separately, capitalism is also premised on robust competition--between investors, issuers, and their intermediaries. A material reduction in competition undermines market efficiency, and may create significant external costs for investors and issuers.

We enthusiastically encourage you to consider recommending the inclusion of competition into the mission of the OSC. Notably, as discussed below in greater detail, we think that this provision could likely stand in opposition to several of the potential recommendations included in the Consultation Report.

Information and Rights for Investors

We find that many issuers and financial intermediaries often argue for a purportedly compelling need to "reduce duplication" and "unnecessary regulatory burdens." Not surprisingly, this isn't an argument you hear often from investors.

The act of making a disclosure is generally 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 and the marketplace provide sufficient basis for policymakers to enable them to avoid accountability.

Unfortunately, the Consultation Report suggests that the Taskforce is considering several distinct efforts that would reduce the timeliness and quality of information available to investors and the public. And while the impact of this lost information may be significant on investors, the companies, and the markets overall, they are nearly entirely ignored.

We urge you to reject this one-sided view towards the capital markets. As the United States Securities and Exchange Commission has posted on its website:

> 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 Taskforce has offered no credible evidence -- much less reasonable analysis -- to support its determinations -- spanning several recommendations -- that less and less

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

timely information would better "facilitate" capital formation or improve the capital markets.

Instead of promoting efficient allocations of capital and protecting investors, many of the recommendations would increase the number of companies and amount of capital in the less-regulated, exempt markets on one hand, while further eroding the number and quality of public companies on the other.[6] Further, many of the recommendations would, if implemented, impose significantly greater costs and risks on investors and the markets.

Don't recommend reducing the timeliness of disclosures.

The Consultation Report expressly contemplates modifying the requirement "for quarterly financial statements to allow for an option for issuers to file semi-annual reporting."[7] In considering this proposal, the Taskforce explicitly cites to concerns raised by smaller issuers regarding the perceived burdens of making the regular filings.[8]

This issue, like many raised in the Consultation Report, is actively under consideration in the U.S. Most recently, following a 2018 tweet by President Donald Trump,[9] the SEC released 46 questions for public comment seeking information "on how we can enhance, or at a minimum maintain, the investor protection attributes of periodic disclosures while reducing administrative and other burdens on reporting companies associated with quarterly reporting."[10]

Objections were received from several investors and their trade groups.[11] As one investor group explained:

> Managers rely on quarterly information to evaluate companies in which they have invested or are considering investing, and use the information to determine the progress that companies have made to achieve their objectives. A reduction in the frequency of reporting from quarterly to semi-annually would reduce the timeliness and usefulness of the information, which would make it more difficult for managers to analyze the performance of, and invest capital

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[6] 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. 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.

[7] Consultation Report, at 11.

[8] Consultation Report, at 11.

[9] President Donal J. Trump (@realDonaldTrump), Twitter, Aug. 17, 2018, *available at* https://twitter.com/realdonaldtrump/status/1030416679069777921?lang=en.

[10] *Request for Comment on Earnings Releases and Quarterly Reports*, Sec. and Exch. Comm'n, Exch. Act Rel. No. 34-84842, Dec. 18, 2018, *available at* https://www.sec.gov/rules/other/2018/33-10588.pdf.

[11] *See, e.g.,* Letter from Mathew Newell, Managed Funds Association, to Vanessa Countryman, SEC, at 2, Sept. 6, 2019, *available at* https://www.sec.gov/comments/s7-26-18/s72618-6082119-191807.pdf.

> in, public companies. Accordingly, while we are supportive of the SEC review of ways to improve the substance of public company reports, we encourage the SEC to maintain quarterly public reporting.

Similarly, the world's largest asset manager opined:

> We believe the current system of quarterly reporting is an important element of transparency for investors. While we could see one potential benefit of moving to semiannual reporting being reduced focus by management on short-term results, we believe the potential loss in transparency and timely availability of information to investors would outweigh the potential benefits. This is particularly so in light of our further view that it is the informal practice of providing forward-looking guidance, rather than quarterly reporting, that pushes management towards "short-termism".[12]

We agree with these sentiments.

While issuers and their advocates have long sought to reduce their burdens from making periodic reports, the reality is that such burdens come along with the opportunities to raise capital from the public.

Reducing the frequency of reporting doesn't make the information contained in them less valuable, it simply creates a longer lag time between events and potential oversight by investors and can also exacerbate volatility. This creates significant risks for the investors and issuers alike.

Put simply, more can go wrong (or right) over six months than over over three. Thus, price adjustments to reflect new information surrounding the releases of new information are likely to be more significant--increasing volatility around disclosure releases. The effects would likely be exacerbated with smaller issuers with fewer holders and securities outstanding.

This could give rise to greater risks for insider trading. Since the information may still exist at the company, there will be greater pressure on investors and other market participants to obtain it (perhaps even illegally obtained) to fill in the newly created information void.

Reducing the frequency of periodic reporting would also disproportionately favor larger investors, larger traders, and "connected" firms, who have greater access to alternative

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[12] Letter from Barbare Novick, Blackrock, to Brent J. Fields, SEC, at 2, Mar. 21, 2019, *available at* https://www.sec.gov/comments/s7-26-18/s72618-5165791-183444.pdf.

data and corporate access sources with which they would most certainly seek to fill in the newly created information void.[13]

So there are very real, negative consequences for reducing the frequency of reporting. But would it really help small issuers? Would it really shift the focus of the company into a longer-term? We are aware of no significant evidence for either. This approach has been tried before. Beginning in 2007, the UK began requiring quarterly reporting, and then in 2014, it dropped the requirement. Only about 10% of the companies elected to stop making the quarterly reports however. According to a 2017 study of the impacts of the changes by the CFA Institute,[14] the introduction of quarterly reporting corresponded to an "increase in analyst coverage of public companies and an improvement in the accuracy of analyst forecasts of company earnings." and for the companies who stopped making the quarterly reports in 2014, they were associated with a "decline" in the analyst coverage.[15]

Importantly, "there was no statistically significant difference between the levels of corporate investment" when quarterly reporting started, or when it stopped (for the small subset of firms who elected to stop making quarterly reports).[16] This isn't surprising. Investors are going to invest, but the information will be more accurate if there is more frequent reporting. That transparency and efficiency is essential to healthy markets.

Further, over the past several years, technology has made it so that information is easier to collect, analyze, and share than ever before. We have seen no credible evidence that the burden of reporting to investors on a quarterly basis is material, and even if so, whether that cost outweighs the material benefits to investors of having more frequent reporting. We understand that some smaller public issuers may nevertheless raise concerns about the perceived burdens of making quarterly reports, however, those concerns must be balanced against investors' needs for timely and accurate information. In fact, the smaller companies that may find the reporting burdens most relatively significant are also precisely the firms for which this information may be most crucial.

Rather than considering reducing the frequency of reporting, we urge you to consider increasing the timeliness of reporting, including having key information provided on a more frequent basis, such as monthly. This could improve transparency into the issuers' position, thus improving the accuracy of valuation of the securities, and efficiency of the markets. To date, despite continued interest by the issuer community, no action has been taken by the SEC to reduce the frequency of reporting.

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[13] In the US, Regulation Fair Disclosure is intended to protect against egregious abuses of selective disclosures to favored investors, research analysts, or others. 17 C.F.R. 243

[14] Robert Pozen, Suresh Nallareddy & Shivaram Rajgopal, *Impact of Reporting Frequency on UK Companies*, CFA Institute Research Foundation, Mar. 2017, *available at* https://www.cfainstitute.org/-/media/documents/article/rf-brief/rfbr-v3-n1-1-pdf (CFA Institute Study).

