March 18, 2021

The Honorable Pat Toomey
Ranking Member
Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

Re: Request for proposals to foster economic growth and capital formation

Ranking Member Toomey:

Thank you for soliciting proposals to increase economic growth and job creation by facilitating capital formation. This is particularly important as we rebuild following the pandemic and its related economic harm.

Introduction

eShares, Inc. d/b/a Carta, Inc. (Carta) was founded in 2012 to develop software to digitize paper stock certificates and manage capitalization tables for private companies. Carta recognized that private equity, including venture capital, was suffering from a paper crisis that rivaled the “Back Room Crisis” that crippled public equities markets in the late 1960’s and early 1970’s.[1] Rather than solving this crisis through centralization and share *immobilization* as was done in public equities, Carta developed a centralized registry of private asset ownership that simplified share *mobilization* through modern technology.

Since then, Carta has evolved into a multi-faceted financial technology company that helps issuers, investors, and employees manage and value equity ownership. Today, Carta has nearly 1,000 employees across 10 offices in the US and abroad. Together we support over 1,000,000 security holders at more than 18,000 companies who manage over $1.2 trillion in equity value across Carta’s platform. We provide portfolio management and reporting tools for thousands of investors and employees, and provide valuation and fund administration services to hundreds of venture capital firms.

We appreciate the opportunity to submit comments and will focus our proposals on broadening investor access and supporting capital formation.

Investor Access

[1] See *Revolution on Wall Street: the Rise and Decline of the New York Stock Exchange*, Ch. 7, Marshall E. Blume, Jeremy J. Siegel & Dan Rottenberg (1993).

Carta believes asset ownership is a critical component of narrowing the wealth gap in the US and globally. To that end, we must shape a policy framework that appropriately enables inverter access to key asset classes, including private markets.

The number of public companies has been steadily declining since 2000.[2] In 2018, registered offerings accounted for $1.4T of new capital compared to approximately $2.9T that was raised through exempt offering channels.[3] Fewer companies are electing to go public and those that do, often do so later in their lifecycle and growth trajectory. The median range for an IPO has increased from 8 years between 1990-1998 to 11 years between 2001 - 2020.[4] Perhaps more important than duration is the growth stage at which companies elect to register and go public. Previously, many companies viewed an IPO as a tool to fuel growth at an earlier stage in their development. Currently, more and more companies use private capital to fuel growth and IPO at a far more mature stage. The end result is that non-accredited investors are restricted from investing in and benefiting from the growth stages of companies before they decide to go public, if they ever do.

Although a recent growth in direct listings and special purpose acquisition companies has increased the number of IPOs this past year, we cannot assume this movement overturns the trend. To that end, policy should enable more investors to access private market ownership.

Skeptics of expanding investor access to private markets will cite concerns around investor protection. We acknowledge that private markets function differently than public markets and that prospective investors should become knowledgeable about the functioning of the marketplace and the risks with any potential investment. We do not, however, believe that increased access results in decreased investor protection. The ability to invest in additional asset classes, such as private markets, can bolster investor protections through diversification.

Accredited Investor Definition: Expand the accredited investor definition to provide a broad swath of investors the ability to invest in and benefit from private markets. Policymakers should expand the onramps for more retail investors to qualify as accredited investors.

Under the current framework, to qualify as an accredited investor, a retail investor must meet certain income and wealth standards, which serve as a proxy for an investor's financial resilience to bear losses. Importantly, the SEC recently expanded the definition, untethering it solely from wealth or income thresholds to enable investors to qualify if they are in good

---

[2] See *Where Have All the Public Companies Gone?* Bloomberg Opinion, (April 9, 2018), available at https://www.bloomberg.com/opinion/articles/2018-04-09/where-have-all-the-u-s-public-companies-gone.

[3] See data from Professor Jay Ritter and the Warrington School of business, available at https://site.warrington.ufl.edu/ritter/files/IPOs-Age.pdf

[4] See *supra* note 4. Note, the median age at IPO between 1999 and 2000 at the height of the market was 5 years.

standing with certain professional certifications, designations, or credentials which in this iteration includes the FINRA Series 7, 65, and 82 licenses.

The SEC also opened the door for future additions to this list. Although it is difficult to codify new additions in statute, we recommend Congress direct the Commission to expand the list to include Certified Public Accountants, Certified Management Accountants, Certified Financial Analysts, Chartered Alternative Investment Analysts, and Certified Financial Planners. Each brings with it a level of expertise that we believe demonstrates an individual's comprehension and sophistication in the areas of securities and investing, and thus obviates the need for various restrictions on their investment choices.

