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JOBS and Investor Confidence Act (House-Amended S. 488): Capital Markets Provisions

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JOBS and Investor Confidence Act (House-Amended S. 488): Capital Markets

SUMMARY

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Capital markets provide financing for businesses to fund their growth that would facilitate innovation and jobs creation, and enhance the society's overall standard of living. They are segments of the financial system in which funding is raised through issuing and trading equity or debt securities, which are forms of financial assets representing ownership or indebtedness of a firm. They are considered the largest source of financing for U.S. nonfinancial companies, significantly larger than bank loans and other forms of financing.

The Securities and Exchange Commission (SEC) is the principal regulator of U.S. capital markets. In recent years, Congress and the SEC began to increasingly direct capital markets regulation away from its traditional "one size fits all" approach. Starting in 2012, the bipartisan Jumpstart Our Business Startups Act (JOBS Act; P.L. 112-106) has scaled regulation for smaller companies and reduced regulations in general for certain types of capital formation. It established a number of new options to expand capital access, including a new provision for crowdfunding. Starting in 2015, parts of the Fixing America's Surface Transportation Act (P.L. 114-94)—referred to as JOBS Act 2.0—provided additional scaled disclosure and reporting related regulatory relief for smaller companies. Following the JOBS Act and JOBS Act 2.0, capital markets regulation has become even more tailored to suit companies of different sizes and with different needs.

However, concerns over capital formation persisted, given that smaller companies continue to face challenges to accessing capital, and the number of initial public offerings (IPOs) remained at far below long-term average levels post-JOBS Act. To address these concerns, Congress has considered numerous legislative proposals to further expand the scaled approach, with some proposals building on existing JOBS Act provisions. The most notable of these proposals is the JOBS and Investor Confidence Act of 2018 (House-amended S. 488), a capital markets package referred to as JOBS Act 3.0. The House replaced the content of the original S. 488 and passed the amended measure by a 406-4 vote on July 17, 2018. The package includes 32 titles, many of which have previously passed the House with bipartisan support as standalone bills. Of the 32 titles, 18 are more capital markets related. They can be grouped under four general categories:

- **Expand Investor Access.** One approach to expand capital access is to expand the investor pool or enhance investor communications. Some of the provisions propose to expand (1) the type of eligible investors by widening certain eligible investor definitions, as seen in Titles IV and X; (2) the number of eligible investors allowed to participate in certain offerings, as seen in Title XXXII; and (3) the communication to eligible investors by allowing broader outreach, as seen in Title I.
- **Reduce Compliance Costs.** Some believe compliance costs could potentially outweigh benefits and are disproportionately burdensome for small and medium-sized businesses. In response to these concerns, certain provisions aim to reduce (Titles V and IX) or better understand (required studies in Titles XXII and XXXI) compliance costs for publicly listed companies.
- **Promote Financial Intermediation.** Capital markets consist of numerous players. Between investors and company issuers, who are the end contributors and recipients of funding, there are financial intermediaries that serve to channel funding or execute trades. Titles XXVI (a required study) and XXXII would promote the use of pooled investment vehicles to channel funding from investors to issuers. Title XXIV would require a study on investment research of small issuers, and Title XX would create a designated new marketplace for smaller issuer stock trading.
- **Increase Investor Protection.** Multiple S. 488 titles would create investor protection safeguards as part of a provision related to capital formation. Other provisions center on investor protection. For example, Titles XXVII (a required study) and XXIX would provide protection to general investors against corporate insiders, and Title XXX would provide targeted protection to senior investors who are victims of financial exploitation.

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Introduction

The JOBS and Investor Confidence Act (S. 488) is a capital markets package consisting of 32 titles that have mostly already passed the House with bipartisan support as standalone bills.[1] Originally a relatively narrow bill, the earlier version of S. 488 was referred to as the Encouraging Employee Ownership Act and was passed by the Senate on September 11, 2017. The original bill's content was incorporated into Section 507 of S. 2155, which was signed into law on May 24, 2018 (P.L. 115-174). A substitute amendment to S. 488 was passed by the House on July 17, 2018, in a 406-4 vote (hereinafter, all discussion of S. 488 refers to the House-amended version of the bill). The package has been referred to as JOBS Act 3.0, following after the initial Jumpstart Our Business Startups Act (JOBS Act; P.L. 112-106) in 2012 and the financial services provisions signed into law as part of the Fixing America's Surface Transportation Act (P.L. 114-94), which are referred to as JOBS Act 2.0.

Some of the provisions in S. 488 are part of a long-running debate about financial market regulation. In response to the 2007-2008 financial crisis, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act; P.L. 111-203) on July 21, 2010.[2] The Dodd-Frank Act is generally regarded as a regulatory overhaul that broadly tightened the U.S. financial regulatory landscape. Since the Dodd-Frank Act, there have been multiple attempts to provide regulatory relief through either repeals to sections of the Dodd-Frank Act or new proposals.

Two of these legislative attempts to provide regulatory relief are the Financial CHOICE Act (FCA; H.R. 10)[3] and the Economic Growth, Regulatory Relief, and Consumer Protection Act (S. 2155, P.L. 115-174).[4] H.R. 10 is a wide-ranging financial reform bill that was passed by the House on June 8, 2017. P.L. 115-174 is a narrower proposal that was passed by the Senate on March 14, 2018, and then passed by the House and signed into law in May 2018. Several of the provisions in H.R. 10 that were not included in P.L. 115-174, many of which are related to capital markets, are included in S. 488. S. 488 passed the House with close to unanimous support. In addition, many S. 488 provisions were included in a House-passed appropriations bill (H.R. 6147). Table A-1 highlights these provisions.

Although S. 488 is generally referred to as a capital markets package, it addresses various other topics; for example, insurance and human trafficking financing (see **Table A-1** for a full list of the 32 titles). S. 488's capital markets provisions are largely focused on smaller companies' access to capital. In addition, several of the titles are oriented toward studies, some of which include recommendations for regulatory action.

This report summarizes the 18 capital markets provisions in S. 488, as amended and passed by the House. Capital markets, for purposes of this report, refer to the segments of the financial system under Securities and Exchange Commission (SEC) oversight and in which funding is raised through equity or debt securities. The report divides the 18 provisions into four general

[1] U.S. Congress, House Financial Services, "House Passes Bipartisan 'JOBS & Investor Confidence Act'," press release, July 17, 2018, at https://financialservices.house.gov/news/email/show.aspx?ID=7UD3NQFEEE64BPYFPVE5Z6WSBQ.

[2] See CRS Report R41350, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Background and Summary*, coordinated by Baird Webel.

[3] See CRS Report R44839, *The Financial CHOICE Act in the 115th Congress: Selected Policy Issues*, by Marc Labonte et al.

[4] See CRS Report R45073, *Economic Growth, Regulatory Relief, and Consumer Protection Act (P.L. 115-174) and Selected Policy Issues*, coordinated by David W. Perkins.

categories: (1) expand investor access, (2) reduce compliance costs, (3) promote financial intermediation, and (4) increase investor protection. These categories may not be mutually exclusive. For example, the proposed changes to Regulation Crowdfunding (see "Title XXXII–Crowdfunding Amendments" section below) could be interpreted as expanding investor access through the amendments to the SEC registration threshold; promoting financial intermediation through the use of pooled investment vehicles; and increasing investor protection through the investment adviser registration requirements. In such case, one primary category is chosen according to the provision's principal functions.

Expand Investor Access

The expansion of investor access is one method to increase funding for issuers (companies looking to raise money) and generate additional investment opportunities for investors. There are two types of securities offerings. One type is called *public offerings*, which are available to all types of investors and have more rigorous disclosure requirements. By contrast, securities offerings that are exempt from SEC registration are referred to as *private offerings* and are mainly available to more sophisticated investors.[5] Because public offerings are already accessible by all investors, the discussions of expanding investor access often revolve around private offerings.