[15] CFA Institute Study, at 2.

[16] CFA Institute Study, at 2.

Ensure investors, the public, and regulators have timely information about institutional holdings.

The Consultation Report "proposes decreasing the shareholder reporting threshold in Ontario from 10 per cent to 5 per cent."[17] We do not take a position about the specific threshold level. However, we note that market participants, the public, and regulators all benefit from more transparent holdings. We also recognized the concerns with the disclosure of potentially sensitive trading information.

This issue is also being reviewed in the United States, although the SEC is contemplating raising reporting thresholds to reduce that transparency. We are sharing our objection to the SEC's proposal here as **Exhibit 2**, which more fully details our thinking on this topic.

Don't recommend reducing access to or utility of information.

The Consultation Report recommends "adopting full use of electronic or digital delivery in relation to documents mandated under securities law requirements (i.e., access equals delivery model) and reducing duplicative and unnecessary regulatory burden."[18]

Access does not equal delivery. It never has. Simply having a document or disclosure available is only likely to make it useful to the subset of persons with the sophistication and resources to know where to find it, read it, and then make sense of it. As discussed above, an efficient regulatory framework should be seeking to level the playing field for market participants--not tilting it further towards the most well-to-do and connected. The Taskforce should be focused on ensuring that all market participants have the relevant information presented to them at the time and in the form that it is valuable to them. This could be a significant disadvantage to smaller investors who may not know where, or have time and money, to look elsewhere.

Further, the Consultation Report notes that the Taskforce is

> considering streamlined reporting and regulatory requirements, including but not limited to:
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> a. Combining the form requirements for the Annual Information Form (AIF), Management's Discussion & Analysis (MD&A) and financial statements
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> b. Simplifying the content of the Business Acquisition Report or revising the significance tests so that BAR requirements apply to fewer significant acquisitions.[19]

[17] Consultation Report, at 25.
[18] Consultation Report, at 14.
[19] Consultation Report, at 15.

Consolidation, simplification, and reduction of redundancies in reporting by issuers of securities is a modestly valuable exercise. However, too often, these efforts are simply oriented toward withholding valuable information from investors. If a disclosure is truly redundant, then the marginal cost to the issuer of its presentation a second time is likely very low. At this same time, the benefit to the recipient may be significant. The timing and content of delivery of information are both important. Attention should be paid to making sure that investors are presented with the relevant information at the time that it would be most useful to them.

Again, a regulator and issuer acknowledging that valuable information may be buried in another document is unhelpful, and again makes it more likely that only larger, more sophisticated and resourced market participants are likely to connect the disparate dots.

Substantively, we are disappointed that the regulators have already raised the threshold for BARs so that "fewer significant acquisitions" would trigger them. We understand that there may be a reasonable debate about whether an acquisition may be viewed as "significant" for investors or the marketplace. However, if an acquisition is "significant," it should trigger a BAR. While we doubt that the recently adopted reforms to the BAR thresholds are likely to be revisited soon, we believe that raising the threshold to ignore some significant acquisitions is contrary to the purpose of the BAR regime overall.

Similarly, the Consultation Report "proposes to incorporate additional confidentiality exceptions in the Securities Act to permit disclosure under expanded circumstances" related to investigations by the OSC.[20] We generally disagree. At root, market participants should know whether and to what extent their counterparties may be suspected of wrongdoing or facing significant regulatory risks. These risks may be material to investors in, or counterparties to, those firms, and further expansion of the confidentiality exemptions could leave investors and the marketplace with greater unknown risks.

In contrast to those efforts to restrict access to useful information, we recognize that the Consultation Report

> proposes that the OSC mandate that capital market participants provide open data so that data sharing arrangements can be further encouraged and facilitate more FinTech solutions for businesses (thereby reducing costs and minimizing duplication of processes) and investors.[21]

We support that proposal, which could make information both more available, but more useful for investors.

We also noted that the Consultation Report

[20] Consultation Report, at 41.
[21] Consultation Report, at 33.

> proposes to mandate disclosure of material ESG information which is compliant with either the TCFD or SASB recommendations for issuers through regulatory filing requirements of the OSC.[22]

While we take no position on the mandatory disclosure requirements, we note that many investors and other market participants are already integrating ESG factors in their investment processes, and that this integration is likely to be aided significantly by more standardized disclosures from issuers.

While regulators around the world (including the SEC)[23] are, to varying degrees, seeking to implement mandates for ESG-related disclosures. That said, the SEC seems to be far less aggressive in this regard than other regulators.

Don't reduce investors' ability to exercise their rights.

Most investors cannot reasonably be expected to be expert in all areas of corporate oversight, such as comparative executive compensation and evolving business practices across industries. As a result, many investment fiduciaries retain outside services to provide them with information and expertise to help them in their stewardship of investments, including their proxy voting.

The Consultation Report

> proposes to introduce a securities regulatory framework for PAFs to ensure that PAFs' institutional clients are provided with the issuer's perspective concurrent with the PAF's recommendation report. The Taskforce proposes providing an issuer with a statutory right to rebut (at no cost) the reports published by PAFs, provided that the issuer published the relevant materials (such as the Management Information Circular) within a specified time period prior to the meeting. This right of rebuttal would apply, with respect to each of the issuer's resolution, when the PAF is recommending to its clients to vote against management's recommendations. The PAF would be required to include the rebuttal in the report it provides to its clients. The Taskforce also proposes a framework that ensures PAFs are not in a conflicted position when providing services to issuers and recommendations to clients by restricting PAFs from

[22] Consultation Report, at 27.

[23] The SEC offered a Concept Release on its overall issuer disclosure regime in 2016, and received tens of thousands of comments, many of which urged for greater disclosures regarding environmental and other ESG factors. The comment file is available at https://www.sec.gov/comments/s7-06-16/s70616.htm.

> providing consulting services to issuers in respect of which PAFs also provide clients with voting recommendations.[24]

The regulation of so-called proxy advisory firms is a hotly-debated area in both the US and Canada. And this isn't terribly surprising. Corporate executives and issuers tend to prefer their shareholders never disagree with them, and the proxy advisers--as independent third parties--sometimes recommend that shareholders not support various management decisions.

In 2010, the SEC released a "Concept Release" on potential reforms to the U.S. Proxy System,[25] which suggested a number of potential reforms, which generally weren't implemented. In 2012, the Canadian Securities Administrators similarly released a 24-page Consultation Paper, which noted that

> market participants, primarily issuers and their advisors, fall into the following broad categories: (i) potential conflicts of interest, (ii) perceived lack of transparency, (iii) potential inaccuracies and limited engagement with issuers, (iv) potential corporate governance implications, and (v) the extent of reliance by institutional investors on the recommendations provided by proxy advisory firms.[26]

That proposal also outlined potential reforms.

Nearly a decade later, after immense lobbying by corporate issuers and their allies, we are here again. In the US, in September 2018, the SEC staff withdrew two no-action letters regarding proxy advice.[27] In November 2019, the SEC proposed major reforms to the proxy process,[28] which were generally panned by investors and cheered by corporate issuers and their allies.[29]

We think the extensive comments from the Council of Institutional Investors from November 14th, January 30th, February 4th, February 13th, and February 20th capture and illustrate many investors' concerns. These efforts make it clear that the reforms now adopted by the SEC, and under consideration by the Taskforce, are contrary to the facts and informed and efficient markets.

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[24] Consultation Report, at 24.

