The Office of Congressman
Byron Donalds

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For Immediate Release
March 12, 2025

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Donalds Calls For The Elimination Of Biden-Era Political Weaponization From The Securities And Exchange Commission

WASHINGTON – This afternoon, Congressman Byron Donalds (R-FL) raised concerns to the U.S. Securities and Exchange Commission (SEC) regarding "regulation by enforcement" actions—which utilize novel legal theories to penalize market participants.

"Regulation by enforcement" actions harm individuals, businesses, markets, the investing public, and the SEC itself. They also deny market participants fair notice, create uncertain and inconsistent standards of conduct, increase the cost of capital, create an unwillingness to invest capital at all, and weaken public trust of the Commission and its enforcement actions.

Under the Biden administration, SEC Chairman Gary Gensler led the Commission to unprecedented levels of political weaponization and corruption. Under the Trump administration, Acting SEC Chairman Mark Uyeda is taking corrective action to reform the Commission back to its core mission. The next step that Acting Chairman Uyeda can take to reform the Commission is to dismiss "regulation by enforcement" actions.

Read the full text of the letter *HERE* or below:

The Honorable Mark Uyeda
Acting Secretary
U.S. Securities and Exchange Commission
100 F Street NE,
Washington, DC 20549

The Honorable Hester Peirce
Commissioner
U.S. Securities and Exchange Commission
100 F Street NE,
Washington, DC 20549

Dear Acting Chairman Uyeda and Commissioner Peirce,

I write to you today to thank you for your leadership and request that you continue the Commission's recent commitment to dismissing questionable regulation by enforcement actions – those enforcement actions involving conduct that market participants did not previously understand to be a violation of the federal securities laws despite reasonable reliance and interpretation of existing laws, regulations, policies, and guidance.

The regulation by enforcement approach harms individuals and businesses, the markets, the investing public, and the Commission itself. Regulation by enforcement denies market participants with fair notice, creates uncertain and inconsistent standards of conduct, increases the cost of capital, in some cases creating an unwillingness to invest capital at all, and weakens public trust of the Commission and the credibility of SEC enforcement actions. The SEC's recent decision to dismiss cases against the cryptocurrency industry serves as a commendable recognition of the need to foster innovation and protect investors from arbitrary and enforcement-based regulation. I believe a similar approach is needed to rectify the Commission's string of enforcement actions against investors in small-cap and micro-cap public companies.

As you noted in August of last year, since 2017, the Commission has brought a series of enforcement actions against these investors on a novel interpretation that their investing activities meant that these investors were "dealers" and, as such, needed to register as such under the Securities Exchange Act of 1934. I agree that the facts of that case, and the facts of all cases in which this interpretation has been pursued, demonstrate why regulation by enforcement is extremely problematic.

The Commission's interpretation of "dealer" in these regulation by enforcement actions is inconsistent with the term's historical meaning and with the Commission's own guidance over the years. For more than a century, the terms "broker" and "dealer" have referred to the method in which a public securities business effectuates customer securities transactions. A "broker" acts as an agent, and trades "for the account of" the customer, whereas a "dealer" acts as a principal, and effectuates the customer's trade by taking the opposite side in the dealer's "own account." This is how everyone, including the Commission, understood the text of the Exchange Act at the time it was enacted.

Writing off decades of its own interpretations as neither "dispositive" nor "binding," the Commission's enforcement position is that any company whose business model is based on the purchase and sale of securities is a dealer, regardless of whether the company renders any of the services that have been the hallmark of a dealer, such as effectuating customer orders.

As you correctly noted, the form of investment that is the subject of these cases – the "market-adjustable convertible security" or "variable rate" security, typically either a convertible promissory note or convertible preferred stock, has been a customary investment security for companies – both public and private – since the 1990s. This form of investment is but one variant of a standard private placement that has been commonly available since long before that time. Indeed, since at least the 1990s, the Commission has routinely reviewed and declared effective registration statements covering the resale of shares underlying such market-adjustable convertible securities.

The Commission has also provided written interpretations regarding certain forms of these investments – private investments in public equities ("PIPEs") and equity lines of credit ("ELOCs"). These investments are so customary and prolific that, as you also correctly note, no investor in these securities would ever have had any reason to believe that their activity could trigger dealer registration obligations. It is no exaggeration to say that the community of investors in variable rate securities have been shocked to learn that, after decades of observing and sanctioning capital formation using this investment method, the government now believes that these investors have been acting unlawfully.

This new and overly broad interpretation of dealers has no bounds and provides no guidance or discernable standard of acceptable conduct. All types of professional investment firms in the country, including hedge funds, investment companies, investment advisers, family offices, venture capital funds, and private equity funds, are dealers under this interpretation, as they are all engaged in the business of buying and selling securities for their own account. It would be a massive understatement to say that this interpretation has enormous implications, and will have a broad chilling effect, on the financial industry and capital formation writ large.

The dealer cases have already caused serious harm to the small public company markets. Many firms are no longer willing to provide capital to small public companies because of the risk of enforcement prosecution and a lack of any guidance as to what types of investments or what types of companies are allowable without registering as a dealer. Other firms have unsuccessfully attempted to register as dealers, with their applications being deferred or denied by the sole available self-regulatory organization, FINRA. The harm from this regulation by enforcement is tangible. Since 2017, the number of reported annual financings on OTC Markets has decreased by over 50%, and the aggregate amount financed annually has decreased by over 25%.

Ending these cases would benefit the micro and small-cap markets, which have historically struggled with unnecessary regulatory burdens that stifle investor participation. Small-cap and micro-cap investors play an integral role in providing critical capital to small public companies, often fueling innovation and economic growth within the small and micro-cap markets, on both the national securities exchanges and on the OTC markets. These markets are vital for capital formation, particularly for companies that do not yet meet the criteria for traditional exchange listings or are too small to attract institutional capital.

By dismissing these dealer cases, the SEC would be sending a strong message to investors and entrepreneurs that the agency is committed to facilitating the growth and development of small companies while still maintaining its core responsibility to protect investors and ensure transparency and fairness in the markets. It would also serve to restore confidence in the OTC and small public markets, encouraging the influx of new capital that these markets desperately need.

I understand that the SEC must uphold its duty to protect investors and prevent fraud, however, focusing resources on ensuring fair practices rather than pursuing litigation based on novel theories will ultimately serve the best interests of both investors and small public companies. If you have any questions, please feel free to reach out to Ryan Donnelly, Ryan.Donnelly@mail.house.gov or my office at 202-225-2536.

Byron Donalds (R-FL) Member of Congress

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