For purposes of investor protection, private offerings are often limited in the kinds of investors to which they can be offered. Two common approaches to expanding capital access are to expand the investor pool or enhance investor communication for private offerings. Some of the S. 488 provisions propose to expand (1) the type of eligible investors by widening the accredited investor definition, as seen in Titles IV and X; and (2) the communication to eligible investors by allowing broader outreach, as seen in Title I.

Title I–Helping Angels Lead Our Startups

Title I would require the SEC to issue a rule that exempts promotional events for private corporate securities offerings called demo days from general solicitation rules in federal securities law under certain conditions.

Prospective corporate issuers often find it useful to market their private offerings at promotional events known alternatively as demo days, venture fairs, or pitch days (generically referred to as demo days). The events are often sponsored by angel investors (early-stage investors, mostly high-net-worth individuals), venture capital associations, nonprofits, or universities and are used to communicate that a company is interested in, if not actively seeking, investor financing.

Rule 506 of Regulation D (Reg D) under the Securities Act of 1933 permits companies to offer privately placed (through private markets) equity or debt securities offerings to any number of accredited investors (financial institutions and individual investors who meet certain asset or income thresholds) and up to 35 nonaccredited investors without being subject to state and federal securities registration requirements.[6] Popular with emerging companies, Rule 506 offerings have no size limits but were historically subject to a general solicitation ban (a prohibition on their general promotion or advertising). Responding to concerns that the ban was unduly burdensome, the JOBS Act amended Rule 506 by creating an offering category under Reg D called Rule

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[5] See CRS In Focus IF10747, *Private Securities Offerings: Background and Legislation*, by Eva Su.

[6] 17 C.F.R. §230.506. More details see SEC, *Rule 506 of Regulation D*, at https://www.sec.gov/fast-answers/answers-rule506htm.html.

506(c), wherein issuers can engage in general solicitations to accredited investors while taking "reasonable steps" to verify that status. After the rule's adoption, whether an issuer was still subject to the general solicitation ban during demo days remained a question for many.[7]

The SEC's 2015 question and answer guidance document attempted to provide more clarity. It states that if prospective investors were invited to a demo day by an issuer or a person acting on its behalf via a general solicitation, the issuer can then use Rule 506(c) if it takes reasonable steps to verify that a purchaser is an accredited investor and that the offering is limited to such investors.[8]

Notwithstanding the SEC guidance, uncertainty over the applicability of the general solicitation ban at demo days has persisted. Moreover, there are other concerns that even if the general solicitation ban was clearly not being enforced at demo days, the demands of the accredited investor verification process would discourage investor interest.[9]

Title I attempts to address the aforementioned concerns related to demo days. It would require the SEC to revise Rule 506 to clarify that the limits on general solicitation are not applicable to presentations, communications, or events conducted on behalf of an issuer at an event sponsored by certain organizations, including (1) the United States or any territory, the District of Columbia, or any state; (2) a college, university, or other institution of higher education; (3) a nonprofit organization; (4) an angel investor group; (5) a venture forum, venture capital association, or venture capital trade association; or (6) any other group, person, or entity that the SEC designates.

Analyzing similar legislation in the 114th Congress (H.R. 4498), the Congressional Budget Office (CBO) estimated that the cost of the SEC's implementation would be less than $1 million.[10]

Title IV and X–Fair Investment Opportunities for Experts and Family Office Technical Correction

Titles IV and X would broaden the definition of *accredited investors* to include more investors with technical expertise.

The purpose of the accredited investor concept is to identify entities and persons who can bear the economic risk of investing in unregistered securities and to protect ordinary investors from excess risk and potential fraud.[11] Qualifying as an accredited investor is significant because accredited investors may participate in investment opportunities that are generally not available to nonaccredited investors, such as investments in private companies and offerings by hedge funds, private equity funds, and venture capital funds.[12]

According to the SEC's current definition, an accredited investor, in the context of an individual, is defined using a number of income and net worth measures: (1) earned income that exceeded

[7] For example, see Carastone Law Firm, "SEC Says Demo Days and Pitch Events May Not Be General Solicitation," August 13, 2015, at https://carastone.com/sec-says-demo-days-and-pitch-events-may-not-be-general-solicitation/.

[8] Available at https://www.sec.gov/divisions/corpfin/cfnew/cfnew0815.shtml.

[9] Kiran Lingam, "General Solicitation Rules: The Old Way Preserved Under 506(b), Or Is It?" Seed Invest, September 15 2016, at https://www.seedinvest.com/blog/jobs-act/general-solicitation-rules-the-old-way-preserved-under.

[10] Congressional Budget Office (CBO), "H.R. 4498, Helping Angels Lead Our Startups Act," March 2, 2016, at https://www.cbo.gov/publication/51479.

[11] For information about unregistered securities, see CRS Report R45221, *Capital Markets, Securities Offerings, and Related Policy Issues*, by Eva Su.

[12] Ibid.

$200,000 (or $300,000 together with a spouse) in each of the prior two years, and can reasonably be expected to be the same for the current year; or (2) net worth more than $1 million, either alone or together with a spouse (excluding the value of the person's primary residence). An accredited investor, in the context of an institution, includes certain entities with more than $5 million in assets, as well as regulated entities such as banks and registered investment companies that are not subject to the assets test.[13]

The income- and net-worth-based definition of an accredited investor has generated criticism, as it arguably suggests that higher net worth equates to investing sophistication. The definition also generates concerns about its sufficiency in capturing those who need investor protection. Some question, for example, whether a senior citizen, who relies on his or her existing net worth as the sole source of financial security, should be eligible for higher-risk investing.

In addition, the effects of inflation adjustments could be significant in the long run. For example, the current accredited investor thresholds are not inflation adjusted. According to a SEC study, although 10% of overall U.S. households qualified as accredited investors in 2013, the percentage would be 4%, after inflation adjustments from 1982 to 2013.[14]

In particular, Title IV would amend the Securities Act of 1933 accredited investor definition by including certain nonaccredited investors who could demonstrate relevant financial education and experience.[15] The provision would adjust income and net worth limits for inflation every five years and change the accredited investor definition to include those with qualifying license and education or experience.

Title X would specify that family offices and family clients are accredited investors. Family offices are entities established by wealthy families to manage their wealth and provide other services to family members, such as tax and estate planning services.[16]

CBO estimates that implementing similar bills (H.R. 1585 and H.R. 3972) would cost the SEC less than $500,000. The costs would be offset by fee collections.[17]

Title XI–Expanding Access to Capital for Rural Job Creators

Title XI would formally incorporate a focus on rural small businesses into the mission of the SEC Office of the Advocate for Small Business Capital Formation.

In 2014, according to research conducted by the Economic Innovative Group (EIG), a research and policy advocacy group, more than 355,000 new firms were formed in U.S. metropolitan areas. By contrast, firm startups in nonmetropolitan areas, commonly defined as rural, reportedly dropped below 50,000, to 49,100, a historical first.[18]

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[13] SEC, *Report on the Review of the Definition of "Accredited Investors,"* December 18, 2015, at https://www.sec.gov/files/review-definition-of-accredited-investor-12-18-2015.pdf.

[14] Ibid. Percentage household calculations based on Survey of Consumer Finances data for 1983 and 2013. The SEC has not revised the income and net worth tests since 1982.

[15] Proposed amendments to 15 U.S.C. §77b(a)(15).

[16] SEC, *Family Office A Small Entity Compliance Guide*, 2011, at https://www.sec.gov/rules/final/2011/ia-3220-secg.htm.

[17] CBO, H.R. 1585, *Fair Investment Opportunities for Professional Experts Act*, October 12, 2017, at https://www.cbo.gov/publication/53265, and H.R. 3972, *Family Office Technical Correction Act of 2017*, October 20, 2017, at https://www.cbo.gov/publication/53228.