[25] *Concept Release on the U.S. Proxy System*, SEC, 75 Fed. Reg. 42982, July 22, 2010, *available at* https://www.sec.gov/rules/concept/2010/34-62495fr.pdf.

[26] Consultation Paper 25-401: Potential Regulation of Proxy Advisory Firms, Canadian Securities Administrators, June 21, 2012, *available at* https://www.osc.gov.on.ca/documents/en/Securities-Category2/csa_20120621_25-401_proxy-advisory-firms.pdf.

[27] *Statement Regarding Staff Proxy Advisory Letters*, SEC, Sept. 13, 2018, *available at* https://www.sec.gov/news/public-statement/statement-regarding-staff-proxy-advisory-letters.

[28] *Amendments to Exemptions From the Proxy Rules for Proxy Voting Advice*, SEC, 84 Fed. Reg. 55518, Dec. 4, 2020, available at https://www.govinfo.gov/content/pkg/FR-2019-12-04/pdf/2019-24475.pdf.

[29] Comments available at https://www.sec.gov/comments/s7-22-19/s72219.htm.

For example, the data reflects that proxy advisory firms are not "wrong" nearly as often as claimed, and the nature of their relationships with investors requires timely and fair consideration of the relevant issues. The insistence that issuers be able to have the opportunity to "rebut" recommendations in the proxy advice documents themselves would both introduce delays and substantively interfere in the advice sought.

The government would not let an opposing legal counsel interfere and interject into the advice a lawyer could provide his client, and yet that is nearly exactly what this proposal would do between a fiduciary and its adviser.

But perhaps one of the most bizarre parts of the proxy advisory firm reform process in the US was that an industry trade group apparently organized the sending of fake comments to the SEC comment file in support of the SEC's proposal. When the SEC leadership (including Chairman Clayton) referenced the letters in support of the effort, the press dug in and figured out that they were completely bogus. US Senator Chris Van Hollen pressed SEC Chairman Clayton at a Senate Banking Committee hearing to explain how the SEC was "duped," but that openly fraudulent process didn't deter the SEC from just weeks later adopting:

- Revisions to the exemptions from the proxy rules regarding proxy voting advice;[30] and
- Additional guidance regarding investment advisers' responsibilities when voting proxies.

The SEC explained that it would "consider whether to adopt proxy rule amendments to provide investors who use proxy voting advice with should receive more transparent, accurate, and complete information on which to make voting decisions, without imposing undue costs or delays." Ironically, investors are concerned with the changes adopted by the SEC precisely because it will lead to less accurate information and would likely impose "undue costs or delays." Frankly, that is our primary concern with the Consultation Report's proposal. Not surprisingly, the SEC's new rule is already being challenged in court, and may be stricken.[31]

The Consultation Report also contemplates compelling proxy advisory firms to separate their consulting and advisory services. While we are sensitive to concerns regarding potential conflicts of interest, we struggle to see the magnitude alleged. As a practical matter, it would make sense that an adviser with expertise on a specific issue might be retained by different parties to offer that expertise. It is common in many professions, such as lawyers. Yes, there may be conflicts of interest, but there are relatively easy,

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[30] *Exemptions from the Proxy Rules for Proxy Voting Advice*, SEC, Exch. Act Rel. No. 34-89372, July 22, 2020, *available at* https://www.sec.gov/rules/final/2020/34-89372.pdf.

[31] Svea Herbst-Bayliss, *Proxy adviser ISS to push ahead with lawsuit against SEC over new rule*, Reuters, Aug. 13, 2020, *available at* https://www.nasdaq.com/articles/proxy-adviser-iss-to-push-ahead-with-lawsuit-against-sec-over-new-rule-2020-08-13.

and straight forward ways to address them. There generally isn't a subject matter prohibition, as the Taskforce appears to be considering.

The proposal -- which is more draconian than any other major jurisdiction has proposed -- would also create significant challenges for investors and issuers in both the US and Canada, as they would be unable to receive the expertise desired. Lastly, we find it odd that the proposal would impose more strict limits on proxy advisers than on the somewhat analogous rating agencies (who also provide significant consulting services).

We urge the Taskforce to revise significantly or abandon its anti-investor, proposed proxy advisor reforms.

Lastly, we acknowledge that the SEC is purportedly on the verge of further limiting shareholders' abilities to offer shareholder proposals or re-proposals using the existing Rule 14a-8 process. We strongly urge the Taskforce to not follow in these anti-investor initiatives. All investors, regardless of size, should reasonably have rights to raise and vote issues of interest to them, as owners.

Expand the ability of shareholders to vote on matters using so-called universal proxy ballots.

The Consultation Report recommends proposing to

> facilitate the use of "universal proxy ballots" — a single ballot that lists the director nominees of each side of a dispute and allows a shareholder to vote for a combination of nominees — seeks to provide shareholders who vote by proxy with greater voting flexibility.[32]

Universal proxy ballots have been discussed and proposed in the US for years.[33] These reforms are long overdue, as the comments from investors in the SEC's comment file make clear.[34]

Investors who cannot attend meetings should not be at a material disadvantage to attendees and management when looking to vote on contested issues, including members of the board of directors. We appreciate this proposal and urge you to strengthen and adopt it.

Raising Capital Without Commensurate Investor or Market Protections

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[32] Consultation Report, at 28.

[33] See, *Universal Proxy*, SEC, 81 Fed. Reg. 79122, Nov. 10, 2016, *available at* https://www.govinfo.gov/content/pkg/FR-2016-11-10/pdf/2016-26349.pdf.

[34] Comments available at https://www.sec.gov/comments/s7-24-16/s72416.htm. See, e.g., Letter from Jeff Mahoney, Council of Institutional Investors, to Brent J. Fields, SEC, Sept. 7, 2017, *available at* https://www.sec.gov/comments/s7-04-17/s70417-2282650-161025.pdf.

Investors need trust in the products they buy. One of the reasons why the North American securities markets have been world leaders has been that they provide robust information to investors, and liability protections if that information is wrong. While the securities regulatory regime demands significant public disclosures by public companies about their governance, operations, and financials, the same requirements do not generally apply to exempt securities.

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.

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 exempt securities today. Similarly, a significant portion of the mortgage-related financial products that were the foundation of the Financial Crisis of 2008-2009 were made through exempt offerings.

But let us highlight two very examples from the US: Uber Technologies and WeWork. Uber made its IPO in May of 2019. 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.[35] 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, 2019, still less than three months after its IPO, the company was trading at a market capitalization of less than $55 billion.[36]

The company didn't lose more than half of its users or revenues over just a few months 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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[35] 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.

[36] Despite the impact of the coronavirus, Uber is trading at about that same level now. (last accessed Sept. 3, 2020).

of $47 billion in early 2019.[37] 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.[38] By early this year, Softbank revalued the company at less than $3 billion. Investors in Softbank's fund lost billions of dollars. Again, nothing materially changed about the company to reduce its value by over 90% 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.[39]

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.

A study by Goldman Sachs found that since 2010, stock prices of companies making their IPOs have trailed the Russell 3000 by a whopping 28 percentage points over their first three years of trading.[40] These disappointing statistics will deter, not attract, capital to capital markets.

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

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[37] 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).

[38] 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.

[39] *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.

[40] 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.

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 securities regulatory regime in both Canada and the US to cover the vast majority of capital raising and investments would help remedy this situation.

Unfortunately, the Taskforce proposes several reforms that would, if implemented, follow the US trend of expanding the exempted markets and expand risks of these markets to more market participants. We urge you to revise significantly or abandon these proposals.

Don't further limit issuer and intermediary liability.

