



**PROPOSALS TO FOSTER CAPITAL FORMATION AND
ECONOMIC GROWTH IN THE BIOECONOMY**



March 18, 2021

The Honorable Pat Toomey
Ranking Member Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20515

Dear Ranking Member Toomey,

The Biotechnology Innovation Organization (BIO) appreciates the opportunity to provide the Senate Committee on Banking, Housing, and Urban Affairs with a set of proposals to promote capital formation for entrepreneurs and innovators in the research and development-intensive biotechnology industry while increasing opportunities and enhancing protections for investors.

BIO represents nearly 1,000 companies in the biotechnology ecosystem. Our members are responsible for innovating the next generation of treatments, diagnostics, cures, alternative energy sources, and new food sources that will secure the health and safety of our Nation. Even in today's uncertain times, America's small biotechnology (biotech) companies, both public and private, continue to lead efforts to address the most devastating global health risks and diseases.

In fact, 76 percent of all global research and development (R&D) aimed at tackling the COVID-19 pandemic is generated by small biotech companies.¹ Small biotech companies are also responsible for 80 percent of all scientific R&D.² All of these companies started as a revolutionary idea in a laboratory that was nurtured by private market financing and many eventually mature into public companies. It is for this reason that the world leader in life sciences innovation also happens to be the country with the deepest capital markets.

Just as science is perpetually seeking to improve, so too should capital formation policies that facilitate access to capital, broaden available pools, and provide liquidity to existing pools all while ensuring that regulatory disclosures and reporting requirements scale with the maturity of the enterprise. It is important to R&D-intensive industries, particularly those in the life sciences, that securities and capital formation regulatory frameworks shift away from the current framework of one-size-fits-all, every-company-is-the-same to a more nuanced approach.

Thank you for your longstanding interest in facilitating capital formation for our small business innovators. We stand ready to assist you in developing any of these proposals submitted for your consideration today.

Sincerely,

/s/

Dr. Michelle McMurry-Heath
President and CEO,
Biotechnology Innovation Organization

¹ <https://www.bio.org/policy/human-health/vaccines-biodefense/coronavirus/therapeutic-development/bio-covid-19-therapeutic-development-tracker>

² <https://www.iqvia.com/insights/the-iqvia-institute/reports/emerging-biopharmas-contribution-to-innovation>



The Importance of Capital Formation in the Life Sciences

The American bioeconomy, which includes life sciences as well as agriculture and bio-industrial companies, is a testament to the benefits of free and fair capital markets that allow for the transparent pricing and transfer of risk among its participants.

Our capital markets are a key reason why the United States remains the global leader in life sciences research and in the translation of scientific discovery into therapeutics, diagnostics, cures, energy sources, and safer more readily available and disease-resistant food supplies.

The American economic and capital market engine is the envy of the world. Our system has been developed over decades to be what it is today. It is hard to replicate, but very easy to erode with the stroke of a pen implementing policies that yield to hyperbole without appreciation for the history that made us great, or humility for the competitive forces that define our present and future.

Global competition in the “biotechnology revolution” is accelerating as nations continuously learn from and adapt to American-born innovation, which includes not only our novel ideas and technologies but also new business models. Together, American biotechnology entrepreneurs are turning science fiction into therapeutics, and in the process changing the competitive landscape and how the world thinks about financing and incentivizing innovation.

Accordingly, it is incumbent upon all of us to continuously improve our capital market system in ways that preserve our competitive advantages. We must do this by ensuring that American innovators have efficient access to broad pools of capital throughout their lifecycle, that the pricing and transfer of risk is efficient and transparent, that all pools of capital are liquid and provide the opportunity to exit positions, and that investors are not only compensated for the risks but are provided with transparent reporting that takes into consideration a company’s size and experience.

Herein, BIO proposes a number of policies that will help to preserve the safety, soundness, and competitive advantages of the current capital market structure while strengthening key aspects to benefit R&D entrepreneurs by subtly expanding rules, reducing barriers to entry, cutting red-tape, and minimizing frictions that have been found to cost valuable dollars to research and development in the life sciences.

These changes will provide biotech entrepreneurs and investors the confidence to continue their work knowing that the system of regulations is there to support them and is specifically designed to the unique needs of the biotechnology ecosystem. Some of these changes could be accomplished by SEC action alone or by legislation. BIO would be pleased to work with you in crafting legislation to accomplish any of these proposals.