[18] John W. Lettieri, "U.S. Senate Committee on Small Business and Entrepreneurship Hearing on The Challenges and Opportunities of Running a Small Business in Rural America," April 26, 2017, at https://eig.org/news/u-s-senate-

Citing these rural economic trends, some observers have looked to the SEC's Office of the Advocate for Small Business Capital Formation, which has a mission to advocate for small business interests and small business investors, as a helpful resource. More specifically, there is interest in formally incorporating a rural dimension into the unit's mission of small business advocacy.[19]

Title XI would amend the Securities Exchange Act of 1934, which established the Office of the Small Business Advocate, to broaden the office's formal focus to include rural small businesses. It would also require the annual reports issued by the office to report on the challenges confronting small rural enterprises.

CBO estimates that the cost of implementing a similar bill (H.R. 4821) between 2018 and 2022 would be less than $500,000.[20]

Reduce Compliance Costs

The number of publicly listed U.S. companies has declined by half over the past two decades, and small- to medium-sized companies are said to have more difficulty accessing capital relative to larger companies. Numerous factors contributed to this trend, but one of the most debated factors is the compliance costs for companies to go and stay public.[21]

Some believe the compliance costs associated with capital markets regulation could potentially outweigh the benefits of being a public company and are disproportionately burdensome for small and medium-sized businesses. The compliance costs include external auditing, legal fees, and financial reporting fees. According to the IPO Task Force,[22] public companies in 2011 faced a onetime initial regulatory compliance cost of around $2.5 million and annual ongoing compliance costs of $1.5 million.[23] The key benefits of compliance often include investor protection and risk mitigation.

In response to these concerns, certain S. 488 provisions aim to reduce (Titles V and IX) or better understand (Titles XXII and XXXI) compliance costs for publicly listed companies.

Title V–Fostering Innovation

Title V would enable public companies that graduate out of Emerging Growth Company (EGC) status to continue to take advantage of the exemption from required outside auditor attestation of their internal financial controls for several years.

committee-small-business-entrepreneurship-hearing-challenges-opportunities-running-small-business-rural-america-2.

[19] U.S. Congress, *Expanding Access to Capital for Rural Job Creators Act*, 115th Cong., 2nd sess., January 29, 2018, H.Rept. 115-53, at http://www.lis.gov/cgi-lis/cpquery/R?cp115:FLD010:@1(hr531).

[20] CBO, "H.R. 4281, Expanding Access to Capital for Rural Job Creators Act," December 14, 2017, at https://www.cbo.gov/publication/53369.

[21] For more details on the decline of the number of publicly listed companies, see CRS Report R45221, *Capital Markets, Securities Offerings, and Related Policy Issues*, by Eva Su.

[22] The IPO Task Force was formed in response to discussions held during the March 11, 2011, Access to Capital Conference at the U.S. Treasury Department. It is composed entirely of a group of private-sector professionals. PRWEB, "IPO Task Force Issues Recommendations to Improve the Capital Markets for Emerging Growth Companies," October 2011, at http://www.prweb.com/releases/2011/10/prweb8893873.htm.

[23] The IPO Task Force, *Rebuilding the IPO On-Ramp Putting Emerging Companies and the Job Market Back on the Road to Growth*, October 2011, at https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf.

The JOBS Act aims to stimulate corporate capital formation and the number of initial public offerings (IPOs) particularly for emerging and smaller firms. To help boost IPOs, the act creates a new kind of securities issuer called an EGC that is entitled to various forms of regulatory relief. EGCs were first launched after the enactment of the JOBS Act in 2012. To qualify as an EGC, which can be held by a company for five years, a firm must have had less than $1.07 billion in gross revenues in the most recent fiscal year.

One of the areas of regulatory relief that an EGC may receive is related to the Sarbanes-Oxley Act (SOX). Under Section 404(a) of SOX, public companies are required to provide the SEC a top management-prepared report assessing the effectiveness of their internal controls over their financial reporting (processes aimed at ensuring the integrity of financial and accounting disclosures), which may help reduce financial fraud. Section 404(b) of SOX requires a company's outside auditors to attest to that managerial assessment. The requirement may help reduce corporate financial fraud, but is widely seen to be disproportionately costly to smaller-sized firms.

EGCs lose that status after five years, which means the end of the regulatory relief they are entitled to, including the Section 404(b) exemption. Title V would amend SOX to provide for an additional five-year exemption from 404(b) for EGCs with average annual gross revenues of less than $50 million and with less than $700 million in public float.[24]

A 2011 SEC staff study mandated by the Dodd-Frank Act estimated the expense for Section 404(b) to be about $1 million annually;[25] other studies estimated that the cost for some smaller companies can be multiples of that.[26] Many EGCs are biotechnology firms, and officials at a biotechnology trade group, BIO, have argued that Section 404(b) diverts capital from critical research and development. They have praised the legislation's five-year extension as critical protection against Section 404(b) expenses for several years, which is seen by BIO to be especially meaningful as many biotechnology EGCs are still said to be in the pre-revenue stage.[27]

By contrast, concerns over the general expansion of the Section 404(b) exemption can be found in the SEC's 2011 staff study. It recommended against extending the 404(b) exemption to firms with market valuation between $75 million and $250 million, arguing that it improves the reliability of internal control disclosures and financial reporting, and benefits investors.[28] The Dodd-Frank Act exempts firms with public floats of less than $75 million from Section 404(b).[29]

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[24] Issuers with public floats of $700 million or more are called large accelerated filers. Public float means "the aggregate worldwide market value of the voting and non-voting common equity of the issuer held by non-affiliates." S. 488 text at https://www.congress.gov/bill/115th-congress/senate-bill/488/text.

[25] U.S. Securities and Exchange Commission, Division of Economic and Risk Analysis, Study and Recommendations on Section 404(b) of the Sarbanes-Oxley Act of 2002 for Issuers with Public Float Between $75 and $250 Million, April 2011, at https://www.sec.gov/news/studies/2011/404bfloat-study.pdf.

[26] Dhammika Dharmapala, "Estimating the Compliance Costs of Securities Regulation: A Bunching Analysis of Sarbanes-Oxley Section 404(b)," *Harvard Law School Forum on Corporate Governance and Financial Regulation*, August 17, 2016, at https://corpgov.law.harvard.edu/2016/08/17/estimating-the-compliance-costs-of-sarbox-section-404b/.

[27] Biotechnology Innovation Organization (BIO), "BIO Praises Reps. Sinema and Hollingsworth for Introducing the Fostering Innovation Act," press release, March 22, 2017, at https://www.bio.org/press-release/bio-praises-reps-sinema-and-hollingsworth-introducing-fostering-innovation-act.

[28] U.S. Securities and Exchange Commission, Division of Economic and Risk Analysis, *Study and Recommendations on Section 404(b) of the Sarbanes-Oxley Act of 2002 for Issuers with Public Float Between $75 and $250 Million*,

[29] This represents the value of the portion of a company's public shares in public hands that is not held by promoters, company officers, controlling-interest investors, or the government.

CBO estimates that implementation of a similar bill (H.R. 1645) would have no significant effect on the SEC's costs.[30]

Title IX–Encouraging Public Offerings

Title IX would allow all issuers making an IPO to be able to (1) test-the-waters, meaning to communicate with certain potential investors to gauge their interests in a potential offering during the registration process; and (2) conduct confidential review, meaning to file confidential draft registration statements with the SEC. These benefits were previously available only to EGC status companies.

In response to declining IPOs over the past two decades and in an effort to reduce barriers for smaller companies accessing public offerings, Title I of the JOBS Act established streamlined compliance options for companies that meet the definition of a new type of issuer, called an emerging growth company, to scale down compliance requirements and facilitate IPOs. Because of the rapid adoption of the EGC status by companies going public, some have proposed extending certain EGC benefits to other IPOs. Two of the key EGC benefits discussed in Title IX are test-the-waters and confidential review. The expansion of these two EGC benefits has received agency support. Effective on July 10, 2017, the SEC expanded the EGC confidential review benefit to all companies.[31] It is also reportedly studying a move to expand the test-the-waters benefits to all issuers.[32]

CBO estimates that implementing a similar bill (H.R. 3903) would cost the SEC less than $500,000 to update its guidance. The costs would be offset by fee collections.[33]

For more on EGCs, see CRS In Focus IF10855, *Capital Access: IPO and "IPO On-Ramp"*, by Eva Su.

