

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2561 Rayburn House Office Building
Washington, DC 20515-6515

July 27, 2023

The Honorable Gary Gensler
Chairman
U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549

Dear Chairman Gensler:

The House Committee on Small Business (the Committee) writes to inquire about two of the Securities and Exchange Commission's (SEC) recently proposed rules, one relating to the definition of exchange (Exchange Rule), and the other concerning private fund advisors (Private Fund Advisor Rule).¹ These rules would heap additional requirements on small investment advisory practices and undermine small business capital access and innovation. It appears that the SEC may not have properly considered small entities during this rulemaking process.

The SEC proposed updating its definition of an "Exchange" and "Alternative Trading Systems" under the Securities and Exchange Act of 1934.² This rule incorporates Communication Protocol Systems, Alternative Trading Systems, and many Decentralized Finance (DeFi) firms into the SEC's regulatory scheme.³ By broadly interpreting the term "exchange," the Commission's rule could impact numerous platforms only tangentially related to finance and financial exchanges, such as messaging platforms and certain types of software.⁴ This change would not only increase costs for Communication Protocol System and the small businesses that rely on them, but also discourage the creation of new Communication Protocol Systems. Additionally, DeFi firms represent an emerging avenue for innovation and capital access for many small businesses.⁵ These changes to the exchange rule place additional burdens on small business that the rule does not adequately consider.

¹ Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 87 Fed. Reg. 16886 (2022) (to be codified at 17 CFR 275); Amendments Regarding the Definition of "Exchange" and Alternative Trading Systems (ATSS) That Trade U.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities, 87 Fed. Reg. 15496 (2022) (to be codified at 17 CFR 232, 240, 242, 249); *See also* Supplemental Information and Reopening of Comment Period for Amendments Regarding the Definition of "Exchange", 88 Fed. Reg. 29448 (to be codified at 17 CFR 232, 240, 242, 249).

² Amendments Regarding the Definition of "Exchange" and Alternative Trading Systems (ATSS) That Trade U.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities, 87 Fed. Reg. 15496 (2022) (to be codified at 17 CFR 232, 240, 242, 249).

³ *Id.*

⁴ *Id.*; *See also* Letter from Patrick McHenry, Chairman, House Comm. on Financial Serv.'s, to Vanessa Countryman, secretary, U.S. Securities & Exchange Cmm'n (Jun. 13, 2023).

⁵ David Gogel, *DeFi: Beyond the Hype*. U. OF PA., WHARTON (May 30, 2021) (in collaboration with the World Economic Forum).

The proposed Private Fund Advisor Rule would add additional disclosure requirements relating to preferential treatment and fund performance, and prohibit certain sales practices, conflicts of interest, and compensation schemes.⁶ These requirements will add compliance costs for investors and limit the creativity and innovation of investment vehicles.⁷ Private equity is a crucial component of capital access for US small businesses—85 percent of private equity investment goes toward small entities.⁸ Additionally, due to the current high interest rate environment, private equity investment has certain advantages for small businesses when compared to traditional loans.⁹ As with most regulation, this rule would have a disproportionate impact on smaller investors, for whom regulatory compliance is more expensive, and adds additional barriers to capital access for other small businesses.¹⁰

It is important for agencies to correctly evaluate small businesses interests—which make up 99.9 percent of all businesses in the United States—when passing any new rule. America’s small businesses deserve to have their voices heard and considered. We therefore request the following information as soon as possible but no later than August 10, 2023:

1. How will the changes to the Private Fund Advisor Rule affect capital availability for small businesses?
2. What impact would these rules have on innovation within the financial industry and small business capital access?
3. Did the SEC use its proposed new definitions of an “exchange” when identifying potentially impacted businesses in its Private Fund Advisor Rule?
 - a. If not, how would the rule changes within Private Fund Advisor Rule be augmented by the impacts of the Exchange Rule?
4. What additional cost would a sole proprietorship incur to employ someone or contract with an entity to comply with the Private Fund Advisor Rule?
 - a. Larger entities often have existing staff and infrastructure to support compliance efforts.¹¹ Are there currently services available to small businesses and sole proprietorships that would assist in complying with these proposed rules?

⁶ Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 87 Fed. Reg. 16886 (2022) (to be codified at 17 CFR 275).

⁷ Ed Dartley, et al., *SEC Proposes Significant New Rules for Private Fund Advisers*, K&L GATES (Apr. 7, 2022)

⁸ *These Are the Builders*, AM. INVESTMENT COUNCIL (Last visited Jul. 20, 2023), <https://www.investmentcouncil.org/builders/>.

⁹ Jared Gross, *Private Equity: Braced for a Turn in Rates*, J.P. MORGAN (last visited Jul. 21, 2023).

¹⁰ *Regulations*, NAT’L FED’N OF INDEP. BUSINESSES (last visited Jul. 21, 2023).

¹¹ *Id.*

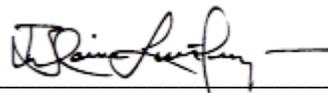
5. Since 2021, the amount of time the SEC has allowed for comments on its proposed rules has decreased substantially.¹² Has the SEC considered how this condensed comment period may prevent or limit the comments it receives from small businesses?
6. Instead of incorporating emerging financial firms into the existing regulatory scheme, did the SEC consider alternative rules that would be more specifically targeted at Communication Protocol Systems and DeFi firms?
7. Under the SEC's proposed exchange rule, when individuals use a website such as Twitter or Discord to communicate and confirm trades, would those websites be operating as an exchange?
 - a. If so, how would this rule impact emerging and new small social media platforms, websites, and software developers?

To schedule the delivery of your response or ask any related follow-up questions, please contact Committee on Small Business Majority Staff at (202) 225-5821. The Committee on Small Business has broad authority to investigate "problems of all types of small business" under House Rule X. Thank you in advance for your cooperation with this inquiry."

In God We Trust,



Roger Williams
Chairman
Committee on Small Business



Blaine Luetkemeyer
Vice Chairman
Committee on Small Business



Jake Ellzey
Member of Congress
Committee on Small Business



Aaron Bean
Member of Congress
Committee on Small Business

cc: The Honorable Nydia M. Velasquez, Ranking Member
Committee on Small Business

¹² Jennifer Schulp & Nicholas Anthony, *The SEC Short-Changes Public Comment*, CATO INST. (Jan. 13, 2022).