The Consultation Report recommends an exemption for continuous reporitng companies that would only have an abridged prospectus, and investors would not enjoy "'the civil and statutory protections associated with prospectuses."[41]

What is the rational basis for this consideration, other than to inappropriately benefit issuers engaged in wrongdoing, at the expense of investors, the public, and the economy? At a basic level, we question the basis for this new determination, which seems largely out-of-step with the relatively limited amount of private litigation occurring in Canada in this space today.

While issuers and their advocates have long pressed for these reforms in both the US and Canada, the experiences with past efforts to curtail liability have not proven to materially change overall investment. In fact, we have yet to see significant evidence that removing information and liability would make investors (1) want to invest more, (2) choose their investments more wisely, thus allocating capital to its better uses, or (3) value their investments more efficiently. To the contrary, the only guaranteed result of this proposal would be to explicitly reduce accountability and trust in the marketplace.

Further, in the US, we have found that private enforcement of the exempt markets is exceedingly difficult and rare, often based on the significantly greater legal burdens falling on the plaintiffs in the exempt securities arena, the relatively bespoke nature of transactions, and the dollars involved. However, the private enforcement mechanism is an important tool to promote market integrity. If an offering were to not include the "civil and statutory protections," this would shift a massive burden on to regulators to engage in greater efforts to oversee exempt offerings, and expend potentially significant enforcement resources to promote the integrity of those offerings.

Stop expanding exemptions and exceptions to basic protections.

The Consultation Report proposes expanding exemptions from securities law protections in a number of discrete ways. However, it nearly expressly ignores that, when compared

[41] Consultation Report, at 12.

to exempt 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;
- 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;
- 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).

These realities should be factored into any consideration of expanding the exempt markets. They generally aren't.

The Consultation Report

> proposes modernizing the rules so that this early-stage financing of start-ups can be undertaken by angel groups to assist with capital formation. The Taskforce proposes changes to the current registration requirements to enable angel groups to work with their "accredited investor" members to encourage investments in early stage issuers.[42]

As explained elsewhere, further expanding exemptions to permit issuers to collect capital, but without providing any information and rights to investors, is not risky for investors, but the overall economy. Further, we are aware of absolutely no evidence to suggest that this proposal would lead to any increased net investment in startups. We urge you to abandon this proposal.

[42] Consultation Report, at 33.

Similarly, the Consultation Report recommends that "securities issued by a reporting issuer using the accredited investor prospectus exemption should be subject to only a seasoning period."[43]

After expanding the exempt markets so much in recent years, there is now growing pressure on regulators to ease the tradability of those securities. We have seen a number of proposals, including for creating so-called "venture exchanges" in the US.

Unfortunately, these efforts have the practical impact of simply recreating a "public" functional securities regime--but without the essential disclosures, rights, and accountability that make the regulatory regime function properly.

Sure, market participants would be able to physically trade an exempt security, but upon what information would a price be determined? Would both parties have similar information and rights? What risks exist when one party may have significantly more information and rights than the other in such a transaction?

It does not matter how sophisticated an investor may be, if they don't have the information upon which to use their talents, they are simply gambling. By reducing the holding period for exempt securities, the Taskforce would be essentially recommending that investors and other market participants should be able to more freely trade securities--despite the reality that essential information about those securities and various rights may be very unevenly distributed between the transacting parties. This is likely to result in significant new inefficiencies, including unappreciated risk transfers from larger, better-informed parties to smaller, less-informed parties. It is also likely to dramatically expand risks of fraud, but with markedly lower likelihood of recourse than in non-exempt securities transactions.

Put simply, the four-month time limits on trading exempt securities already far too short.

The Consultation Report troublingly suggests further exacerbating disparities between market participants and expanding risks for investors by expanding the definition of "accredited investors." Specifically, the Taskforce

> proposes to expand the AI definition to those individuals who have completed relevant proficiency requirements, such as the Canadian Securities Course Exam; the Exempt Market Products Exam; the CFA Charter or; who have passed the Series 7 Exam and the New Entrants Course Exam (as defined in NI 31-103).[44]

[43] Consultation Report, at 10.
[44] Consultation Report, at 18.

The SEC is engaged in a very similar exercise in the US. Just last month, in a bitterly partisan vote, the SEC adopted similar reforms to its "accredited investor" definition.[45]

In the US, for the first five decades after the Great Depression, the SEC generally required nearly all offerings of securities to be registered. However, since the 1980s, the SEC has exempted offerings including laxing Rule 506 and 144A requirements, if they are sold to persons or companies that are deemed to be sufficiently "sophisticated" to fend for themselves. Originally, exemptions were conditioned on investors having access to the same types of information they might otherwise get from a registration statement. That is no longer the case. So now, an issuer need not make any material disclosures or provide material or equal rights and information to investors.

At the same time, since "sophistication" is a difficult measure, the SEC and Congress settled on wealth and income thresholds. These thresholds are called "accredited investors" and "qualified institutional buyers," and qualifying persons or firms are thus afforded the "privilege" of making investments without the benefit of the information, rights, or legal protections of the federal securities laws. And for years, there has been a fight over what dollar amounts are appropriate.

As about 70% of capital raised in the US is now exempt from the registration and reporting requirements,[46] there is significant pressure on regulators to permit others to have access to those offerings. After a heated public debate, the SEC voted on August 26, 2020 to revise the definition of "accredited Investor" to ostensibly take into account investors' actual sophistication. It now allows people with Series 7s to invest in private offerings. In theory, that may make sense. However, now the SEC is in a very new and difficult position, where it has to pass judgment on different credentials.[47]

For example, the agency didn't allow Chartered Financial Analysts or Certified Public Accountants to be included at this stage. However, the agency explicitly opened the door to include other designations. We question how the SEC or OSC or some other body could reasonably distinguish between different credentials or accrediting bodies? Is a graduate degree enough? What if it is from McGill University? What about if it is from the University of Phoenix online? How about another set of designations? The SEC has never before assessed the substantive merits of qualifications of investors. We do not believe it is equipped to do that. We similarly don't believe the OSC or other

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[45] See Paul Kiernan, *SEC Gives More Investors Access to Private Equity, Hedge Funds*, Wall Street Journal, Aug. 26, 2020, *available at* https://www.wsj.com/articles/sec-gives-more-investors-access-to-private-equity-hedge-funds-11598452858.

[46] *Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets*, SEC, 85 Fed. Reg. 17956, 17957, Mar. 31, 2020, *available at* https://www.govinfo.gov/content/pkg/FR-2020-03-31/pdf/2020-04799.pdf.

[47] Paul Kiernan, *SEC Gives More Investors Access to Private Equity, Hedge Funds*, Wall Street Journal, Aug. 26, 2020, *available at* https://www.wsj.com/articles/sec-gives-more-investors-access-to-private-equity-hedge-funds-11598452858.

securities market regulator or SRO is currently equipped to undertake this new task without the expenditure of significant new resources and testing.

Separately, the Consultation Report

> proposes that the OSC establish a retail private equity investment fund proposal for public input to incorporate private equity investing good practices, and the strengths of the retail investment fund industry. The Taskforce proposes that the OSC examine an established example in other jurisdictions, such as the Interval Fund concept in the U.S.[48]

As we have said before, no matter how sophisticated the investor, the investor must have relevant data and rights with which to exercise that sophistication. Without addressing those inadequacies, simply expanding the pool of potential investors so more persons is likely to do little more than expand the risks, inefficiencies, and greater costs of the exempt markets--again, to the disadvantage of those with lesser resources, connections, and expertise.