Title XXII–Modernizing Disclosure for Investors

Title XXII would direct the SEC to conduct a cost-benefit analysis of Form 10-Q, including the costs and benefits to certain small companies and alternative formats for reporting, and deliver the results as well as recommendations no later than 180 days after the enactment of the act.

Publicly traded companies are required to provide ongoing disclosures through annual reports (10-K), quarterly reports (10-Q), and current reports (8-K).[34] Form 10-Q provides information on unaudited quarterly financial statements, risk factors, sales of securities and use of proceeds, among other disclosures.[35] Some in Congress are concerned about disclosure-related costs to issuers, especially smaller issuers. Proponents of 10-Q reduction also argue that quarterly reporting is a distraction to companies' longer-term strategies, whereas opponents of the reduction are concerned about its destruction to financial transparency and investor protection. The

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[30] CBO, "H.R. 1645, Fostering Innovation Act of 2017," November 1, 2017, at https://www.cbo.gov/publication/53280.

[31] SEC, "SEC's Division of Corporation Finance Expands Popular JOBS Act Benefit to All Companies," press release, June 29, 2017, at https://www.sec.gov/news/press-release/2017-121.

[32] Dave Michaels, "Companies Could Get More Flexibility to Launch IPOs," *Wall Street Journal*, February 22, 2018, at https://www.wsj.com/articles/companies-could-get-more-flexibility-to-start-ipos-1519295400.

[33] CBO, "H.R. 3903, Encouraging Public Offerings Act of 2017," October 27, 2017, at https://www.cbo.gov/publication/53263.

[34] SEC, Fast Answers, *Form 10-Q*, at https://www.sec.gov/fast-answers/answersform10qhtm.html.

[35] SEC, Form 10-Q General Instructions, at https://www.sec.gov/about/forms/form10-q.pdf.

President reportedly stated that he has made a separate request to the SEC to study shifting from quarterly reporting to semi-annual reporting.[36]

CBO estimates that implementing a similar bill (H.R. 5970) would cost the SEC around $2 million to conduct the analysis. The costs would be offset by fee collections.[37]

Title XXXI–Middle Market IPO Underwriting Cost

Title XXXI would require the SEC to study the costs associated with small and medium-sized companies when they undertake an IPO.

Companies seeking to do an IPO generally contract with an underwriter to intermediate between the issuing firm and potential investors. Among other things, underwriters (1) assist in the preparation of the IPO; (2) help determine the amount of capital to be raised through the IPO; (3) assist with the company's road show and other promotional activities;[38] and (4) provide various kinds of post-IPO support, including arranging research coverage for the securities.

In exchange for these services, underwriters often receive a "gross spread" as compensation, the difference between the price that the underwriter buys an IPO share at and the share price that it then offers to the public.[39] For middle-market firm IPOs (commonly described as IPOs between $25 million and $100 million), research has found that during the current century, firms generally had gross spreads of around 7%. That cost has reportedly remained largely unchanged since at least the 1990s and generally contrasts with much lower gross spreads for large IPOs (typically described as IPOs above $100 million), which may be a function of the greater negotiating leverage that comes with their size.[40]

To better understand cost discrepancies between mid-market and large IPOs, Title XXXI would require the SEC in consultation with the Financial Industry Regulatory Authority (FINRA, the self-regulatory organization that is the principal regulator of SEC-registered broker-dealers) to study "the costs associated with small and medium-sized companies to undertake initial public offering." FINRA does not define small or medium-sized companies and IPOs.

CBO estimates that SEC implementation of a similar bill (H.R. 6324) would entail a gross cost of about $1 million.[41]

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[36] Mamta Badkar, "Trump Asks SEC to Study Ending Quarterly Earnings Reports," *Financial Times*, August 17, 2018, at https://www.ft.com/content/c1d133aa-a211-11e8-85da-eeb7a9ce36e4.

[37] CBO, "H.R. 5970, Modernizing Disclosure for Investors Act," July 17, 2018, at https://www.cbo.gov/publication/54207.

[38] In advance of its IPO, a road show is a securities issuer's presentation to potential buyers, securities analysts, and asset managers.

[39] A less common IPO underwriter protocol entails underwriters providing a guarantee to the stock issuing company that it would use its "best efforts" to sell their stocks issued to the public at the best price possible. More details at Investopedia, "Do Underwriters Make Guarantees to Sell an Entire IPO Issue?" June 8, 2018, at https://www.investopedia.com/ask/answers/06/underwriteripo.asp#ixzz5QKyP7bZc.

[40] SEC Commissioner Robert J. Jackson, "The Middle-Market IPO Tax," April 25, 2018, https://www.cbo.gov/publication/54216https://www.sec.gov/news/speech/jackson-middle-market-ipo-tax.

[41] CBO, "H.R. 6324, Middle Market IPO Underwriting Cost Act," July 11, 2018, at https://www.cbo.gov/publication/54216.

Promote Financial Intermediation

Capital markets consist of numerous players. Between investors and company issuers, who are the end contributors and recipients of funding, there are financial intermediaries that serve to channel funding or execute trades. Financial intermediaries generally include brokers, dealers, exchanges, investment companies, investment advisors, research firms, and rating agencies, to name a few.

The most notable financial intermediation trend during the past 70 years has been the shifting of investment activities from individuals to delegated fund management firms. Whereas investors used to buy and sell stocks and bonds directly, they now predominately invest through pooled investment vehicles like mutual funds, exchange-traded funds, and private equity funds.[42] Some provisions in S. 488, for example, Titles XXVI and XXXII, promote the use of pooled investment vehicles to channel funding from investors to issuers.

In addition, the trading of small company stocks is widely regarded as less efficient than the trading of larger companies' stocks. SEC research shows that smaller company stocks have less research coverage, less market quality, and lower liquidity, which adversely affect the stock performance and pricing.[43] Some S. 488 provisions specifically address these challenges. For example, Title XXIV would promote investment research of small issuers, and Title XX would create a designated new marketplace, called venture exchange, for smaller issuer stock trading.

Title III–Small Business M&A and Brokerage Simplification

Title III would remove requirements that merger and acquisition (M&A) brokers, who facilitate sales of privately held small and medium-sized firms, register as brokers under federal securities law.

M&A brokers are also known as Main Street brokers. They are intermediaries who conduct privately negotiated sales of privately held small and mid-sized companies by facilitating securities transactions that transfer ownership and control of such firms to a buyer who intends to operate the firm.

The Securities Exchange Act of 1934, a major federal securities law which authorized the creation of the Securities and Exchange Commission, broadly defines a broker as "a firm or individual who effects transactions in securities on behalf of others." Dealers are defined as "firms or individuals who trade their own securities for profit," called *trading for its own account*.

Being a registered M&A broker can be relatively costly compared with an unregistered broker. Historically, there has been some uncertainty over whether M&A brokers, many of whom self-identify as finders, meet the definition of a broker under the Securities Exchange Act. Some have argued that broker-dealer regulations were originally meant to prevent "high pressure selling

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[42] Merritt Fox et al., *Securities Market Issues for the 21st Century*, May 30, 2018, published by Columbia Law School and Columbia Business School's Program in the Law and Economics of Capital Markets.

