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SEC Receives Final Recommendations from Small and Emerging Companies Advisory Committee

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In 2011, the Security and Exchange Commission ("SEC") formed the Advisory Committee on Small and Emerging Companies (the "Committee") to provide recommendations on rules, regulations, and policies relating to capital raising, securities trading, public reporting, and corporate governance of small private businesses and publicly traded companies with less than $250 million in public market capitalization.



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The Committee was to be temporary, but has had its term renewed several times. The Committee's final term expired on September 24, 2017.

This past Friday, September 21, 2017, the Committee issued its Final Report summarizing its recommendations from the past six years as well as detailing those areas the Committee has identified as areas for continued focus:

1. FACILITATING EXEMPT OFFERINGS

A. Finders

The Committee recognized that identifying potential investors is challenging, and that the regulatory uncertainty and expense in complying with the law only makes things more difficult. All of this has led to widespread noncompliance by those broker-dealers who should be registered. The Committee renewed its recommendation that the SEC "adopt rules in the near future to provide regulatory certainty for finders" and, in the meantime, promulgate guidance to bring some clarity and certainty. The Committee characterized this issue as "critical" and noted that the failure to address these regulatory issues has impeded capital formation and deterred meaningful oversight.

B. Accredited Investor Definition

The SEC is directed to review the definition of "accredited investor" every four years,

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and the Committee has consistently recommended that any changes "do no harm" to the current private offering framework. In its Final Report, the Committee continued to recommend no heightened standards for qualifying as an "accredited investor" because any decrease in the number of accredited investors would disproportionately impact those living in areas with lower cost of living, as well as women and minorities. Instead, the Committee actually recommended that the SEC expand the definition to take into account other measures of sophistication beyond income and net worth.

2. REPORTING COMPANIES

A. Scaled Disclosure

Currently, the Committee noted that disclosure requirements place a disproportionate burden on smaller companies. The SEC has attempted to simplify filing requirements for these smaller companies, but the Committee's position is that more could be done. First, the Committee noted that the relatively new category of "emerging growth company" (EGC) provides a number of accommodations to disclosure requirements which ought to be extended to "smaller reporting companies" (SRCs). Second, the Committee recommended that the threshold definition of SRC should be increased. And third, the Committee urged the SEC to revise the definition of an "accelerated filer" to include companies with a much larger public float.

B. Board Diversity

The Committee has long noted that diversity on a company's board is associated with "improved competitiveness and talent management, greater access to capital, more sustainable profits, and better relations with stakeholders and therefore plays an important role in capital formation for small and emerging companies." Current rules have failed to require or encourage disclosure of diversity, which would be useful to stockholders, employees, and customers. Therefore, the Committee renewed its recommendation that the SEC amend its rules to generate more disclosure useful to investors.

3. MARKET STRUCTURE

"The Committee has frequently expressed concern that U.S. equity markets do not always offer a satisfactory trading venue for the securities of small and emerging companies. Among other things, we have discussed that there is insufficient liquidity for those securities and that listing requirements can prove too difficult for smaller companies to meet."

A. Secondary Market Liquidity

The Committee expressed concern that the limited secondary market causes investors to be reluctant to invest. Although Congress added a new Section 4(a)(7) to the Securities Act to exempt certain secondary sales of securities that are purchased by an accredited investor, that new Section 4(a)(7) in some respects is

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more restrictive than the 4(1½) exemption it codified. In addition, the Committee urged the SEC to facilitate the creation of a separate U.S. equity market for trading by accredited investors in small and emerging companies generally, and in particular by adopting the Committee's May 15, 2017 recommendation to preempt state regulation of secondary trading in securities of Tier 2 Regulation A issuers that are current in their ongoing reports.

B. Tick Size

The Committee was interested in enhancing liquidity for smaller companies, and a promising method for doing so is allowing "smaller exchange-listed companies to voluntarily choose trading increments or tick-sizes greater than the current increment of one penny." The thought is that widening spreads from the current one-penny increments could provide economic incentives that would encourage the provision of trading support to the equity securities of small and mid-cap companies, thus increasing liquidity for these securities. The Committee encouraged the SEC to continue exploring this option.

Anyone with questions on these latest recommendations by the Advisory Committee on Small and Emerging Companies, or on SEC rules and regulations generally, can contact Rich May, P.C. attorneys Thomas Bilodeau and Nathaniel Donoghue.

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