If the Taskforce is focused on promoting fair access to investment products and opportunities to all investors, it should require that those issuers provide timely, relevant information and rights to investors on a fair and transparent basis. That isn't by expanding the exempt markets, but instead reducing those markets dramatically. That way, everyone can invest and have the benefits of the securities laws. Unfortunately, the Taskforce proposals seem to be going in the opposite direction, and letting everyone invest without the benefits of the securities laws, at much greater risk to those investors, the public, and the economy overall.

Focus on Competition in the Marketplace

The Consultation Report is somewhat facially conflicted in that while it would propose adding "fostering competition" to the mission of the OSC,[49] it would separately propose several reforms that, if adopted, would explicitly unlevel the markets in favor of larger market participants versus smaller market participants.

For example, as described above, reducing the content and timeliness of issuer disclosures disadvantages all investors, but the negative impacts will most disproportionately fall on smaller investors who cannot afford alternative data sources or who may not have the financial or other relationships to fill in the new information gaps.

But perhaps the most explicit anti-competitive item listed on the recommendations is the proposal to introduce a version of the "well-known, seasoned issuer" designation. Specifically, the Consultation Report

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[48] Consultation Report, at 22.
[49] Consultation Report, at 6.

> proposes that the Securities Act be amended to allow the OSC to develop a WKSI model in Canada to issue shelf prospectus receipts automatically for issuers that are above a certain public float or have issued debt securities above a set amount in a specified time period and have established an appropriate disclosure record.
>
> The OSC should also consider implementing additional changes to the shelf prospectus system to provide similar accommodations to those available to WKSIs in the United States.[50]

By definition, a WKSI systematically reduces the marginal burdens and cost of capital for larger firms more than smaller firms. Again, we would urge the Taskforce to go in the opposite direction.

But further, the Taskforce seems to ignore the US experience with WKSI offerings. WKSI process in the US has become an increasingly commonly used mechanism to raise capital, and even sell more complex financial products. The shelf offering process has been used to sell, for example, complex products that were linked to market volatility. The risks and complexities have, in some cases, proven to be profound. We do not think that investors should be deprived of the investor protections that accord to "traditional" offerings simply because a company is large enough to frequently offer securities into the marketplace. The investors are buying a specific security, and they should receive the securities law protections afforded to that every time--not just when the issuers are small.

Efforts to Harmonize With and Learn From US Laws and Rules

While we generally urge you to be thinking of ways to harmonize with the US, we think that the Taskforce should be mindful of the evolving regulatory landscape in the US and around the world. Many of the proposals outlined in the Consultation Report have either been proposed or adopted by the SEC in the very recent past in a series of hyper-partisan votes.[51] We urge you to advise caution to the OSC, before it seeks to "match" US efforts that are highly controversial, extremely contested, and likely to be reversed quickly, if there is a change in administrative priorities.

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[50] Consultation Report, at 16.

[51] *See, e.g.*, Hon. Allison H. Lee and Hon. Caroline Crenshaw, *Joint Statement on the Failure to Modernize the Accredited Investor Definition*, SEC, Aug. 26, 2020, *available at* https://www.sec.gov/news/public-statement/lee-crenshaw-accredited-investor-2020-08-26; see also, Hon. Allison H. Lee, *Regulation S-K and ESG Disclosures: An Unsustainable Silence*, SEC, Aug. 26, 2020, *available at* https://www.sec.gov/news/public-statement/lee-regulation-s-k-2020-08-26; Hon. Allison H. Lee, *Paying More For Less: Higher Costs for Shareholders, Less Accountability for Management*, SEC, July 22, 2020, *available at* https://www.sec.gov/news/public-statement/lee-open-meeting-2020-07-22.

Conclusion

We appreciate your efforts to review financial regulation and offer suggested improvements.

As you consider your recommendations, 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 the economy. That will require promoting timely and complete disclosures, investor rights, and competition.

We would welcome discussing these and other matters subject to the Taskforce's review and recommendations at your convenience. Please feel free to contact me to schedule that discussion at (202) 909-6138 or by email at ty@healthymarkets.org.

Thank you for your efforts to continually improve the North American capital markets.

Sincerely,

Tyler Gellasch

Executive Director

EXHIBIT 1

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

[21]

[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* Ihttps://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

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[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;

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[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, Ihttps://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

[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.

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[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"

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[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

[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

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[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]

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[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=AQAAAMAHB5GFl5wQoB3PCBE-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 (202) 909-6138 or by email at ty@healthymarkets.org.

Sincerely,

Tyler Gellasch
Executive Director

EXHIBIT 2

August 28, 2020

Via Electronic Mail

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Reporting Threshold for Institutional Investment Managers[1]

Dear Ms. Countryman:

The Healthy Markets Association[2] objects to the above-referenced proposal to reform the holdings reporting threshold for institutional investors.

The 13F Proposal is contrary to the law and public policy. Further, the Commission has failed to demonstrate that it has conducted the necessary analysis, or has otherwise engaged in an appropriate rulemaking process that is consistent with its statutory obligations.[3]

Because the 13F Proposal is fatally flawed, it should be rescinded.

Background

In July 1968, Congress directed the Commission to study the impact of institutional traders on the markets. In April 1971, the Commission sent its Institutional Investor Study Report to Congress.[4] That Report found "gaps in information about the purchase, sale and holdings of securities by major classes of institutional investors."[5] The Commission's report to Congress recommended that Congress revise the securities

[1] *Reporting Threshold for Institutional Investment Managers*, SEC, Exch. Act Rel. No. 34-89290 (July 10, 2020), *available at* https://www.sec.gov/rules/proposed/2020/34-89290.pdf ("13F Proposal").

[2] 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 or our members, please see our website at http://healthymarkets.org.

[3] See, e.g., Administrative Procedure Act, 5 U.S.C. §551 et seq.

[4] INSTITUTIONAL INVESTOR STUDY REPORT OF THE SECURITIES AND EXCHANGE COMMISSION , House Doc. 92-64, 92nd Cong. (1971), *available at* http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1970/1971_0310_SECInstitutionalInvestor_25.pdf ("1971 SEC Report").

[5] 1971 SEC Report, at X-XI.

laws to require continuous reports of holdings and transactions from "all types of institutional investors."[6] Those sentiments were generally echoed by the President's Commission on Financial Structure and Regulation and by the Senate Subcommittee on Securities in 1973.[7]

As part of the Securities Act Amendments of 1975, Congress adopted section 13(f) of the Exchange Act to provide for the "rapid dissemination of the institutional disclosure information to the public."[8] Section 13(f) expressly requires institutions that exercise discretion over $100 million or more of covered securities ("13(f) Securities") to provide detailed holdings information to investors and the public.[9]

Pursuant to that law, since 1978, the Commission has required institutional owners to file reports within 45 days of the end of the year in which a firm first hits the threshold, and within 45 days following the end of each subsequent quarter.[10] In the more than four decades since the rule was first implemented, the Commission has never adjusted the dollar threshold nor the time horizon for filing reports.

In 1999, the Commission mandated that the filings be made via the SEC's EDGAR system.[11] The data is submitted in a machine-readable (XML) format.[12]

In practice, each quarter, the American Bankers Association creates a list of qualifying securities, and the Commission then publishes that list as the definitive list of 13(f) Securities.[13] That list is not exhaustive. It "generally include[s] equity securities that are traded on an exchange or quoted on National Association of Securities Dealers Automated Quotations (NASDAQ), equity options and warrants, shares of closed-end

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[6] 1971 SEC Report, at XI; *see also, Filing and Reporting Requirements Relating to Institutional Investment Managers*, Sec. and Exch. Comm'n, 43 Fed. Reg. 26700, 26701 (June 22, 1978), *available at* https://tile.loc.gov/storage-services/service/ll/fedreg/fr043/fr043121/fr043121.pdf (Rule 13f-1 Release).