[43] "Liquidity" describes the speed and ease with which transactions occur without affecting the price. For more on small company trading challenges, see Stephen Luparello, Director of SEC Division of Trading and Markets, *Testimony on "Venture Exchanges and Small Cap Companies*," March 11, 2015, at https://www.sec.gov/news/testimony/testimony-venture-exchanges.html.

tactics" and the "third party custody" of securities trade-related funds, roles no longer said to be applicable.[44]

In 1985, the Supreme Court held in a pair of cases that the sale of all of, or a controlling interest in, a firm constitutes a securities transaction.[45] As a result of these decisions, persons involved in facilitating the sale of an operational business could arguably qualify as "brokers" under the Securities Exchange Act.[46]

In January 2014, the SEC issued a no-action letter on unregistered broker liability. A no-action letter is an agency response to an individual or entity suggesting that the SEC staff would not recommend enforcement actions against certain products, services, or actions with regards to the uncertainty of the violation of federal securities law.[47] In the letter, SEC stated that subject to various stipulations, it would not recommend SEC enforcement action in the event that an intermediary were to facilitate a securities transaction connected to the transfer of ownership of a privately held firm.[48] The letter received generally favorable responses from stakeholders.[49]

Broadly consistent with the SEC's no-action letter, Title III would amend the Securities Exchange Act to exempt from registration requirements merger-and-acquisition brokers who provide intermediate ownership transfers of privately held companies with annual earnings of less than $25 million or annual revenues of less than $250 million. However, there are a number of stipulations; among them, a broker cannot (1) receive, hold, transmit, or have custody of funds or securities to be exchanged by parties to an ownership transfer; (2) engage on behalf of an issuer in a public offering of registered securities; (3) engage on behalf of any party in a transaction involving specified shell companies; (4) provide financing related to the transfer of ownership; and (5) be a "bad actor," including being a broker who has had their SEC registration suspended or revoked.

CBO estimates that implementation of a similar bill (H.R. 477) would cost the SEC less than $500,000.[50]

Title VIII–Exchange Regulatory Improvement

Title VIII states that "over time, national exchanges have expanded their businesses beyond listings and trading to include the sale of additional products and services to their members and listed companies." To more clearly identify the business lines that should be overseen by the SEC, the provision would direct the SEC to clarify what constitutes a securities exchange *facility*

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[44] Alon Y. Kapen, "Do Private Company M&A Intermediaries Need to Register with the SEC as Broker-Dealers?" *NY Venturehub*, July 17, 2017, at https://www.nyventurehub.com/2017/07/17/do-private-company-ma-intermediaries-need-to-register-with-the-sec-as-broker-dealers/.

[45] *Landreth Timber Co. v. Landreth*, 471 U.S. 681 (1985); *Gould v. Reufenacht*, 471 U.S. 701 (1985).

[46] Available at https://supreme.justia.com/cases/federal/us/471/681/.

[47] SEC, *No Action Letters*, at https://www.sec.gov/fast-answers/answersnoactionhtm.html.

[48] Letter from the SEC Division of Trading and Markets dated January 31, 2014, at https://www.sec.gov/divisions/marketreg/mr-noaction/2014/ma-brokers-013114.pdf.

[49] For example, see Russell D. Sacks, Thomas Donegan, and Charles S. Gittleman, "SEC offers relief to M&A brokers," *Journal of Investment Compliance*, vol. 15, no. 2 (2014), at https://doi.org/10.1108/JOIC-05-2014-0015.

[50] CBO, "H.R. 477, Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2017," at https://www.cbo.gov/publication/53356.

in Section 3(a) of the Securities Exchange Act of 1934 within 360 days of the enactment of the act.[51]

The SEC broadened the national exchanges' business lines beyond their traditional trading functions in 1998, when it confirmed that the exchanges could structure as for-profit entities.[52] Title VIII aims to provide clarification regarding the regulation of these business lines; namely, if and how these business lines would qualify as facilities of an exchange, thus subject to certain SEC regulatory scrutiny. The SEC oversees 21 national securities exchanges as of August 2018.[53]

CBO estimates that implementing a similar bill (H.R. 3555) would cost the SEC around $1 million to conduct required studies and rulemaking.[54]

Title XX–Main Street Growth

Title XX would allow national exchanges to create and register venture exchanges with the SEC that would provide an additional trading venue for smaller and emerging companies. Only venture securities would be allowed to trade on venture exchanges. Venture securities refer to securities of (1) an early stage growth company that are exempt from certain registration;[55] (2) an emerging growth company issuer;[56] (3) certain other issuers below pre-specified public float and average daily trading volume thresholds.[57] To consolidate liquidity, venture exchanges would carry out auctions instead of continuous trading and the venture securities could trade only on the exchange it is listed. The SEC would be required to provide venture security disclosure standards and consider establishing an Office of Venture Exchange within its Division of Trading and Markets.

The idea of a venture exchange was first proposed by the SEC Advisory Committee on Small and Emerging Companies in 2013 to address liquidity challenges for smaller and emerging companies by establishing a new and separate equity market for them.[58] Smaller issuers were said to operate in different equity market structures and face greater liquidity challenges.[59] The venture exchanges are meant to provide a marketplace with different regulatory requirements to foster trading for the smaller and emerging issuers. This could be especially helpful for some of the more recently enacted securities offering regimes to expand liquidity for small issuers.[60]

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[51] 15 U.S.C. §78c(a).

[52] H.Rept. 115-883, *Exchange Regulatory Improvement Act*, August 8, 2018, at https://www.congress.gov/115/crpt/hrpt883/CRPT-115hrpt883.pdf.

[53] SEC, *National Securities Exchanges*, at https://www.sec.gov/fast-answers/divisionsmarketregmrexchangesshtml.html.

[54] CBO, "H.R. 3555, Exchange Regulatory Improvement Act," July 11, 2018, at https://www.cbo.gov/publication/54210.

[55] Exempt from registration pursuant to section 3(b) of the Securities Act of 1933 (15 U.S.C. §§77a et seq.).

[56] For more on emerging growth company, see CRS In Focus IF10855, *Capital Access: IPO and "IPO On-Ramp"*, by Eva Su.

[57] Public float means "the aggregate worldwide market value of the voting and non-voting common equity of the issuer held by non-affiliates." S. 488 text at https://www.congress.gov/bill/115th-congress/senate-bill/488/text.

[58] Liquidity describes the speed and ease with which transactions occur without affecting the price. For more on the original suggestion of venture exchanges, see SEC Advisory Committee on Small and Emerging Companies, *Letter to Chairman Walter*, March 21, 2013, at https://www.sec.gov/info/smallbus/acsec/acsec-recommendation-032113-emerg-co-ltr.pdf.

[59] Stephen Luparello, *Testimony on "Venture Exchanges and Small-Cap Companies,"* at https://www.sec.gov/news/testimony/testimony-venture-exchanges.html.

[60] Venture exchanges could build on some of the recently enacted regimes to provide a new marketplace for the smaller

However, concerns still exist regarding venture exchange execution viability, given failures of similar previous attempts, and retail investor protection concerns.[61]

CBO estimates that implementing a similar bill (H.R. 5877) would cost the SEC around $1 million a year. The costs would be offset by fee collections.[62]

Title XXIV–Improving Investment Research for Small Issuers

Title XXIV would direct the SEC to conduct a study on the investment research coverage for small issuers, including EGCs and other companies considering going public.[63] The required study would have seven components, including research providers, incentives, challenges, and impacts. The SEC would submit the results and recommendations no later than 180 days after the enactment of the act.

Low investment research coverage often corresponds to lower stock liquidity and less efficient price performance.[64] More than half (61%) of the publicly traded firms listed on a major U.S. exchange with market capitalization of less than $100 million do not receive research coverage.[65] For over-the-counter companies,[66] based on a recent survey, 68% of them do not receive research coverage.[67] Many reasons were said to have contributed to research coverage conditions; for example, economic incentives, regulatory environment, and market structure.

CBO estimates that implementing a similar bill (H.R. 6139) would cost the SEC $1 million to conduct the study. The costs would be offset by fee collections.[68]

Title XXV–Developing and Empowering our Aspiring Leaders

Title XXV would broaden the definition of a venture capital fund under federal securities law. The reform would enable the funds to increase the amount of secondary market securities they can acquire from the companies they invest in without triggering the requirement that their advisers register with the SEC under the Investment Advisers Act of 1940 (P.L. 76-768).

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issuers, like Regulation A+, Regulation Crowdfunding, and other eligible small issuer securities, to expand their liquidity. For more on Regulation A+, see CRS In Focus IF10848, *Capital Access: SEC Regulation A+ ("Mini-IPO")*, by Eva Su. For more on Regulation Crowdfunding, see CRS Report R45221, *Capital Markets, Securities Offerings, and Related Policy Issues*, by Eva Su.

