U.S. Securities and Exchange Commission
Small Business Capital Formation Advisory Committee

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February 28, 2023

The Honorable Gary Gensler
Chair
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1070

Dear Chair Gensler:

Many of us have proudly served on the SEC Small Business Capital Formation Advisory Committee since we were first appointed by the Commission in April 2019, when the Committee was created. As the inaugural members' four-year terms draw to a close, the Committee feels it is appropriate to share some perspectives based on our wide array of experiences and expertise.

From the beginning, we have been guided by the conviction that small business is the lifeblood of our country. To keep small businesses healthy – so that they are in a position to grow and create more jobs – we believe it is imperative that the SEC do all it can to foster capital formation even as it maintains the necessary protections for the investors providing that important capital.

Despite the progress made over the past four years, there are still numerous barriers to capital formation that need to be addressed so that underrepresented businesses, including minority-owned and women-owned business enterprises, as well as those that are located outside prominent entrepreneurial hubs or in regions with less robust capital-raising networks, can flourish.

In one of our earliest sessions, the Committee was introduced to the fact that 70% of venture capital funds are concentrated in three metro areas.[1] That geographic inequity has had a profound impact on the economic development of the rest of United States.

While our Committee has made recommendations for how the Commission can be doing more to promote private and public equity investing across the entire country, the fact remains that a bulk of company formation still occurs on the coasts. Making it easier and more efficient for companies to raise capital regardless of geographic location carries the added benefits of promoting economic development across our nation.

In addition, a good portion of our efforts over the past four years has focused on policy recommendations that aim to create and foster ecosystems that include smaller investors and investment pools whose capital will be more readily available to smaller companies. Over the past few decades, as the capital markets have grown, many traditional capital providers, *e.g.*, venture capital firms and mutual funds, have

[1] *See* the 2020 Annual Report of the Office of the Advocate for Small Business Capital Formation.

become very large, making it more difficult for smaller, emerging growth companies to remain relevant to them.

The SEC has a vital role to play in creating robust ecosystems for these investors while carefully balancing the need for adequate investor protections. Our Committee continues to see an urgency here because, frankly, most of the large investors, who will continue to get larger, are expected to further reduce their already limited focus on financing small companies. To address this issue, we need to promote the growth of diverse entrepreneurial ecosystems, by providing pathways that make it easier for investors to find and finance small-business investment opportunities. Otherwise, too many small companies will be at risk of "dying on the vine" – and with them their innovation, job creation, and economic opportunities that fuels our country's global economic dominance.

Consistent with a number of our Committee recommendations over the past four years, as well as many of the recommendations on similar issues made by our predecessor committee, the SEC's Advisory Committee on Small and Emerging Companies, the Commission can carry out its important mission of facilitating capital formation, protecting investors, and ensuring fair, orderly and efficient markets through attention to the following objectives:

1. ***Recognize the importance of the private markets for small business growth.***

   We urge the Commission to support small business growth—the bread-and-butter enterprises across the country—and facilitate greater access to capital for founders, particularly underrepresented founders, through future rulemaking efforts consistent with our October 2022, February 2022, August 2020, May 2020 and November 2019 recommendations. We urge the Commission to avoid unintended consequences in its exempt offering rule-making efforts that could hurt small business growth.

   Recognizing that the Commission may be considering changes to Regulation D, the Committee has not been in favor of making Regulation D harder to use by increasing disclosure requirements. The Committee supports maintaining the elements of the current exempt offering framework that are functioning well and reaffirms its recommendations from February 2022 and December 2019, including the Committee's support for an exempt offering framework that is clear, concise and effective for small businesses to raise capital, and reaffirms its request that the Commission "do no harm" to Regulation D Rule 506(b).

   Similarly, recognizing that the Commission may be considering changes to the "accredited investor" definition, the Committee notes that accredited investors are a critical source of early-stage capital for small businesses in communities across the country, and changes that would shrink the pool of currently accredited investors would have a detrimental effect on small business capital formation. The ripple effects of limiting access to early-stage capital could negatively impact access to future rounds of financing from funds and other later-stage investors, rippling further into the companies that will one day go public. Consistent with our October 2022, February 2022 and November 2019 recommendations, the Committee believes that the accredited investor definition should be expanded and that the Commission's rule making should not limit the current pool of accredited investors.

   In order to promote small business capital formation, especially underrepresented businesses and businesses that are not in regions with robust capital raising networks, consistent with our November 2020 and May 2020 recommendations, the Committee supports a framework to permit certain finders to engage in limited capital raising activities involving accredited investors.