Summary of Proposals

INTENDED EFFECT	PROPOSAL
Broaden Access to Capital and Improve Liquidity	1. <i>Legislative:</i> Amend business development company acquired fund fees and expenses rules
	2. <i>Legislative:</i> Allow pooled investment vehicles, such as interval funds, to invest in private securities and open these securities to accredited investors
Alleviate Unnecessary Regulatory Burdens	1. <i>Legislative:</i> Amend the JOBS Act to extend the “Emerging Growth Company” status to 10-years from 5-years
	2. <i>Legislative:</i> Amend penny stock exemption definition to reflect the modern economy by replacing “tangible assets” with “shareholder’s equity”
	3. <i>Regulatory:</i> Entice long-term investing in Smaller Reporting Companies (SRC) by allowing them to report earnings semi-annually
Improve the Trading Environment for Small Cap Biotechs	1. <i>Regulatory:</i> Compel SEC to issue guidance permanently exempting U.S. institutions from complying with MiFID II
	2. <i>Regulatory:</i> Compel SEC to issue guidance that the JOBS Act supersedes the Global Settlement and Regulation FD for emerging growth companies
	3. <i>Regulatory:</i> Compel SEC to issue guidance on short selling transparency disclosures for small cap stocks

Broadening Access to Capital and Improving Liquidity

I. Business Development Company Acquired Fund Fees and Expenses

Business Development Companies (BDCs) serve an important role in lending to small biotechnology companies as bank lending is often a consequence of financial conditions and risk appetite in the market cycle. Too often, traditional bank lending to this sector is stifled by the risks inherent in the probability of outcomes. The primary impediment that BDCs have in raising additional capital, and thus stifling access to capital by end consumers (biotechs), is that the acquired fund fees and expenses (AFFE) rule effectively double-counts fees, thus dissuading capital contributions. By removing this double-counting provision, BDCs would be able to raise more capital, and, thus, provide more capital to small market capitalization companies, including those in the biotechnology industry.

Previous legislation by Rep. Brad Sherman (D-CA) and Rep. Steve Stivers (R-OH) has been introduced to address the issue, and BIO would support a reintroduction of the bill, linked [here](#).

II. Pooled Investment Vehicles

Closed-end funds (CEFs), a type of pooled investment vehicle, have limited redemption rights, which allow CEFs the ability to invest in thinly traded securities, such as the private market securities and penny stocks of startup companies. This would offer liquidity to the private market for biotech startup funding, which in turn would allow for a broader and deeper pool of capital



available for biotechnology companies and other startups. In fact, the U.S. Department of the Treasury issued a report³ recommending that the SEC review existing rules governing interval funds “to determine whether more flexible provisions might encourage creation of registered CEFs that invest in offerings of smaller public companies and private companies whose shares have limited or no liquidity.”

Previous legislation introduced by Rep. Anthony Gonzalez (R-OH) provides this broadening ([here](#)) and BIO would support its reintroduction.

Alleviating Unnecessary Regulatory Burdens

I. JOBS Act Emerging Growth Company (EGC) Extension

In 2012, recognizing the regulatory burdens on small companies, Congress passed the Jumpstart Our Business Startups (JOBS) Act. The creation of EGC status within the JOBS Act was an important recognition by Congress that scaled disclosures for small businesses would support their growth without undermining investor protections. However, most biotechnology companies that make the transition into public markets still do not generate revenues for years beyond the current five-year EGC exemption limitation. A permanent extension of the EGC exemption to ten years from five years will align with the realities of the market, better serve with the original intention of the JOBS Act, and still preserve investor protections.

Previous legislation introduced by Rep. Bryan Steil (R-WI), provides this extension and BIO would support an introduction of the bill, linked [here](#).

II. Update the Penny Stock Definition for the 21st Century

Many biotechnology companies, in desperate search for funding, end up listing in over-the-counter exchanges and classified as penny stocks for the purposes of SEC Exchange Act Rule 3a. This designation effectively limits a broker-dealer’s ability to facilitate sales of the stock and inhibits secondary liquidity, a feature of over-the-counter markets.

Current exemptions from Rule 3a contained in Rule 3a51-1 were formulated when the Exchange Act was legislated in 1934. In it, appropriate for the 1930s, defined an exemption from the penny stock definition for firms with net tangible assets of \$2 million for firms with three years of operations or \$5 million for firms with less than three years of operations. Unfortunately, R&D costs and the intangible assets they represent are not considered as this was not the main asset of the U.S. economy in the 1930s. In today’s economy, intangible assets (e.g. intellectual property) is the main asset companies produce, particularly for R&D innovators in the life sciences.

BIO believes it is time to update these antiquated definitions that represent the world as it was almost 100 years ago. This must be accomplished legislatively.

