COMPETITIVE ENTERPRISE INSTITUTE

WEBmemo

August 16, 2017 **No. 45**

Shrinking Government Bureaucracy

Rethinking the Securities and Exchange Commission

Free Market Reforms to Increase Financial Opportunities for Investors and Entrepreneurs

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The nation's securities laws and the very existence of the Securities and Exchange Commission (SEC) are premised on the situation American investors faced in the 1930s. Those conditions do not hold today.

When President Franklin D. Roosevelt signed the Securities Act of 1933 and the Securities Exchange Act of 1934, many Americans did not have electricity or a telephone.[1] Investors were limited to mail or physical travel to study the particulars of a given firm. Now, many Americans pay their electricity bills on their phones—from which they also can access information from all over the world on industries and firms.

Originally, under the 1933 Securities Act, securities transactions were regulated by the Federal Trade Commission (FTC) and applicable state agencies, the same as other business transactions. However, the 1934 Securities and Exchange Act created the SEC, which meant investors and entrepreneurs had to comply with a host of prescriptive mandates before offering shares of their businesses—which federal regulators considers "securities"—to investors.[2] Over the decades, laws such as Sarbanes-Oxley and Dodd-Frank have further piled on to these mandates. It is long past time to peel away the regulatory onion.

Therefore, Congress and the Trump administration should abolish the Securities and Exchange Commission. In the process, they should transfer its duties to police and punish fraud to the Federal Trade Commission. At the same time, they should make participation in the stock exchanges and their rulemaking body, the Financial Industry Regulatory Authority, voluntary for entrepreneurs and investors.

Abolishing the SEC and transferring federal jurisdiction over securities to the FTC would mean that stock exchanges—including the New York Stock Exchange (NYSE) and NASDAQ—would no longer have quasi-governmental powers as "self-regulatory organizations" through their jointly controlled Financial Industry Regulatory Authority, which answers to the SEC.

Instead, they would go back to being purely optional for listing securities, as they were for nearly 150 years before the creation of the SEC. Entrepreneurs selling pieces of their businesses could choose any venue they thought would be best to do this—whether NYSE or eBay. In this free securities market, entrepreneurs and investors would gravitate to venues

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with rules that best suited them for the execution of securities transactions, just as they do today for every other kind of transaction.

Since the advent of Sarbanes-Oxley and Dodd-Frank, policy makers of both parties have come to recognize the burden these hastily passed laws have imposed on investment and capital formation and looked for ways to reduce it.

When President Obama signed the Jumpstart Our Business Startups (JOBS) Act in 2012, which offered modest deregulation of investment-based crowdfunding, he remarked that "laws that are nearly eight decades old make it impossible for [ordinary Americans] to invest" in small startups, and "a lot has changed in 80 years." He was right. A lot has changed since the first federal laws were enacted to regulate the securities markets, and the government needs to follow suit.

Every day on the Internet, not just products, but businesses, are bought and sold. Yet, amazingly, investors and entrepreneurs can face volumes more paperwork for a $500 transaction that falls within the SEC's jurisdiction than for a $500,000 transaction that falls on other agencies' turf.

For example, in 2012, a gas station and convenience store in North Carolina exchanged hands on eBay for about $1.2 million.[3] Yet as large as it was, this transaction was governed by a fraction of the rules for a $120 investment in a publicly traded company regulated by the SEC.

This illustrates how our securities laws are impeding capital formation. Buying an entire business requires much more due diligence than investing in a portion of a business, yet investors in the latter face far more paperwork and regulations.

Had the gas station owner sought investors and offered to sell 50 percent of the business for half a million dollars in shares, she would not have been able to make the transaction on eBay. Instead, she would be required to go through a licensed broker-dealer, because selling a piece of a business is considered a "securities transaction" and is therefore subject to the plethora of securities laws enforced by the SEC.

In the 21st century, offering a part of a business should face no more or no less rules than selling an entire business. If the gas station owner who lists on eBay engaged in deceptive or fraudulent behavior, the FTC and state agencies could address the situation as needed.

Notes

[1] Michael E. Parish, *Anxious Decades: America in Prosperity and Depression, 1920-1941* (London: W.W. Norton, 1992). Jodie T. Allen, "How a Different America Responded to the Great Depression," Pew Research Center, December 14, 2010, http://www.pewresearch.org/2010/12/14/how-a-different-america-responded-to-the-great-depression/.

[2] Deepa Sharkar, "Securities Exchange Act of 1934, Wex Legal Dictionary, accessed July 18, 2017, https://www.law.cornell.edu/wex/securities_exchange_act_of_1934.

[3] Timothy P. Carney, "Entrepreneurs win half a loaf with the JOBS Act," *Washington Examiner*, April 1, 2012, http://www.washingtonexaminer.com/entrepreneurs-win-half-a-loaf-with-the-jobs-act/article/1208256.