[61] Senate Banking Venture Exchanges and Small-Cap Companies Hearing, March 10, 2015, at https://www.gpo.gov/fdsys/pkg/CHRG-114shrg94374/pdf/CHRG-114shrg94374.pdf.

[62] CBO, "H.R. 5877, Main Street Growth Act," July 19, 2018, at https://www.cbo.gov/publication/54227.

[63] For more on emerging growth company, see CRS In Focus IF10855, *Capital Access: IPO and "IPO On-Ramp"*, by Eva Su.

[64] Cem Demiroglu and Michael Ryngaert, *The First Analyst Coverage of Neglected Stocks*, June 22, 2010, at https://onlinelibrary.wiley.com/doi/abs/10.1111/j.1755-053X.2010.01084.x; and JSE, *The Benefits of Sell-Side Research*, at https://www.jse.co.za/content/JSEDocumentItems/Benefits%20of%20Research.pdf.

[65] Cowen, SEC Investor Advisory Committee, *Capital Formation, Smaller Companies, and the Declining Number of Initial Public Offerings*, June 22, 2017, at https://www.sec.gov/spotlight/investor-advisory-committee-2012/jeffrey-solomon-presentation.pdf.

[66] Over-the-counter securities are not listed on a national securities exchange, they trade through inter-dealer quotes.

[67] OTC Markets, "Small-Cap Companies are Missing Key Ways to Attract New Investors and Raise Capital, According to New Survey," June 14, 2017, at https://www.otcmarkets.com/stock/OTCM/news/Small-Cap-Companies-are-Missing-Key-Ways-to-Attract-New-Investors-and-Raise-Capital—According-to-New-Survey?id=162042&b=y.

[68] CBO, "H.R. 6139, Improving Investment Research for Small and Emerging Issuers Act," July 17, 2018, at https://www.cbo.gov/publication/54208.

The Dodd-Frank Act requires advisers to private funds, such as hedge funds and private equity funds, to register with the SEC under P.L. 76-768. A venture capital fund (VC fund) is another type of private fund that is generically defined as an investment fund that manages investor assets through the acquisition of private equity stakes in startup and small to medium-sized firms. Unlike advisers to hedge funds and private equity funds, the Dodd-Frank Act exempted advisers to venture capital funds from having to register with the SEC as advisers. Under the act, the SEC had to define a VC fund, which it did. Among other things, a VC fund is defined as an entity that (1) represents itself as pursuing a venture capital strategy to its investors and prospective investors; and (2) has no more than 20% of its total assets invested in assets that are not "qualifying investments," equity securities acquired directly from a company that it has invested in (e.g., primary market securities).

If a VC fund no longer meets this definition, its adviser must then register with the SEC as a nonexempt private fund adviser under the Investment Adviser Act often at a significant expense.

VC funds are often portrayed as engines of economic development.[69] There are concerns, however, over the existence of certain perceived hurdles to their ability to fully play that role. One concern is that VC funds are increasingly challenged because their portfolios of nonqualifying investment, primarily in the form of secondary market shares of their portfolio companies, are nearing the aforementioned 20% limit. As such, VC fund advocates such as the VC fund trade group, the National Venture Capital Association, argue that the secondary market equity 20% limit often causes funds to forgo general investment opportunities.[70]

Title XXV would require the SEC to issue rules revising the definition of a VC fund's qualifying investments to include primary market or secondary market equity securities issued by a company that a fund is investing in, expanding the size of a fund's potential portfolio of a company's secondary market securities. SEC-issued rules would also have to provide that a VC fund's qualifying investments must be predominantly primary market securities issued by a firm that it is investing in, an attempt to ensure that a VC fund's corporate acquisitions would have to entail slightly more primary shares than secondary shares.

Although praised by the VC fund industry, a concern of some critics, including the Consumer Federation of America, a consumer and investor advocate, is that by permitting an expanded VC fund investment presence in secondary market shares, the legislation would shift VC fund activity away from direct primary investment stakes in startup firms.[71]

CBO estimates that SEC implementation of a similar bill (H.R. 6177) would entail a gross cost of about $1 million.[72]

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[69] For example, see John Austin, "The Rust Belt Needs Capital to Turn Talent and Innovation into Jobs," *Brookings*, August 14, 2018, at https://www.brookings.edu/blog/the-avenue/2018/08/14/the-rust-belt-needs-capital-to-turn-talent-and-innovation-into-jobs/.

[70] National Venture Capital Association, "Letter to the Honorable Jeb Hensarling and the Honorable Maxine Waters," July 10, 2018, at https://nvca.org/wp-content/uploads/2018/07/NVCA-Letter-of-Support-for-the-DEAL-ACT-7102018-FINAL.pdf.

[71] Americans for Financial Reform and the Consumer Federation of America, "Open Letter to Congress from on H.R. 3555, H.R. 6021, and H.R. 6177," July 11, 2018, at https://consumerfed.org/wp-content/uploads/2018/07/afr-cfa-comments-hfsc-markup.pdf.

[72] CBO, "H.R. 6177, Developing and Empowering our Aspiring Leaders Act of 2018," July 11, 2018, at https://www.cbo.gov/publication/54211.

Title XXVI–Expanding Investment in Small Business

Title XXVI would direct the SEC to study the 10% threshold limitation for "diversified company" qualification under the Investment Company Act of 1940 (P.L. 76-768).[73] The threshold specifies that to qualify for the diversified company status, the investment company shall not invest in more than 10% of any single issuer's outstanding voting shares (among other requirements). The provision would direct the SEC to study the impact of the threshold and report on findings and recommendations no later than 180 days after the enactment of the act.

A fund is required to disclose whether it is a diversified or a nondiversified fund. To be diversified, a fund must meet several requirements, including that it is not investing in more than 10% of any single issuer's outstanding voting shares. Some believe that the threshold limits investment companies' ability to take meaningful positions in small-cap companies because a relatively small dollar amount could potentially exceed the threshold for a small-cap company.[74] Some argue this limitation could hinder the capital provision of funds to smaller companies.[75] Others believe that the idea is plausible, but in practice, investment companies would not likely take a large position in a portfolio company anyway, given the risks of selling such positions.[76]

CBO estimates that implementing a similar bill (H.R. 6319) would cost the SEC around $1 million to produce the report.[77]

Title XXXII–Crowdfunding Amendments

Crowdfunding is a fundraising method of pooling small individual investments from a large number of investors.[78] Title XXXII would allow special purpose vehicles (SPVs) to invest in crowdfunding offerings by pooling money into a fund advised by a registered investment advisor.[79] The provision would clarify the existing crowdfunding regulation[80] through adding the definitions of *crowdfunding vehicle*, *crowdfunding vehicle adviser*, and the amendments to SEC registration exemption requirements.[81]

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[73] According to 15 U.S.C. §80a-5(b)(1), diversified company means "a management company which meets the following requirements: At least 75 per centum of the value of its total assets is represented by cash and cash items (including receivables), Government securities, securities of other investment companies, and other securities for the purposes of this calculation limited in respect of any one issuer to an amount not greater in value than 5 per centum of the value of the total assets of such management company and to not more than 10 per centum of the outstanding voting securities of such issuer."

[74] H.Rept. 115-878, *Expanding Investment in Small Business Act*, July 31, 2018, at https://www.congress.gov/115/crpt/hrpt878/CRPT-115hrpt878.pdf.

[75] Testimony of Thomas Quaadman, executive vice president, *Statement of the U.S. Chamber of Commerce*, May 23, 2018, at https://financialservices.house.gov/uploadedfiles/hhrg-115-ba16-wstate-tquaadman-20180523.pdf.

[76] Testimony of Professor John Coffee, Columbia University Law School, May 23, 2018, at https://financialservices.house.gov/uploadedfiles/hhrg-115-ba16-wstate-jcoffee-20180523.pdf.

[77] CBO, "H.R. 6319, Expanding Investment in Small Business Act," July 11, 2018, at https://www.cbo.gov/publication/54212.