Although professional designations and licenses are important, those should not be the new threshold. We recommend lawmakers direct the creation of more accessible onramps outside of professional certifications or company-sponsored licenses. We recommend FINRA be empowered to establish an accredited investor exam. FINRA is well positioned to create and administer an examination it believes appropriate to ensure an individual has the ability to operate as a sophisticated investor. Importantly, such an exam -- just as the Securities Industry Essentials (SIE) is currently structured -- would not require an individual to be associated with a broker-dealer firm. This accomplishes the goal of preparing an investor but creates a more accessible onramp to investment opportunities that drive alpha and help with diversification.

Appropriately expanding the accredited investor definition helps broaden access to investments for more people, especially those from non-traditional backgrounds, as well as lower cost of living areas where salary and income levels may not meet existing thresholds. Improving this definition may make a material difference in democratizing ownership.

Investment Vehicles: Increase retail investor access to private market investments through pooled vehicles.

As noted above, many retail investors are prohibited from investing directly in the private market. Further, the regulatory framework that governs a pooled fund such as a closed-end fund often limits the investor class to accredited investors and in some cases qualified purchasers.

According to an SEC staff guidance, a closed-end fund may not invest more than 15% of its assets in private funds unless it limits the sale of its shares to accredited investors. Closed-end funds are professionally managed and another vehicle that can provide investors access to alpha in private markets along with the diversification of broader asset class exposure. Those investors, however, should not be limited to the already affluent.

Lawmakers should remove the limitation that caps investment in private assets if a closed-end fund allows non-accredited investors to participate. The current policy incentivizes funds to exclude non-accredited investors and damages retail investor access and upside.

Capital Formation

Expanding investor access increases the supply of capital and liquidity that can help grow businesses from concept to company. Policymakers should not, however, stop there, but undertake efforts that will help craft a policy framework to expand access to capital and, importantly, secondary market liquidity.

Streamlining primary offerings should be done in tandem with creating a more robust and liquid secondary marketplace for those offerings. As has been noted by the SEC, "secondary market liquidity is a key concern of investors and may have a significant impact on an issuer's choices with respect to capital raising . . . an investor's willingness to participate in an exempt offering and the price he or she would be willing to pay may depend on the investor's assessment of whether, when, and on what terms the security can be resold."[5] Carta believes that a lack of secondary market liquidity in private markets affects primary offering capital formation.

Secondary market liquidity, or lack thereof, affects an issuer's cost of capital. Businesses "trying to attract capital often struggle because potential backers are reluctant to invest unless they are confident there will be an exit opportunity."[6] Without secondary market liquidity, issuers will pay higher premiums or be unable to attract capital. In this situation, investors apply meaningful illiquidity discounts to private market investments that increase the cost of capital for private issuers. The illiquidity discount ranges, but some experts project that it can reduce the value of an asset by the expected cost of trading that asset over its lifetime; those experts estimate these discounts can range between 20% and 30% of market value.[7] Creating a more liquid market for private securities that could reduce the illiquidity discount applied to private market investments by even 50 percent would have unlocked an additional $270 to $405 million in available investment, based on 2019 numbers when $2.7 trillion was raised in exempt offerings.

Further, an illiquid secondary market not only increases the cost of capital for the issuer, but also impairs the investor's ability to sell the security when he or she would like to realize a gain, exit a position, and reallocate capital to additional investments. This has knock-on economic effects. Illiquid and liquid value are not perfect substitutes. Research shows that investors

---

[5] *Concept Release on Harmonization of Securities Offering Exemptions. pp. 14. Securities Exchange Act Release No. 33-10649 (June 18, 2019), 84 FR 30460 (June 26, 2019) (the "Concept Release"). https://www.sec.gov/rules/concept/2019/33-10649.pdf*

[6] Letter from SEC Advisory Committee on Small and Emerging Companies (May 2017) pp.1 https://www.sec.gov/info/smallbus/acsec/acsec-recommendation-051517-secondary-liquidity-recommendation.pdf

[7] See Aswath Damodaran, *The Cost of Illiquidity*, at 13, 27, available at http://people.stern.nyu.edu/adamodar/pdfiles/country/illiquidity.pdf

measure consumption relative to liquid wealth, given its ability to meet day-to-day needs.[8] As an investor's illiquid holdings increase in proportion to total wealth, consumption decreases, diminishing broader economic activity. Second, the same research indicates that "...illiquidity leads to a large reduction in the allocation to both illiquid and liquid assets..."[9] Essentially, as a larger percentage of one's wealth is illiquid, he or she is more risk-averse. This leads to decreasing capital allocation across asset classes. Lastly, as a private market security increases in value, owners may seek to realize the gains and allocate that capital to additional growth opportunities. Illiquid assets hinder that from occurring.

