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Recommendations Of SEC Government-Business Forum On Small Business Capital Formation

The following is written by Laura Anthony, Esq., a going public attorney focused on OTC listing requirements, direct public offerings, going public transactions, reverse mergers, Form 10 and Form S-1 registration statements, SEC compliance and OTC Market reporting requirements.

In early April, the SEC Office of Small Business Policy published the 2016 Final Report on the SEC Government-Business Forum on Small Business Capital Formation, a forum I had the honor of attending and participating in. As required by the Small Business Investment Incentive Act of 1980, each year the SEC holds a forum focused on small business capital formation. The goal of the forum is to develop recommendations for government and private action to eliminate or reduce impediments to small business capital formation.

The forum is taken seriously by the SEC and its participants, including the NASAA, and leading small business and professional organizations. The forum began with short speeches by each of the SEC commissioners and a panel discussion, following which attendees, including myself, worked in breakout sessions to drill down on specific issues and suggest changes to rules and regulations to help support small business capital formation, as well as the related, secondary trading markets. In particular, the three breakout groups were on exempt securities offerings; smaller reporting companies; and the secondary market for securities of small businesses.

Each breakout group is given the opportunity to make recommendations. The recommendations were refined and voted upon by the forum participants in the few months following the forum and have now been released by the SEC in a report containing all 15 final recommendations. In the process, the participants ranked the recommendations by whether it is likely the SEC will give high, medium, low or no priority to each recommendation.

Recommendations often gain traction. For example, the forum first recommended reducing the Rule 144 holding period for Exchange Act reporting companies to six months, a rule which was passed in 2008. Last year the forum recommended increasing the financial thresholds for the smaller reporting company definition, and the SEC did indeed propose a change following that recommendation.last year the forum recommended changes to Rule 147 and 504, which recommendations were considered in the SEC's rule changes that followed.

Forum Recommendations

The following is a list of the recommendations listed in order or priority. The priority was determined by a poll of all participants and is intended to provide guidance to the SEC as to the importance and urgency assigned to each recommendation. I have included my comments and commentary with the recommendations.

1. As recommended by the SEC Advisory Committee on Small and Emerging Companies, the SEC should (a) maintain the monetary thresholds for accredited investors; and (b) expand the categories of qualification for accredited investor status based on various types of sophistication, such as education, experience or training, including, but not limited to, persons with FINRA licenses, CPA or CFA designations, or management positions with issuers.

2. The definition of smaller reporting company and non-accelerated filer should be revised to include an issuer with a public float of less than $250 million or with annual revenues of less than $100 million, excluding large accelerated filers; and to extend the period of exemption from Sarbanes 404(b) for an additional five years for pre- or low-revenue companies after they cease to be emerging-growth companies.

3. Lead a joint effort with NASAA and FINRA to implement a private placement broker category including developing a workable timeline and plan to regulate and allow for "finders" and limited intermediary registration, regulation and exemptions. I think this topic is vitally important. The issue of finders has been at the forefront of small business capital formation during the 20+ years I have been practicing securities law.

Despite all these efforts, it has been very hard to gain any traction in this area. Part of the reason is that it would take a joint effort by FINRA, the NASAA and both the Divisions of Corporation Finance and Trading and Markets within the SEC. This area needs attention. The fact is that thousands of people act as unlicensed finders—an activity that, although it remains illegal, is commonplace in the industry. In other words, by failing to address and regulate finders in a workable and meaningful fashion, the SEC and regulators perpetuate an unregulated fringe industry that attracts bad actors equally with the good and results in improper activity such as misrepresentations in the fundraising process equally with the honest efforts. However, practitioners, including myself, remain committed to affecting changes, including by providing regulators with reasoned recommendations.

1. The SEC should adopt rules that pre-empt state registration for all primary and secondary trading of securities qualified under Regulation A/Tier 2, and all other securities registered with the SEC. I have been a vocal proponent of state blue sky pre-emption, including related to the secondary trading of securities. Currently, such secondary trading is usually achieved through the Manual's Exemption, which is not recognized by all states. There is a lack of uniformity in the secondary trading market that continues to negatively impact small business issuers.

2. Regulation A should be amended to: (i) pre-empt state blue sky regulation for all secondary sales of Tier 2 securities (included in the 4th recommendation above); (ii) allow companies registered under the Exchange Act, including at least business development companies, emerging-growth companies and smaller reporting companies, to utilize Regulation A; and (iii) provide a clearer definition of what constitutes "testing-the-waters materials" and permissible media activities.