[78] SEC, *Updated Investor Bulletin: Crowdfunding for Investors*, at https://www.sec.gov/oiea/investor-alerts-bulletins/ib_crowdfunding-.html.

[79] A special purpose vehicle is a *bankruptcy-remote entity* that is used to isolate assets.

[80] SEC, *Regulation Crowdfunding*, at https://www.sec.gov/smallbusiness/exemptofferings/regcrowdfunding.

[81] Proposed amendments to Securities Act of 1933 (15 U.S.C. §§77a et seq.), Securities Exchange Act of 1934 (15 U.S.C. §§78l et seq.), Section 3(c) of the Investment Company Act of 1940 (15 U.S.C. §80a–3(c)), and Investment Advisers Act of 1940 (15 U.S.C. §§80b–1 et seq.).

The provision would define crowdfunding vehicle as a company or SPV that (1) has purposes limited to acquiring, holding, and disposing securities issued by a single company in transactions made pursuant to crowdfunding exemption requirements; (2) issues only one class of securities; (3) receives no compensation for such activities; (4) is a co-issuer with the company whose securities it holds; and (5) meets certain disclosure obligations and the use of investment adviser requirements. Crowdfunding vehicle adviser refers to an investment adviser who solely advises crowdfunding vehicles and would be required to register with the SEC.

The provision would also modify certain crowdfunding transaction exemptions from SEC registration requirements.[82] Specifically, it would modify the current issuer registration threshold from $25 million in assets, among other conditions, to (1) a public float of less than $75 million and (2) annual revenues of less than $50 million.[83]

The SEC promulgated Regulation Crowdfunding pursuant to Title III of the JOBS Act in October 2015.[84] Some believe that the use of Regulation Crowdfunding could increase with the modifications to the SEC's current treatment of SPVs and the thresholds maintained in the Exchange Act that once crossed, trigger SEC registration.[85] The basic concept of using a SPV (in the form of a crowdfunding vehicle) is to pool money from many individual investments into a single entity, with the SPV organizer to be a single point of contact for all of the SPV's investors.[86] The use of SPVs could expand financial intermediation and promote capital access, whereas the required crowdfunding vehicle adviser registration is a method to mitigate certain investor protection concerns.

The provision is similar to H.R. 6380 from the 115th Congress and is a modified version of H.R. 4855 from the 114th Congress. CBO has not provided cost estimates for H.R. 6380. It estimated H.R. 4855 would have had no significant effects on the SEC's costs and operations.[87]

Increase Investor Protection

The policy debate about capital markets often revolves around the perceived tradeoffs between expanding capital formation and protecting investors, two of the SEC's core missions. Expanding capital formation allows for greater access of investment opportunities for more investors and increased funding for businesses. But expanded capital formation also involves investor protection challenges, including the challenge to ensure that investors, such as less sophisticated retail investors, comprehend the risks they are bearing. For example, proposals that reduce the regulatory compliance that a securities issuer or a market intermediary must comply with can decrease these market participants' compliance costs and increase the speed and efficiency of capital formation. However, this reduced regulation may also expose investors to additional risks. In addition, investor protection can help contribute to healthy and efficient capital markets

[82] Section 12(g)(6) of the Securities Exchange Act of 1934 (15 U.S.C. §78l(g)(6)).

[83] The provision states that a public float "(i) shall be calculated by multiplying the aggregate worldwide number of shares of the common equity securities of an issuer that are held by non-affiliates by the price at which those securities were last sold (or the average bid and asked prices of those securities) in the principal market for those securities."

[84] For more on Regulation Crowdfunding and securities offerings in general, see CRS Report R45221, *Capital Markets, Securities Offerings, and Related Policy Issues*, by Eva Su.

[85] H.Rept. 114-661, *Fix Crowdfunding Act*, at https://www.congress.gov/114/crpt/hrpt661/CRPT-114hrpt661.pdf.

[86] Testimony of William Beatty, past-president of North American Securities Administrators Association, *The JOBS Act at Four: Examining Its Impact and Proposals to Further Enhance Capital Formation*, April 14, 2016, at https://financialservices.house.gov/uploadedfiles/hhrg-114-ba16-wstate-wbeatty-20160414.pdf.

[87] CBO, "H.R. 4855, Fixing Crowdfunding Act," June 16, 2016, at https://www.cbo.gov/publication/51763.

because investors may be more willing to provide capital, and even at a lower cost, if they have faith in the integrity and transparency of the underlying markets.

There are multiple titles in S. 488 that would create investor protection safeguards as part of a capital formation oriented provision. For example, Title XX aims to facilitate trading activities, but it would also direct the SEC to issue disclosure requirements. These requirements could help investors understand the distinct features and risks of certain investment products and activities.

There are also S. 488 provisions that center on investor protection. For example, Titles XXVII and XXIX would provide protection to general investors against corporate insiders and Title XXX would provide targeted protection to senior investors who are victims of financial exploitation.

Title XXVII–Promoting Transparent Standards for Corporate Insiders

Title XXVII would direct the SEC to study whether Rule 10b5-1, a rule that allows corporate insiders to trade for legitimate reasons without running afoul of insider trading inquiries, should be amended.[88] The SEC would issue the report no later than a year following the enactment of the act. It would also carry out related rulemaking consistent with the study results.

Federal law bans insider trading, which is the buying or selling of a security on the basis of material nonpublic information that provides unfair advantages to corporate insiders over other investors.[89] But public company executives often receive compensation in the form of company stock or stock options. Insider trading restrictions could pose challenges for them to legitimately liquidate stocks.[90] The SEC enacted Rule 10b5-1 in 2000 to allow executives to make prearranged trades at a time when they are not in possession of insider information to avoid insider trading inquiries.[91] Yet studies repeatedly show that the Rule may have been abused, evidenced by corporate insider trades within 10b5-1 plans that earned abnormal returns.[92] For example, a *Wall Street Journal* investigation found 1,418 executives, including some with 10b5-1 plans, had made beneficial trades.[93]

CBO estimates that implementing a similar bill (H.R. 6320) would cost the SEC around $1 million.[94]

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[88] 17 CFR § 240.10b5–1 and U.S.C. §78j.

[89] Ibid.

[90] Stuart Gelfond and Arielle L. Katzman, *A Guide To Rule 10b5-1 Plans*, March 24, 2016, at https://corpgov.law.harvard.edu/2016/03/24/a-guide-to-rule-10b5-1-plans.

[91] Speech by Linda Thompson, SEC director of Division of Enforcement, "Remarks at the 2007 Corporate Counsel Institute," March 8, 2007, at https://www.sec.gov/news/speech/2007/spch030807lct2.htm#foot19.

[92] Alan Jagolinzer, *Do Insiders Trade Strategically Within the SEC Rule 10b5-1 Safe Harbor?* Stanford Graduate School of Business, Working Paper, 2005, at https://www.thecorporatecounsel.net/HotTopics2007/materials/docs/FAQ/12_06_Jago.pdf.

[93] Susan Pulliam and Rob Barry, "Executive's Good Luck in Trading Own Stock," *Wall Street Journal*, November 27, 2012, at https://www.wsj.com/articles/SB10000872396390444100404577641463717344178.

[94] CBO, H.R. 6320, Promoting Transparent Standards for Corporate Insiders Act, July 11, 2018, at https://www.cbo.gov/publication/54213.

Title XXIX–Enhancing Multi-Class Share Disclosures

Title XXIX would amend the federal securities law so public companies who have issued multi-class shares of stock would be required to provide more comprehensive disclosure on the stock holdings of corporate officials and other individuals with significant holdings of company stock.

Common equity shares of publicly traded companies are typically composed of one share class wherein anyone who holds a share has voting rights equal to that of other shareholders. Voting rights typically give shareholders the right to vote on certain matters of corporate policy, including the right to vote in elections for a company's board of directors and on proposals that would significantly alter corporate goals, or that would result in major structural changes.