[7] Rule 13f-1 Release, at 26701 (citing to Report of the Senate Subcommittee on Securities, Committee on Banking, Housing. and Urban Affairs, 93rd Cong. (1973)).

[8] Report to Accompany S.249, Securities Act Amendments of 1975, Sen. Rep. No. 94-75, at 87, 94th Cong. 1975 ("Senate Report").

[9] 15 U.S.C. § 78m(f).

[10] Rule 13f-1 Release, at 26701.

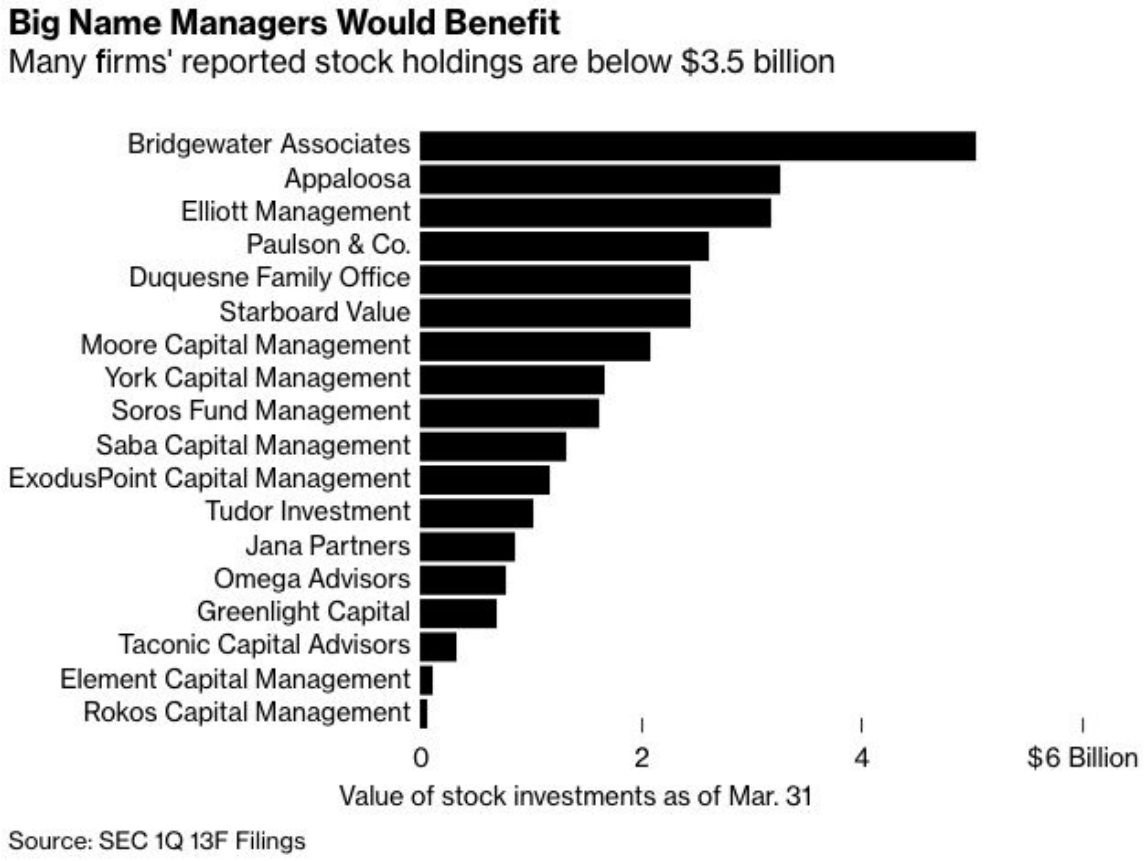
[11] *Rulemaking for EDGAR System*, Sec. and Exch. Comm'n, Exch. Act Rel. No. 34–40934, 64 Fed. Reg. 2843, 2845, (Jan 19, 1999), *available at* https://www.govinfo.gov/content/pkg/FR-1999-01-19/pdf/99-1043.pdf ("EDGAR Reform Adoption").

[12] See generally, EDGAR Form 13F XML Technical Specification (Version 1.3), Sec. and Exch. Comm'n, *available at* https://www.sec.gov/info/edgar/specifications/form13fxmltechspec.htm.

[13] *See, e.g.*, *List of Section 13F Securities, Second Quarter FY 2020*, Sec. and Exch. Comm'n, available at https://www.sec.gov/divisions/investment/13f/13flist2020q2.pdf (reflecting a copyright by the American Bankers Association). Notably, the Commission's Inspector General took issue with the preparation of the list by a third party and with a lack of Commission staff oversight of the process in 2010. See, i.e., SEC IG Report, at vi ("In addition, our review disclosed that a third party prepares the official list of Section 13(f) securities that the Commission is required to provide to the public, and has been doing so since 1981, based upon specifications received from the SEC in 1979. The official list prepared by the third party is posted to the Commission's website each quarter; however, no SEC division or office conducts any review of the list for accuracy and completeness before it is posted.").

investment companies, and some convertible debt securities."[14] It does not include, for example, selling put options, or other derivative equity positions.

As a result, several very large investment firms have only fractions of their total assets counting toward the threshold today.[15] The following chart was prepared by Bloomberg.



Form 13F reports are often filed by "investment advisers, banks, insurance companies, broker-dealers, pension funds and corporations."[16] To assist filers, the Commission maintains a Frequently Asked Questions page on its website containing answers to more than sixty questions.[17] Perhaps because of the relative ease of avoiding the

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[14] SEC IG Report, at v.

[15] See, e.g., Miles Weiss, Benjamin Bain, and Hema Parmar, *Tepper, Einhorn, Soros Stock Holdings Would Go Dark in SEC Plan*, Bloomberg, July 14, 2020, *available at* https://www.bloomberg.com/news/articles/2020-07-14/tepper-einhorn-soros-stock-holdings-would-go-dark-in-sec-plan (noting that "Bridgewater Associates, the world's biggest hedge fund manager with $138 billion of assets, is in striking distance of the SEC's suggested limit because the firm holds just $5 billion of stocks.").

[16] Review of the SEC's Section 13f Reporting Requirement, Inspector General of the Sec. and Exch. Comm'n, Rep. 480, at iv, Sept. 27, 2010, *available at* https://www.sec.gov/files/480.pdf ("SEC IG Report").

[17] *Frequently Asked Questions About Form 13F*, Sec. and Exch. Comm'n, *available at* https://www.sec.gov/divisions/investment/13ffaq.htm (updated Feb. 24, 2020).

thresholds or the ease in making the reports, there has been essentially no significant effort to materially ease the filing burdens on institutional investors.

However, for years, corporate issuers and their advocates have expressed concerns to the Commission and Congress that activist funds were able to escape the reporting requirements by acquiring financial exposures that weren't on the list of 13(f) Securities, but were nevertheless equivalent to equity interests.

As discussed below, some fund investors have been able to acquire significant interests in companies without having to file Forms 13F and alerting the company, other market participants, or regulators. Further, the rules don't expressly prohibit "wolf pack" behavior, where different investors may work together to establish significant holdings in a company, again, without alerting the company, other market participants, or regulators. Congress and the SEC have, in the past, explored efforts to revise the requirements to address these perceived loopholes.