3. Simplify disclosure requirements and costs for smaller reporting companies and emerging-growth companies with a principles-based approach to Regulation S-K, eliminating information that is not material, reducing or eliminating non-securities-related disclosures with a political or social purpose (such as pay ratio, conflict minerals, etc.), making XBRL compliance optional and harmonizing rules for emerging-growth companies with smaller reporting companies.

4. Mandate comparable disclosure by short sellers or market makers holding short positions that apply to long investors, such as through the use of a short selling report on Schedule 13D.

5. The SEC should provide scaled public disclosure requirements, including the use of non-GAAP accounting standards that would constitute adequate current information for entities whose securities will be traded on secondary markets. This recommendation came from the secondary market for securities of small businesses breakout group. I was part of the smaller reporting companies breakout group, so I did not hear the specific discussion on this recommendation. However, I do note that Rule 144 does provide for a definition of adequate current public information for companies that are not subject to the Exchange Act reporting requirements. In particular, Rule 144 provides that adequate current public information would include the information required by SEC Rule 15c2-11 and OTC Markets specifically models its alternative reporting disclosure requirements to satisfy the disclosures required by Rule 15c2-11.

6. The eligibility requirements for the use of Form S-3 should be revised to include all reporting companies.

7. The SEC should clarify the relationship of exempt offerings in which general solicitation is not permitted, such as in Section 4(a)(2) and Rule 506(b) offerings, with Rule 506(c) offerings involving general solicitation in the following ways: (i) the facts and circumstances analysis regarding whether general solicitation is attributable to purchasers in an exempt offering should apply equally to offerings that allow general solicitation as to those that do not (such that even if an offering is labeled 506(c), if in fact no general solicitation is used, it can be treated as a 506(b); and (ii) to clarify that Rule 152 applies to Rule 506(c) so that an issuer using Rule 506(c) may subsequently engage in a registered public offering without adversely affecting the Rule 506(c) exemption. I note that within days of the forum, the SEC did indeed issue guidance on the use of Rule 152 as applies to Rule 506(c) offerings, at least as relates to an lternative trading systemintegration analysis between 506(b) and 506(c) offerings.

8. The SEC should amend Regulation ATS to allow for the resale of unregistered securities including those traded pursuant to Rule 144 and 144A and issued pursuant to Sections 4(a)(2), 4(a)(6) and 4(a)(7) and Rules 504 and 506.

9. The SEC should permit an ATS to file a 15c2-11 with FINRA and review the FINRA process to make sure that there is no undue burden on applicants and issuers. An ATS is an "alternative trading system." The OTC Markets' trading platform is an ATS. This recommendation would allow OTC Markets to directly file 15c2-11 applications on behalf of companies. A 15c2-11 application is the application submitted to FINRA to obtain a trading symbol and allow market makers to quote the securities of companies that trade on an ATS, such as the OTC Markets. Today, only market makers seeking to quote the trading in securities can submit the application. Also today, the application process can be difficult and lack clear guidance or timelines for the market makers and companies involved. This process definitely needs attention and this recommendation would be an excellent start.

10. Regulation CF should be amended to (i) permit the usage of special-purpose vehicles so that many small investors may be grouped together into one entity which then makes a single investment in a company raising capital under Regulation CF; and (ii) harmonize the Regulation CF advertising rules to avoid traps in situations where an issuer advertises or engages in general solicitations under Regulation A or Rule 506(c) and then converts to or from a Regulation CF offering.

11. The SEC should provide greater clarity on when trading activities require ATS registration, and when an entity or technology platform needs to a funding portal, broker-dealer, ATS and/or exchange in order to "be engaged in the business" of secondary trading transactions.

12. Reduce the Rule 144 holding period to 3 months for reporting companies. I fully support this recommendation.

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Securities Law Blog is written by Laura Anthony, Esq., a going public lawyer focused on OTC Listing Requirements, Direct Public Offerings, Going Public Transactions, Reverse Mergers, Form 10 Registration Statements, and Form S-1 Registration Statements. Securities Law Blog covers topics ranging from SEC Compliance, FINRA Compliance, DTC Chills, Going Public on the OTC, and OTCQX and OTCQB Reporting Requirements. Ms. Anthony is also the host of LawCast.com, the securities law network.

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