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Via Email: submissions@banking.senate.gov

Senate Mike Crapo, Chairman
Senate Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, DC

Senator Sherrod Brown, Ranking Member
Senate Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, DC

Re: Request for Proposals to Foster Economic Growth

Dear Hon. Senators Crapo and Brown:

I am a member of the U.S. Securities and Exchange Commission's Advisory Committee on Small and Emerging Companies. The SEC requests that I confirm to you that the opinions and recommendations here are my own and do not represent the views of the SEC, or any of the Commissioners, staff or the other committee members. Further, the opinions and recommendations here are my own in all regards. I do not speak for any other person.

Thank you for your request for proposals to foster economic growth. I write to you today from the perspective of a legal advisor to small businesses, the engine for growth in American's economy. For 39 years, I have been a practicing corporate, securities, and mergers and acquisitions attorney in the Dallas-Fort Worth area. The last half of that period has been spent largely representing small and emerging companies.

This letter is based on my real-world experiences in State of Texas, a portion of the heartland of the United States, like Idaho and Ohio, that is so often ignored by Washington.[1]

Considering the foregoing, I have the following recommendations.

One. Create a small person or entity exemption from the broker-dealer registration requirements in Section 15 of the Securities Exchange Act of 1934.

This point involves an arcane requirement of the securities laws. Nonetheless, it is significant because it separates those who try to comply with the law from those who with nefarious intent.

Section 15 of the Securities Exchange Act creates a complicated regimen for the registration of securities brokers and dealers with the SEC and requires joining a self-regulatory body such as FINRA.[2] Requirements include passing tests and maintaining net capital. From time to time, there are scofflaws who engage in the business of finding money (*i.e.*, investors) or engage in selling businesses without registering as required by Section 15 of the '34 Act.

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These persons should be registered as "brokers", but the requirements are too complex and expensive to make compliance cost-effective for the small business person or entity.[3] Although the number of years is not settled (16 years is the lowest number offered), the private bar and others have advocated for the SEC to craft a limited registration or exemption for the brokers.[4] For reasons unclear, the suggestions have languished with the SEC staff within the Division of Trading and Markets.[5] It is safe to say that the public is *Waiting for Godot* with respect to the SEC staff action on this matter.

Why is this important? There are three reasons.

a. The change will prevent securities fraud victimizing small companies and their investors. An exemption such I am proposing will separate those who are intent on compliance but cannot because of limited resources from those who have no intent of complying with the securities laws. (*I.e.,* this is a tool to separate the good guys from the bad.) If a small broker does not register at the state level or demonstrate an applicable state exemption, then he or she has no intent to comply with the laws. In this manner, companies selling securities and their legal counsel can select more trustworthy brokers.

b. Although the Commission takes little interest in enforcing mandatory registration among these unregistered small brokers, the staff nonetheless take the position that companies (and their lawyers) selling securities by using unregistered brokers are participating in violations of the law. Thus, the Commission says, "We won't help the public by enforcing these laws, but so you the public go and be the securities police." Often small companies must choose between an unregistered broker making beguiling promises about boatloads of capital and competent securities counsel quoting inscrutable (to the businessperson) legal requirements.

c. The proposed changes will only affect *federal* registration. The small brokers will remain subject to state broker registration requirements unless an exemption applies. Two levels of regulation are not needed here.

Because of the SEC staff's foot-dragging in this area, the exemption should be self-executing without SEC rulemaking being a condition to effectiveness.

The following responds to the questions asked in your request.

<u>Brief description of the proposal</u>, Create two small broker exemptions from the registration requirements of Section 15 of the Securities Exchange Act of 1934, without preempting state broker registration laws.

<u>Impact on economic growth</u>. The proposal will increase economic growth by facilitating securities law compliance and reducing securities fraud among investors in small businesses.

<u>Impact on the ability of consumers, market participants and financial companies to participate in the economy</u>. By reducing fraud and increasing compliance, the proposal will

facilitate participation by these groups in the capital formation by small businesses and investment in these companies.

Legislative language. I propose the following addition to Section 15(a)(3) of the Securities Exchange Act of 1934:

(3) in addition to subsection (2) of this Section 15(a), the brokers described in subparts (A) and (B) shall be exempt from the registration requirements of Section 15(a) not required to be registered under Section 5 of the Securities Act of 1933 so long as the issuer does not have a class of securities required under Section 12(b) or Section 12(g) of this Act:

A. *Finders or occasional brokers that do not engage in capital-raising activities more than once in any 12-month period, and who do not make any offerings with a gross offering amount of more than $10.0 million.*

B. *Brokers that are not engaged in any offerings or company sales for more than $25.0 million per transaction or more than $75.0 million in total offerings in any 12-month period.*[6]

C. *These brokers shall be exempt from the requirements (i) to maintain minimum net capital accordance with applicable rules of the Commission adopted pursuant to Section 15(b), (ii) to join a self-regulatory organization, (iii) to designate compliance officers, and (iv) other similar requirements as designated by the Commission.*

D. *All brokers exempt from registration pursuant to subparts A. and B. above shall comply with all state securities laws relating to the registration of securities brokers, dealers, or broker-dealers. Individuals affiliated with these firms shall demonstrate basic knowledge of the securities laws through passing of tests as required by state law.*

E. *The exemptions contained in subparts A. and B. of this Section 15(a) shall not be available to any broker that is subject to the disqualifications provided in Section 15(b)(4) of this Act or who has controlling persons or employees who are subject to those prohibitions.*

F. *Nothing in this Section 15(c) shall exempt the activities of a person described here from the provisions of Section 10(b) of this Act and any other remedial provisions of U.S. securities laws applicable to fraudulent or deceptive activities.*

G. *The Commission may adopt rules pursuant to exemptions contained in this Section 15(a)(3), but effectiveness of this Section 15(a)(3) shall automatic and shall not be conditioned on the adoption of any such rules.*

Other background material as appropriate. Please see the introductory narrative above and the report described in endnote 4.