2. ***Ensure public company rules are mindful of the unique circumstances of small public companies, so that these small companies can attract capital, spur innovation, and create jobs.***

   The transparency and liquidity of our public markets are the envy of the world, and expanding public market benefits to more companies requires an easier path to going and remaining public. Consistent with our prior October 2022, May 2022 and August 2019 recommendations regarding IPO trends and various of the Commission's proposed rules, we urge the Commission to be mindful of the impact its rulemaking has on public company reporting and the disclosure regime for smaller public companies.

   The flexibility afforded by the rules for Emerging Growth Companies and Smaller Reporting Companies, including exemptions, scaling, and phase-ins for new requirements where appropriate, allows smaller companies to build their businesses and balance the needs of companies and investors while promoting strong and effective U.S. public markets. Absent these accommodations, private companies may be deterred from going public and existing small public companies may face greater challenges in remaining public.

We further encourage the Commission to improve the efficacy of Regulation A by addressing secondary market liquidity concerns, consistent with our August 2022 recommendations.

3. Allow retail investors greater access to a wider range of investment opportunities.

To promote further growth of diverse entrepreneurial ecosystems, which ultimately allow investors greater access to a wider range of investment opportunities, we encourage the Commission to promote local offerings, where investors are more likely to have a relationship with the company and explore ways for crowdfunding to be made more accessible, consistent with our November 2020 and December 2019 recommendations.

Given the impact of early-stage investors who tend to invest within their local communities, as well as regional differences in income and wealth, the Committee reaffirms its recommendations from October 2022, February 2022 and May 2020 relating to the creation of a new exemption for local and/or micro-investments that would not be limited to accredited investors.

The Commission should take steps to facilitate capital formation in exempt offerings through pooled investment funds. Consistent with the Committee's recommendations in December 2019 and April 2021, the Commission should allow retail investors to invest in private, growth-stage companies through diversified pooled investment funds, thereby giving retail investors the ability to invest alongside professional investors.

4. Support rules to facilitate the existence and growth of small funds

Early-stage investors play an active role with their portfolio companies by providing hands-on support to founders, participating in board meetings, and supporting customer attraction strategies. Proximity to portfolio companies changes how early-stage investors evaluate investment opportunities. Additionally, the number of companies that the investor can actively mentor limits the number of investments that they can make. As a result, larger venture funds tend to invest larger amounts in a handful of later-stage companies, while smaller funds tend to invest smaller amounts in a proportionate handful of earlier-stage companies.

The Committee has noted that first-time fund managers and smaller funds are declining in number and size, threatening access to the earliest stage capital that is catalytic to new small companies' success. The Committee reaffirms its view that the Commission should study and support rulemaking that encourages the growth of smaller funds.

In addition, the Committee reaffirms the importance of a "fund of funds" model—where a larger fund invests in smaller, regional funds—which could unlock capital otherwise competing for late-stage allocations and benefit smaller companies in emerging entrepreneurial ecosystems, and the Committee encourages the Commission to review our April 2021 recommendations that could make this "fund of funds" structure more prevalent.

5. *Continue to protect investors through effective enforcement and more education and outreach.*

Effective and swift enforcement action by the Commission is key to investor protection and fair and efficient markets. Consistent with our March 2022 recommendation, we believe it is important for the Commission to recognize that a business's failure to succeed is not the same thing as fraud. And further, fraud occurs at the hands of bad actors regardless of regulatory thresholds. The Commission should continue its robust enforcement program to root out fraud across markets of all sizes, while supporting investor education on the importance of portfolio diversification to mitigate risk of one investment's failure. Expanding the Commission's enforcement resources is advisable not only to effect this task but also to underpin the importance of issuer compliance with the rules for exempt offerings.

In addition, we believe that the education and outreach efforts for investors and issuers produced by the Office of the Advocate for Small Business have been creative and effective. We encourage the Commission to continue and to expand those outreach efforts.

As passionate stewards of small businesses from various market perspectives and geographies, the Committee is proud of our work and are grateful for our partnership with the Commission. We salute the Commission for establishing a process by which the capital formation issues that are unique to small businesses can be identified and addressed. We would also like to acknowledge the guidance and thank the staff of the Office of the Advocate for Small Business Capital Formation for all of their work over the past four years.

Lastly, it has been an honor to serve as the inaugural members of the Small Business Capital Formation Advisory Committee. We look forward to the Committee's ongoing role in helping to forge some general consensus on how to achieve the benefits that can be gained through these objectives. We hope our efforts lay the groundwork for more capital formation opportunities for diverse small companies across our country, enabling them to grow and prosper.

Respectfully submitted on behalf of the SEC Small Business Capital Formation Advisory Committee,

Carla J. Garrett
Committee Chair

Jeffrey M. Solomon
Committee Vice Chair

CC: Commissioner Hester M. Peirce
Commissioner Caroline A. Crenshaw
Commissioner Mark T. Uyeda
Commissioner Jaime Lizárraga