At the same time, market participants and their advocates have asked the Commission to shorten the reporting period significantly from the existing 45 days. For example, in 2013, NYSE Euronext, the Society of Corporate Secretaries and Governance Professionals and the National Investor Relations Institute jointly filed a rulemaking petition to the Commission asking for the agency to cut the 45 day reporting period down to two days.[18]

13F Proposal

The 13F Proposal would, by rule, purport to raise the statutory threshold of $100 million to $3.5 billion, thus exempting approximately 90% of the current form 13F filers from having to make the submissions. The 13F Proposal does not address the timing of the reports nor what counts towards the threshold.

The 13F Proposal Is Inconsistent with the Federal Securities Laws and the Provision's Legislative History

The 13F Proposal ignores the law, the legislative history, and the clear purpose for the law itself.

The statute itself declares that "every" manager holding 13(f) Securities whose "aggregate fair market value on the last trading day in any of the preceding twelve months [was] at least $100,000,000 ***or such lesser amount*** (but in no case less than $10,000,000) as the Commission, by rule, may determine, shall file reports."[19]

The statute itself does not contemplate the Commission raising the reporting threshold

[18] Letter from Janet McGinness, NYSE Euronext, et. al. to Elizabeth M. Murphy, Sec. and Exch. Comm'n, Feb. 1, 2013, available at https://www.sec.gov/rules/petitions/2013/petn4-659.pdf.
[19] 15 U.S.C. § 78m(f) (emphasis added).

beyond $100 million. However, the statute expressly contemplates lowering the reporting threshold, but then limits the Commission's authority to set the threshold below $10 million. Put simply, the statute establishes a range within which the threshold is to be set: $10-$100 million.

The legislative record similarly contemplates lowering the threshold, but not raising it beyond $100 million.[20] The Senate Report repeatedly references the $100 million threshold as the "initial" level, and suggests that the Commission would subsequently lower that threshold.[21] The express purpose of starting at $100 million was to capture the largest institutional investors first, which Congress opined could be done relatively quickly and efficiently, and then expand the requirement to smaller managers thereafter.[22]

The 13F Proposal ignores the statutory language, the legislative history of the provision, and the reason Congress established the institutional holdings reporting requirement. The Commission can't do that.

The Commission Fails to Collect and Analyze Relevant Data, Including the Impacts on Market Participants, the Public, and the Commission Itself

The limited analysis provided in the 13F Proposal is an embarrassment to the Commission, and insufficient to withstand legal challenge.

When invalidating another recent Commission action, the DC Circuit explained that

> To 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.'[23]

The Commission has not done that.

The 13F Proposal doesn't examine the purpose of the statute, who uses the filings, why, and to what benefits. It doesn't examine the consequences of the 13F Proposal on

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[20] Report to Accompany S.249, Securities Act Amendments of 1975, Sen. Rep. No. 94-75, at 87, 94th Cong. 1975 ("Senate Report"). But see Senate Report, at 107. We recognize that one sentence in the record suggests that the Commission could raise the threshold, we believe that this authority was intended to adjust the threshold over time within the dollar range created by the statutory language itself ($10-$100 million).

[21] Senate Report, at 86 (noting that the Commission could lower the threshold down to as low as $10 million).

[22] Senate Report, at 86 (noting that by ""limiting initially the impact of the reporting provisions to the largest institutional investment managers, the institutional disclosure program could be implemented rapidly with the least amount of unnecessary costs and burdens.").

[23] *Susquehanna Int'l Group LLP, et al, v. SEC*, 866 F.3d 442, 445 (D.C. Cir. 2017) (internal citations omitted).

the markets, market participants, or itself. Instead, the 13F Proposal essentially relies on four disparate assertions:

- Congress explicitly focused on larger asset managers in 1975, out of sensitivity to the "burdens" of making the filings on smaller firms;
- Since 1975, the market capitalization of the public markets has grown approximately 35 times;[24]
- Since 1975, the number of firms subject to the filing requirement has grown approximately 17 times; and[25]
- Seventeen years ago someone sent the Commission a letter and ten years ago the SEC's Inspector General wrote a report suggesting that the threshold be raised to reflect inflation since 1975.[26]

The Commission's assertions are materially misleading. As described above, Congress "initially" set the filing threshold at $100 million with a clear expectation that the Commission would later lower the threshold. It was never meant to apply to only the very largest firms. Similarly, the clear interest by market participants has been to enhance the reporting requirements, not reduce them.

But perhaps most importantly, the 13F Proposal seems to ignore the reasons Congress established the filing requirement in the first instance. Congress established Section 13(f) for both public and regulatory purposes. According to the Senate Report:

[24] 13F Proposal, at 11.
[25] 13F Proposal, at 11.
[26] 13F Proposal, at 12-13.

B. USES FOR THE INFORMATION

1. Public Use

Perhaps the most important justification for the information collection program which this bill would authorize is the need to collect and disseminate to individual investors data about institutional investment managers. Many people believe that it is not possible to make informed investment decisions on a security without information related to the likely market activity and the degree of institutional concentration in the security. Institutional concentration may suggest a number of things to a variety of investors. For example, to some it may be a good sign because it may suggest that sophisticated investors believe the security is a good investment. To others, it may be a danger sign indicating a potential depressing "overhang," market illiquidity, or high price volatility. That different investors may draw different conclusions from the data is not important; rather, what is important is that information about the securities holdings and certain transactions of institutional investment managers be available to all investors—both institutional and individual—so that they can all have it, whatever its relative usefulness in making their independent judgments. Thus, with the dissemination of data about institutional investment managers, an institutional disclosure program should stimulate a higher degree of confidence among all investors in the integrity of our securities markets. [27]

As anticipated, the filings are used today by academics and market participants. As the Commission has its explicitly acknowledged

> investors would find the information contained in Form 13F filings useful in tracking institutional investor holdings in their investments and that issuers, too, would find detail as to institutional investor holdings useful because much of their shareholder list may reflect holdings in ''street name'' rather than beneficial ownership.[28]

Today, the filings are used by companies. For example, in its joint rulemaking petition to the Commission in 2013, NYSE Euronext explicitly noted that issuers use the disclosures to engage with their owners, and that more timely disclosures would help issuers better communicate with their large shareholders, particularly for proxy considerations. The 13F Proposal ignores that information.

The filings are used by academics. For example, the filings have been used by academics to study the value and impacts of activist hedge fund strategies.[29] The 13F Proposal also essentially ignores that information.

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[27] Senate Report, at 82.
[28] EDGAR Reform Adoption, at 2845.
[29] See, e.g., Lucian Bebchuck, Alon Brav, Wei Jiang, *Long-Term Effects of Hedge Fund Activism*, NBER Working Paper No. 21227, 2015, *available at* https://www.nber.org/papers/w21227.

The Senate Report expects regulators to use the collected data.

> *2. Use by Regulatory Agencies*
>
> Moreover, the SEC, bank regulatory agencies, and other agencies (both federal and state) could be expected to make extensive use of the institutional disclosure data in fulfilling their responsibilities to consider and develop standards designed to protect the public interest within a consistent and coordinated regulatory framework. It would be expected that the SEC might use the institutional disclosure data in two generally different ways: to analyze the characteristics of institutional investment managers, and to analyze the impact of institutional investment managers on the securities markets. [30]

The Commission does not even acknowledge, much less contemplate how those actual and potential uses of information would be impacted by the 13F Proposal. It must.

While the Commission has failed to offer any meaningful justification or analysis of the impact of the 13F Proposal, market research and data firm IHS Markit has prepared a detailed analysis of the impact of the 13F Proposal.[31] That analysis is devastating.

