



February 7, 2023

Ms. Vanessa Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549

**Re: February 7, 2023, Meeting of the U.S. Securities and Exchange Commission Small Business Capital Formation Advisory Committee**

Dear Ms. Countryman:

The American Securities Association (ASA)<sup>1</sup> submits these comments in conjunction with the scheduled February 7, 2023, meeting of the U.S. Securities and Exchange Commission's (SEC) Small Business Capital Formation Advisory Committee (Committee). The ASA is pleased that the Committee will examine the relationship between research coverage of small capitalization companies and the trading liquidity of these companies. We are also interested in the feedback the Committee receives related to the value and delivery mechanisms of research coverage for investors.

**Overview**

The ASA has long been concerned about the decline in the number of public companies over the last two decades, and the regulatory disincentives to go public that still exist for growing companies who need access to the public markets. We also remain concerned that companies are tending to go public much later in their lifecycle, and that while large companies may benefit from recent trends such as direct listings, the IPO process still remains inhospitable to young, small companies that need public capital to be competitive and grow. Having these companies enter the public markets earlier in their growth life cycle would also enable mom-and-pop investors and retirement savers to share in their success and grow their own wealth.

One of the more troubling developments in the public markets over the last two decades has been the collapse in research and analyst coverage of small issuers. Recent data shows that as many as two-thirds of companies with a market cap under \$100 million have no research coverage at all.<sup>2</sup>

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<sup>1</sup> The ASA is a trade association that represents the retail and institutional capital markets interests of regional financial services firms who provide Main Street businesses with access to capital and advise hardworking Americans how to create and preserve wealth. The ASA's mission is to promote trust and confidence among investors, facilitate capital formation, and support efficient and competitively balanced capital markets. This mission advances financial independence, stimulates job creation, and increases prosperity. The ASA has a geographically diverse membership of almost one hundred members that spans the Heartland, Southwest, Southeast, Atlantic, and Pacific Northwest regions of the United States.

<sup>2</sup> CapitalIQ as of June 9th, 2017





While the shift towards index investing and away from individual stock selection may play a role in declining coverage, there are several regulatory issues that have contributed to this decline which should be addressed. The ASA has previously called for the SEC to conduct a holistic review of this decline so that a better understanding of the landscape can lead to policy recommendations to increase analyst coverage of small public companies.

## MIFID II

Last year the SEC took an unfortunate step backwards when it was suddenly announced by SEC staff that the longstanding “no-action” position related to hard dollar payments under the EU’s Markets in Financial Instruments Directive (MiFID II). This ill-advised decision – done outside of a vote by the SEC commissioners – will only exacerbate problems with small capitalization companies receiving research coverage.

We see no reason for the SEC to import a European regulation that has done nothing but exacerbate the lack of research coverage for Small Medium Enterprises (SMEs) across European markets.<sup>3</sup> This unbundling regulation has been so detrimental SME research coverage that the European Commission proposed a reversal of its regulations to exempt SMEs from the harm it has caused.<sup>4</sup> Therefore, we recommend the SEC refrain from adopting a European regulation that has been proven not to work.

## General Recommendations

The ASA wishes to provide the Committee and SEC with the following recommendations:

- **Broker-dealers should be permitted to receive hard-dollar payments for research from clients without having to register as investment advisers.** Since the implementation of MiFID II, there has already been a steep decline in the number of research analysts employed as well as the number of companies covered. There has also been a trend toward coverage of larger, more established companies at the expense of smaller ones, which further exacerbates the difficulties that small companies have in accessing the capital markets.<sup>5</sup> In addition to depriving money managers of valuable research, the continued decline of company specific information in the marketplace can further accelerate the trend toward automated and passive investment strategies. The SEC

<sup>3</sup> [https://www.esma.europa.eu/sites/default/files/trv\\_2020\\_2-mifid\\_ii\\_research\\_unbundling\\_first\\_evidence.pdf](https://www.esma.europa.eu/sites/default/files/trv_2020_2-mifid_ii_research_unbundling_first_evidence.pdf)

<sup>4</sup> <https://www.fintechfutures.com/2020/07/ec-prepares-changes-to-mifid-ii-research-unbundling-rules/>

<sup>5</sup> See e.g. Research Analysts’ Existential Crisis Enters MiFID II Era (Bloomberg) January 3, 2019, available at <https://www.bloomberg.com/news/articles/2019-01-03/the-research-analyst-s-existential-crisis-enters-mifid-ii-era>; Why MiFID II Isn’t Working as Intended and Investors are Losing as a Result (Melius Research) December 6, 2018, available at <http://www.integrity-research.com/mifid-ii-isnt-working-intended-investors-losing-result>





should, at a minimum, reinstate its no-action position that would not require brokers to register as investment advisers until a permanent solution can be achieved.

- **Rule 139 under the Securities Act of 1933 should be amended to permit broker dealers to continue research coverage of issuers without such coverage being deemed an offer or sale of securities.** Currently, such a safe harbor only exists for issuers that are Form S-3 eligible, and not for smaller issuers including emerging growth companies (EGCs).
- **The SEC should produce further concrete recommendations to improve research of pre-IPO and small public companies.** The ASA strongly supported the Treasury Department's previous recommendation for such a review. Further, we believe that a comprehensive review of the 2003 Global Research Analyst Settlement as well as SEC and Financial Industry Regulatory Authority (FINRA) rules should be conducted. While there have been rule changes made to encourage pre-IPO research, without a liability safe harbor it is unlikely that we will see a meaningful increase in pre-IPO research.

### SOX Study

The ASA also recommends this Committee conduct a comprehensive study into the impact that the Sarbanes-Oxley Act (SOX) has had on U.S. capital markets, the willingness and ability of companies to go public, and the competitive position of the United States versus the rest of the world. Specifically, the study should be sent to the full Commission and it should include the following:

- The total aggregate cost of compliance for all public companies to comply with all aspects of the Sarbanes-Oxley Act and its implementing regulations;
- The average cost of compliance per public company to comply with all aspects of the Sarbanes-Oxley Act and its implementing regulations;
- The total aggregate amount and the average amount paid to accounting firms by public companies to certify such public company compliance with all aspects of the Sarbanes-Oxley Act and its implementing regulations;
- The total number of all public companies, not including those defined as Emerging Growth Companies in the JOBS Act, that were found to have been or were accused of committing fraud as confirmed by an enforcement action by the U.S. SEC and/or the U.S. DOJ;
- The total number of Emerging Growth Companies in the JOBS Act, that were found to have been or were accused of committing fraud as confirmed by an enforcement action by the U.S. SEC and/or the U.S. DOJ;
- A comparison between fraud at Emerging Growth Companies and fraud at all public companies; and





- An estimated total cost shareholders incurred for public companies they owned to comply with Sarbanes-Oxley Act and its implementing regulations from 2002-2021.

A study of this nature could be an additional tool for the SEC to have in its arsenal as it contemplates policies to revive the IPO market and offer streamlined opportunities for businesses and investors to build and maintain wealth.

### **Conclusion**

As always, the ASA is ready and willing to engage with members of the Committee and with SEC staff and commissioners on these important issues.

Sincerely,

*Christopher A. Iacovella*

Christopher A. Iacovella  
Chief Executive Officer  
American Securities Association