By contrast, the issuance of multi-class common equity shares typically involves (1) one share class with limited voting power being offered to the public at large, and (2) another share class with relatively more voting power that is often held by the company's founders or current executives. Having superior voting shares may give their holders majority control of a firm.

The 1980s saw a proliferation in the adaption of multi-class share structures as increasingly competitive major stock exchanges relaxed previous listing restrictions on multi-class stock. The last decade or so has seen renewed interest in the issuance of multi-class shares with the number of such companies, including Google and Facebook, reportedly significantly expanding.[95]

In March 2017, the SEC Investor Advisory Committee, a SEC-based committee of investor-related stakeholders, which makes policy recommendations to the agency, criticized multi-class share structures for resulting in corporate insiders' voting power outstripping their actual ownership interest. Among other things, it recommended that companies with multi-class shares clearly disclose the numerical relationship that exists between stock ownership and the attendant voting rights.[96] Similar concerns over multi-class shares undermining corporate governance have been raised by others, including the Council of Investors, an institutional investor trade group.[97]

Although criticized from a corporate governance standpoint, multi-class shares may have a number of potential benefits for some, including preventing investors from coercing management into decisions that might enhance short-term stock performance at the expense of longer-term growth.[98]

Title XXIX would require the SEC to issue rules amending the Securities Exchange Act of 1934 that would require issuers with multi-class share structures to report the following data regarding their corporate executives and the holders of more than 5% of the company's voting power: (1) their percentage of the total number of outstanding securities entitled to vote; and (2) their percentage of the aggregate voting power of all classes of securities entitled to vote.

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[95] Ibid.

[96] "SEC Investor Advisory Committee Recommendation of the Investor as Owner Subcommittee Dual Class and Other Entrenching Governance Structures in Public Companies," CCH, February 27, 2018, at http://business.cch.com/srd/iac030818-investor-as-owner-subcommittee-recommendation-20180308.pdf.

[97] Nicole Bullock, "Investors hail S&P 500 Move over Multiple Class Shares," *Financial Times*, August 1, 2017, at https://www.ft.com/content/0a441900-76ca-11e7-a3e8-60495fe6ca71.

[98] Richard Moroney, "Not All Shares Are Created Equal: More Multiclass Stocks To Join Google in the S&P 500," *Forbes*, July 16, 2014, at https://www.forbes.com/sites/investor/2014/07/16/not-all-shares-are-created-equal-more-multiclass-stocks-to-join-google-in-the-sp-500/#3fc1713250cc.

CBO estimates that the gross cost of SEC implementation of a similar bill (H.R. 6322) would be about $1 million.[99]

Title XXX–National Senior Investor Initiative

Title XXX would direct the SEC to establish a Senior Investor Taskforce to identify challenges and potential regulatory solutions for senior investors over the age of 65. The provision directs the taskforce to coordinate and consult with other internal and external authorities and report every two years on senior investor-related trends, issues, and best practices, among other topics. The taskforce would terminate at the end of the 10-year period starting from the enactment of the act, with the option of reestablishment by the SEC Chairman. The provision also would direct the Government Accountability Office (GAO) to study the financial exploitation of senior citizens and issue a report within one year of enactment of the act.

Senior citizens aged 65 and over are projected to reach 18% of the U.S. population by 2030.[100] This population holds significant amounts of investable assets and is increasingly subject to financial scams and abuses.[101] More than 6.8 million senior citizens, or 17% of Americans aged 65 or older, have reportedly fallen victims of financial exploitation.[102] In addition, the senior financial exploitation cases are vastly under reported; for example, only one in 44 cases were said to ever have been reported.[103]

CBO estimates that implementing a similar bill (H.R. 6323) would cost the SEC $7 million over the 2019-2023 period and less than $500,000 for GAO.[104]

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[99] CBO, "H.R. 6322, Enhancing Multi-Class Share Disclosures Act," July 11, 2018, at https://www.cbo.gov/publication/54215.

[100] Securities Industry and Financial Markets Association, *Senior Investor Protection*, at https://www.sifma.org/explore-issues/senior-investors.

[101] H.Rept. 115-886 at https://www.congress.gov/115/crpt/hrpt886/CRPT-115hrpt886.pdf.

[102] Investor Protection Trust, *Elder Investor Fraud and Financial Exploitation*, March 22, 2016, at http://www.investorprotection.org/downloads/IPT_EIFFE_Medical_Survey_Report_03-22-16.pdf.

[103] National Adult Protective Service Association, *Elder Financial Exploitation*, at http://www.napsa-now.org/policy-advocacy/exploitation.

[104] CBO, "H.R. 6323, National Senior Investor Initiative Act of 2018," July 17, 2018, at https://www.cbo.gov/publication/54209.

Appendix. Provisions in House-Amended S. 488, Financial CHOICE Act (H.R. 10), the Appropriations Omnibus, and Selected House Legislation

As discussed in the introduction, several provisions in S. 488 were included in H.R. 10, the Financial Services and General Government appropriations bill (H.R. 6147), and stand-alone legislation, as shown in **Table A-1**.

Table A-1. Provisions in House-Amended S. 488, H.R. 10, the Appropriations Omnibus, and Selected House Legislation

Topic	S. 488 Title	H.R. 10 Section	H.R. 6147[a]	House Legislation	In This Report
Allows general solicitation for angel investors	I	452	A	H.R. 79	Yes
Expand information used in credit reporting	II	—	B	H.R. 435	—
Small M&A broker exemption	III	401	C	H.R. 477	Yes
Accredited investor definition	IV	860	E	H.R. 1585	Yes
Expand audit attestation exemption	V	441	F	H.R. 1645	Yes
End banking for human traffickers	VI	—	G	H.R. 2219	—
Small business investment company funding	VII	—	H	H.R. 2364	—
Define "facility" of an exchange	VIII	—	—	H.R. 3555	Yes
Expand investor outreach during IPO process	IX	499	K	H.R. 3903	Yes
Family offices deemed accredited investors	X	—	N	H.R. 3972	Yes
SEC study of small rural business capital access	XI	—	Q	H.R. 4281	Yes
Reduce certain living will requirements	XII	151	S	H.R. 4292	—
Penalty for unauthorized information dissemination	XIII	—	—	H.R. 4294	—
International insurance standards	XIV	—	—	H.R. 4537	—
Nonbank stress test repeal	XV	—	Y	H.R. 4566	—
Combat criminal transaction financing	XVI	—	—	H.R. 4768	—
Delays to credit union capital rule	XVII	—	V	H.R. 5288	—
Risk-adjusted valuation for certain derivatives	XVIII	—	—	H.R. 5749	—
Safe harbor for law enforcement cooperation	XIX	—	—	H.R. 5783	—
Venture exchanges	XX	456	—	H.R. 5877	Yes
Charitable mortgage filing forms	XXI	—	—	H.R. 5953	—
Quarterly reporting (10-Q) cost benefit study	XXII	—	—	H.R. 5970	Yes
Fight illicit networks and detect trafficking	XXIII	—	—	H.R. 6069	—
Study of small issuer research coverage	XXIV	—	—	H.R. 6139	Yes
Definition of "qualifying investment"	XXV	—	—	H.R. 6177	Yes
Diversified fund limit threshold study	XXVI	—	—	H.R. 6319	Yes

Insider trading clarification study	XXVII	—	—	H.R. 6320	Yes
Investment adviser "small business" qualification	XXVIII	—	—	H.R. 6321	—
Multi-class share disclosure	XXIX	—	—	H.R. 6322	Yes
Senior investor task force	XXX	—	—	H.R. 6323	Yes
Smaller company IPO cost study	XXXI	—	—	H.R. 6324	Yes
Crowdfunding amendments	XXXII	—	—	H.R. 6380	Yes

Source: Congressional Research Service.

Notes: The table identifies bills that have passed House or have otherwise seen legislative action as of July 30, 2018. M&A=Mergers and Acquisitions and IPO=Initial Public Offering.

a. H.R. 6147 indicates House-passed H.R. 6147, Division B, Title IX, Subtitles.

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