- **The Proposal would exempt approximately 90% of current filers.** According to the IHS Markit Analysis, the new requirement would exempt about 90% of current filers. In drafting Section 13f, Congress explicitly stated that the purpose of the requirement was to "facilitate consideration of the influence and impact of institutional investment managers on the securities markets and the public policy implications of that influence." How is that purpose furthered by exempting so many investors?

  The Commission does not address these basic inconsistencies between the clear intent and language of the statute and the 13F Proposal. It must

- **Holders of a huge swath of companies would disappear.** Specifically, on average, 55% of an issuer's shareholders would stop filing Form 13Fs. As a result, issuers, market participants, and regulators would have a much narrower view of the holders of any particular issuer. Again, how can the "influence" of institutional investors be studied when the majority of a company's shareholders (and over two-thirds of its hedge fund shareholders) would be exempted?

  The Commission again does not address these basic inconsistencies between the clear intent and language of the statute and the 13F Proposal. It must.

- **The Proposal would disproportionately hurt transparency into smaller companies.** The percentage of holdings that would be excluded would be relatively small for mega cap (4.4%) and large cap (5.5%) companies, but would be significantly larger for small cap (14.6%) and micro cap (17.1%) companies.

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[30] Senate Report, at 83.

[31] *SEC's 13F Proposal – Issuer and Investor Analysis*, IHS Markit-Ipreo, Aug. 7, 2020, *available at* https://ipreo.com/blog/secs-13f-proposal-issuer-and-investor-analysis/.

We find this shocking loss of transparency into smaller companies deeply concerning for both the issuers and investors in these companies. It is also impossible to reconcile with the rhetorical support often proffered by the political leaders at the Commission for "small and emerging companies."

The Commission offers no analysis related to this disparate impact on issuers of different sizes. It must.

- **The Proposal would have disparate impacts across different industries.** According to the IHS Markit analysis, the Energy (16.5%), Healthcare (14.9%), and Technology (12.8%) sectors would be severely impacted, as there would be a significant loss into transparency of those companies. However, there would not be a significant loss to the transparency of holdings in Utilities (6.0%).

  The Commission offers no analysis related to this disparate impact on issuers of different sizes. It must.

- **The Proposal would generally not impact index funds, but would dramatically reduce filings by active funds.** According to the IHS Markit analysis, "[s]pecialty investors (20.4%) and alternative investors (32.9%) are the clear outliers as they would dramatically file for less dollars."

  The Commission offers no analysis related to this disparate impact on investors using different strategies. It must.

- **The Proposal punishes long term investors, but rewards high-turnover investors.** According to the IHS Markit analysis, "[v]ery high turnover firms would not have to file for 11 times more of their share value than low turnover investors." In fact, 86% of "activist" investors would no longer have to file Form 13Fs.

  Again, the Commission offers no analysis related to this disparate impact on investors using different dime horizons. It must. And even further, this disparate impact seems directly contrary to the Commission's previously stated interest in promoting long-term investment and capital formation.

While the 13F Proposal explicitly acknowledges that it would "take dark" holdings of more than 4,500 institutional investors managing more than $2.3 trillion in assets, it offers no reasoned analysis as to why they are taking this action and the practical impacts on issuers, investors, other market participants, and regulators. As the IHS Markit analysis confirms, this impact on transparency will be profound.

As previously stated, the 13F Proposal is contrary to the statute, unsupported by substantial evidence, and a clear abuse of the Commission's discretion.[32]

[32] See, *Susquehanna Int'l Group LLP, et al, v. SEC*, 866 F.3d 442, 445 (D.C. Cir. 2017).

The Commission Fails to Examine the Definition of 13(f) Securities

The Commission has effectively outsourced its job of defining "equity securities" under the statute to a third party. And that list does not capture all financial products that can give rise to an economic equivalent of an equity interest or position. The proliferation of complex financial products and strategies has resulted in significant gaps in the existing reporting framework.

The 13F Proposal fails to examine how the definition of 13(f) Securities has impacted filers and users of the disclosures over the decades. For example, has the proliferation of new and complex financial products allowed some types of investors to avoid making these filing requirements?

These are not theoretical concerns. For example, in September 2019, activist investor Elliott Management Corporation publicly released a letter to the Board of Directors AT&T in which the company claimed that it "owns $3.2 billion of the common stock and economic equivalents of AT&T Inc."[33] At the same time, the firm's 13F filings did not appear to reflect nearly that amount. One possibility for the discrepancy could be the use of synthetic long positions that may not have to be disclosed. The strategy of activist funds seeking to avoid public and regulatory holdings disclosures is not unique to the United States. In fact, just a few months ago, Elliott Management was fined €20 million by the French financial regulator, Autorité des Marchés Financiers, for failing to timely file accurate holdings reports related to the firm's holdings in Norbert Dentressangle, a French logistics firm that was the subject of a takeover dispute.[34]

In summary, the definition of 13(f) Securities clearly warrants Commission review and consideration for potential revisions.[35] The Commission has been asked to undertake that review. Yet, the 13F Proposal roundly ignores that information.

The Commission Fails to Examine the Timeliness of Reports

The 13F Proposal ignores recent requests by market participants to improve the timeliness of reporting. Under the existing filing framework, an investor could take a significant position on the first trading day of the year and not have to disclose it until mid-May.

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[33] Letter from Jesse Cohn and Mark Steinberg, Elliott Management Corp., to Board of Directors of AT&T, Inc., Sept. 9, 2019, *available at* https://www.busin€esswire.com/news/home/20190909005482/en/Elliott-Management-Sends-Letter-Board-Directors-ATT.

[34] David Keohane, *French markets regulator fines hedge fund Elliott €20m*, Financial Times, Apr. 22, 2020, *available at* https://www.ft.com/content/976d1e30-e0cf-473f-a743-a6def0c3f21d.

[35] We also question whether the American Bankers Association is the apparent preparation agent for the list, and whether alternatives may better support the intended purpose of the requirement. Similarly, we question whether there may be better alternatives to relying on licensed intellectual property.

Today, investors are able to know and assess the associated risks of their holdings in time increments measured in seconds, minutes, and hours. We find it exceedingly difficult to argue that 45 days following the end of a quarter is a "rapid" disclosure of holdings in today's world.

One cannot credibly suggest five decades of computerized innovation haven't made the gathering of the data, preparation of the filings, and process for submitting the filings significantly easier for reporting firms.

The Commission has been asked to update the rules to match the intent of the law. It hasn't. Instead, the 13F Proposal ignores that information.

Concerns with Propriety and Origins of the 13F Proposal

Finally, the extraordinarily disparate impacts on investors using different strategies, combined with its lack of statutory, evidentiary, or public support, raise significant questions regarding the origins and intent of the 13F Proposal. Put bluntly, the 13F proposal looks and smells like a political favor that is intended to benefit one or more of a small handful of specific activist shareholders or special interests. We urge the Commission to refer the matter to the Inspector General for further inquiry to ensure the propriety of the Commission's regulatory agenda and processes.

Conclusion

We encourage the Commission to study the disclosure of fund holdings, and offer suggested improvements, but those improvements should be focused on promoting transparency and accountability, not obfuscation.

The 13F Proposal is contrary to the law, unsupported by the evidence, and unsupported by reasoned analysis. Accordingly, it should be rescinded.

Thank you for your consideration. Should you have any questions or would like to discuss our letter or exhibit further, please contact me at (202) 909-6138.

Sincerely,

Tyler Gellasch
Executive Director