This moves into another key consideration: investor protection. Carta believes liquidity is a critical component of investor protection. An illiquid secondary market for private securities limits an investor's ability to liquidate holdings at a time of his or her choosing. For employees who may have become shareholders by virtue of employment, increased liquidity in the secondary market helps them meet financial needs and provide for their households. It also allows them to build portfolios with diverse holdings that mitigate risk. This is, of course, true of investors as well who seek to invest in this growing asset class of private market offerings. Such investors should be able to invest and exit a position when they deem appropriate.

Blue Sky Laws: Consider the appropriate role of blue-sky laws.

One avenue to increase liquidity for secondary market transactions is assessing the role of blue-sky laws for secondary market trading. We have seen this debate most recently with the SEC's update to the exempt offering framework, specifically considering extending federal preemption to secondary sales of Regulation A Tier 2. Although the SEC elected not to preempt blue-sky laws given the novel nature of this new exemption and the concerns expressed by commentators, it is a worthy debate.

There are substantive differences in the various state exemptions. This lack of uniformity inhibits the development of a national secondary trading market."[10] The resulting diminished illiquidity in the secondary market for these securities increases transaction costs, lowers the price investors receive when selling, and ultimately, as we detailed earlier, increases the cost of capital for issuers during their primary offering.

These are not easy considerations as policymakers must appropriately balance between the burden of disclosure on issuers and investors, and the utility to investors in the context of

[8] See Andrew Ang, Dimitris Papanikolaou, Mark Westerfield. "Portfolio Choice with Illiquid Assets" Working Paper 19436, pp. 16. National Bureau of Economic Research https://www.nber.org/papers/w19436.pdf

[9] *Id*. at 29. Note, models are relative to the Merton benchmark where trading opportunities arise continuously and a standard calibration indicated that if the expected time between liquidity events is once a year, the investor should cut her investment in the illiquid asset by 33% relative to an otherwise identifiable but dully liquid asset.

[10] Letter from SEC Advisory Committee on Small and Emerging Companies, *supra* note 6, at 1

secondary market transactions. As you consider various reforms, we encourage you to weigh those trade-offs.

Holders of Record Limitation: Monitor impact of Section 12(g) of the Securities Exchange Act of 1934 to allow for more individuals to invest in private companies.

The current threshold limits outside owners to 2000 persons or 500 non-accredited investors held on record (cap table) for an issuer. Although we are not seeing trends hit that threshold at this time, as secondary market liquidity improves, we encourage policymakers to monitor this constraint to ensure such a limitation does not impede investor access and the continued growth of a company.

Broadening Opportunity

As our country rebuilds from the pandemic, we also want to be cognizant of ways to broaden economic opportunity to more people across this country. Our focus on building an ownership economy has pushed us to assess equity distributions across gender, race and ethnicity, and geography.

Although our data is limited to the equity distribution among the employee base, according to our 2020 Table Stakes study[11], the numbers are telling. There are four categories of corporate stakeholders that earn the bulk of equity: founders, senior executives, early employees, and technical employees. Our data show that women and people of color are underrepresented in each category. Women, for instance, own just $.47 in equity for $1.00 men own. People of color made up a small portion of employee stakeholders in our data set, which is consistent with reports showing an overall lack of racial diversity in the startup ecosystem. Of employees surveyed, black and hispanic/latinx employees held a smaller portion of equity ownership, owing in some part to because they often do not sit in higher paying technical roles or move into more senior roles. Carta's data also reveals that equity ownership remains concentrated in places like Silicon Valley; 56% of employees on carta reside in California, holding 76% of the wealth.

Improving this dynamic will take time and work. As policymakers pursue opportunities to drive economic opportunity, we encourage you to consider policies to streamline capital formation for growth stage companies, but work to engage and support businesses emerging from communities of color and from geographical areas beyond the traditional hubs. This may include reimagining traditional policies to provide more resources and support by leveraging such things as public-private funding mechanisms to support private enterprises as they grow.

Broadening economic opportunity should be a key focus and we are committed to working with you on it.

---

[11] Table Stakes https://tablestakes.com/study/

***

Thank you for the opportunity to submit our views. We appreciate your leadership and look forward to working together.

Sincerely,

/s/ Anthony Cimino

Head of Policy
Carta