Two. Create a legislative mandate for the SEC staff to be composed of persons across the U.S.

A review of the SEC commissioners and senior staff reveals that the membership is largely persons who completed their educations and worked in Washington, DC and the Northeast United States. Historically, this concentration made sense because of the locations of

government and capital markets. The advent of the Internet and other factors "shrinking our world" make the concentration obsolete. However, the concentration continues.

In September 2013, I filed a comment letter that took issue with this concentration. I will quote a portion of that letter.[7]

Lack of Experience with Small Business

Attached as Attachment 1 is a summary of the education and work backgrounds of the Chair, other four Commissioners, and the SEC's Division heads and other key persons that I have selected. The information shown is all public, with most information being taken from the SEC's website. Although these persons have a diversity as far as ethnicity and gender, the top leadership is generally a homogenous group otherwise.

The top leadership of the SEC consists almost totally of persons who received their top university degrees in the District of Columbia, the Middle Atlantic States and New England. Of the 11 persons listed on Attachment 1, only three received their top degree outside of this area.

With only two exceptions, these same 11 persons have spent most or all of their careers in these same geographic areas, working with large law firms or in government. If you exclude being a partner in a large law firm as being a management position, only three of these leaders has experience running a business, big or small.

Many of these top leaders have held jobs at private large law firms (mostly headquartered in New York City, Washington or Boston) and the SEC. Top attorneys in these law firms are members of a close circle of elite members of the bar whose business contacts include the top financial and business leaders on the East Coast. Clients of these law firms are large companies, investment funds, financial institutions, wealthy families, etc. Private companies that are clients are likely to be large companies owned by wealthy families, hedge funds, or wealth management companies. Within this group, clients are not likely to include small businesses as they exist on Main Street U.S.A.

Virtually all of these 11 persons have extensive experience in government, often at the SEC. Almost none have worked in private sector management. This background means the Commission and the top staff can speak with very little actual experience of small business.

[Attachment 1 and the original footnotes have been deleted.]

At the time of writing that letter, these senior leaders included no persons from the two most populous states, California and Texas. Obviously, the personnel have turned over, but I dare say that concentration of people from Washington to Boston, with slight diversions to Philadelphia, etc., continues.

Brief description of the proposal. Create a statutory mandate for all of the SEC staff in Washington to reflect the geographic composition of the country's population. Top policy is set in Washington, and the decisions would be improved if the staff reflected a broader cross-section. If necessary, eliminate or reduce the SEC's revolving door by which employees leave for private sector jobs only to return to the SEC at a senior position. This practice increases the "clubiness" of the SEC staff.

I am not recommending any changes to the appointment of SEC commissioners. Those procedures are established.

Impact on economic growth. I believe geographic diversity in the makeup of the SEC staff will improve regulation and enforcement. These changes should affect economic growth by making a more efficient agency.

Impact on the ability of consumers, market participants and financial companies to participate in the economy. Same comment as the previous.

Legislative language. I am afraid I do not know which statutes need changing, but I am sure your staff can identify the relevant law.

Other background material as appropriate. None.

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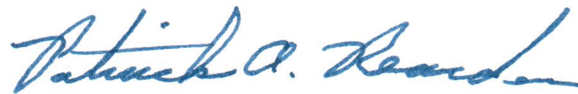
Thank you for taking the time to read this letter. I am happy to answer any questions.

Sincerely yours,



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[1] I will not bother to repeat the relevant facts and statistics that outline the key role of small business in our economy. I am sure that you and your staff are well aware of these.

[2] Financial Industry Regulatory Authority.

[3] A lengthy definition of "broker" is found at Section 3(a)(4) of the '34 Act.

[4] An example of the efforts that gone into these arguments, one can look to the 69-page report on the topic from a select group of American Bar Association securities lawyers published in 2005. See, Task Force of Private Placement Broker-Dealers, ABA Section of Business Law, "Report of the American Bar Association's Task Force on Private Placement Broker-Dealers," 60 *Bus.Law*. 959 (May 2005).

[5] In 2014, the SEC finally issued a no-action letter on unregistered broker-dealers engaged in activities related to mergers and acquisitions that would require registration under Section 15(b) but for the no-action letter. Letter dated January 31, 2014, revised February 4, 2014, signed by David W. Bliss, SEC Chief Counsel and Associate Director, addressed to Faith Colish, *et al.* This was less than half a loaf. First, it did not address private persons acting as brokers in purely capital raising activities unrelated to mergers and acquisition. Second, the staff letter did not have the force of a rule, and there is no certainty that a court would follow it in private litigation.

[6] As an alternative, the brokers described in subpart (B) could be required to complete an abbreviated SEC registration so long as FINRA membership and net capital minimums were not required.

[7] My full letter can be found at https://www.sec.gov/comments/s7-06-13/s70613-338.pdf .