³ <https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf>

III. Semi-Annual Reporting for Smaller Reporting Companies

A steady flow of information and consistent standards in financial reporting and management disclosures is a fundamental requirement for a functioning and transparent public equity market. Investor demands, supported by regulation, is a fundamental pillar of our market. However, the utility of mandatory quarterly filings of Form 10-Q for an R&D company in the life sciences seems superfluous as scientific discovery does not follow quarterly reporting schedules. Moreover, most Smaller Reporting Companies (SRC) and, to a great extent EGCs as well, have very little to report in Form 10-Q. Most of their reporting of crucial importance for investors in this segment of the market come from event-driven reporting requirements in the form of Form 8-K filings. Eliminating the need from two superfluous reporting requirements throughout the year, by allowing SRCs to report semi-annually, would save money that could otherwise be dedicated to research and staff.

BIO recommends that SRCs be provided an exemption from quarterly filings of Form 10-Q for SRCs. The SEC has also previously expressed interest in considering this exemption. This could be accomplished legislatively or regulatorily as the SEC recently did with the expansion of the SRC definition to include a revenue test.

Improving Trading Dynamics for Small Cap Biotechs

I. Permanent Exemption from Markets in Financial Instruments Directive (MiFID II)

The lack of analyst converge in the small market capitalization space is universally decried as a central reason for the dearth of liquidity in the space. In the wake of the EU's passage of MiFID II, analyst coverage has declined significantly, exacerbating the liquidity problem in the small cap universe. Large financial institutions have shed analyst jobs, forcing remaining analysts to focus on a narrow range of companies. While independent market analysis companies have sprang up in the wake of the MiFID II, their research remains out of reach from main street. The Securities and Exchange Commission has responded by repeatedly extending a No Action Letter to industry, exempting them from fully implementing the EU law in the United States. However, market participants, in a vacuum of legal and regulatory clarity, must do what is necessary to ensure that the operations inside their second-largest market do not run afoul of local regulations. The domestic regulatory framework should provide certainty to market participants, not a perpetual kicking of the can. Hope, as they say, is not a strategy.

BIO recommends a permanent exemption for industry. This could be accomplished legislatively or regulatorily, either through a permanent extension of the SEC's No Action Letter or through other permanent regulatory changes.

II. Convergence of JOBS Act and Global Settlement

The JOBS Act significantly liberalized permissible solicitations and removed barriers on research coverage in connection with initial public offerings of EGCs. However, in practice, the SEC guidance has not clarified the distinctions between JOBS Act allowances, outlined in



Section 105(b), and existing structures provided in the Global Settlement to institute separations within investment banks and research analysts.

In SEC guidance, Staff, in certain instances such as in analyst participation in pre-IPO pitch meetings, declared that the JOBS Act did not supersede the Global Settlement and does not override FINRA/NASD and NYSE rules. SEC Staff guidance extended further instances where existing FINRA/NASD rule and Exchange Act rules to deter any behavior, such as testing the waters or analyst participation in road shows, that are included in the Global Settlement and intended to be released under the JOBS Act.⁴

BIO recommends that the Congress mandate a study on the continued impact of the Global Research Analyst Settlement and related FINRA rules on analyst coverage with a focus on exemptive relief for SRCs and EGCs.

III. Short Selling Transparency

Short selling is a necessary market function that allows for efficient price discovery and the balance of expectations in markets. It is a key signal in the information content of markets that provides a natural balance to behavioral extremes seen in markets without short selling. However, in the small market capitalization space, the lack of liquidity allows short selling that can distort markets in the short run, increase volatility in already volatile space, and disturbs both the information content required by other investors and capital formation efforts derived from follow-on offerings for small public life sciences companies. An example of the latter point, who is going to participate in a follow-on offering (when public companies raise more capital by issuing more stock), when there is known short-selling betting against the company and prices are falling?

BIO has long supported legislation requiring the disclosure of short positions comparable to the current requirements for disclosures of long positions. Transparency is the bedrock of our capital markets as it provides a clear, uniform, and accurate signal to participants. Short disclosures would be additive to this fundamental principle of our system and will greatly assist in the central tenets of our markets: price discovery, discounting, and the transfer of risk.

BIO also recommends that short investors be subject to additional requirements such as a duty to update voluntary short positioning disclosures to reflect accurate positioning once closed or reduced and a legal determination that rapidly closing short positions in the wake of publication of a short investment thesis without disclosure of intentions to do so constitutes fraudulent scalping. These suggestions have also been proposed to the SEC for administrative action. The petition for rulemaking ([here](#)) provides additional details.

⁴ <https://www.sec.gov/divisions/marketreg/tmjjobsact-researchanalystsfaq.htm>