



## Statement of the U.S. Chamber of Commerce

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**ON: Legislative Proposals on Capital Formation and  
Corporate Governance**

**TO: United States Senate Committee on Banking,  
Housing, and Urban Affairs**

**BY: Thomas Quaadman, Executive Vice President, Center  
for Capital Markets Competitiveness, U.S. Chamber of  
Commerce**

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1615 H Street NW | Washington, DC | 20062

The Chamber's mission is to advance human progress through an economic,  
political and social system based on individual freedom,  
incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations. The Chamber is dedicated to promoting, protecting, and defending America's free enterprise system.

More than 96% of Chamber member companies have fewer than 100 employees, and many of the nation's largest companies are also active members. We are therefore cognizant not only of the challenges facing smaller businesses, but also those facing the business community at large.

Besides representing a cross-section of the American business community with respect to the number of employees, major classifications of American business—e.g., manufacturing, retailing, services, construction, wholesalers, and finance—are represented. The Chamber has membership in all 50 states.

The Chamber's international reach is substantial as well. We believe that global interdependence provides opportunities, not threats. In addition to the American Chambers of Commerce abroad, an increasing number of our members engage in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Chairman Crapo, Ranking Member Brown, and members of the Committee on Banking, Housing, and Urban Affairs: my name is Tom Quaadman, executive vice president of the Center for Capital Markets Competitiveness (“CCMC”) at the U.S. Chamber of Commerce (“Chamber”). Thank you for the opportunity to testify today about ways to strengthen the national asset that is America’s capital markets, improve the corporate governance of public companies, and help growing businesses access the capital they need to innovate, grow, and create jobs throughout the country.

Over the past two years, Congress and the Administration have made tremendous strides in pursuing a pro-growth agenda that has resulted in historically low unemployment and the highest growth rates since the financial crisis of 2008. The 2017 Tax Cuts and Jobs Act has made the U.S. tax system more competitive on a global basis, while businesses large and small are capitalizing on the reform by reinvesting back into their companies, rewarding their existing employees, and hiring more workers. A bipartisan coalition of this Committee also helped shepherd the Economic Growth, Regulatory Relief, and Consumer Protection Act into law last Congress. This legislation has already reduced some of the misguided regulatory mandates that fell upon small and mid-size institutions in the wake of the financial crisis, and the Chamber expects to see continued positive outcomes from the legislation in the years to come.

The Administration, as well as the independent regulatory bodies that oversee the financial system, have also embarked on several initiatives to “right-size” regulation for the economy. The last Congress made important use of the Congressional Review Act to relieve the economy of harmful mandates, and regulatory agencies today are putting a greater focus on economic analysis and conducting rulemaking in a more deliberative process than has been done in the past.

It is little wonder that the economy has responded positively to these actions by Congress and the Administration. The Chamber expects to see continued positive developments through 2019, in no small measure due to the renewed emphasis on growth that we have seen recently out of Washington.

Left largely unaddressed, however, are much-needed reforms to the regulatory framework for our capital markets, which provide the bulk of financing for American businesses. In fact, over the last twenty years our capital markets have vastly outstripped bank financing as the primary means of capital for companies, and now provide somewhere around two-thirds of the financing for American business. These sources of capital stretch across both debt and equity markets, as well as public and private channels. While the technological change underlying this transformation

continues to evolve at a rapid pace, the regulatory framework for our capital markets remains very much stuck in a 1930's-like mindset.

To its credit, Congress has recognized this problem and taken action to promote entrepreneurship in recent years. The 2012 Jumpstart our Business Startups (JOBS) Act included the most significant reforms to our securities laws in years, and directly contributed to an uptick in the initial public offering (IPO) market in the years following its passage. In creating the regulatory framework for equity crowdfunding, modernizing Securities and Exchange Commission (SEC) Regulation A, and allowing for general solicitation for certain private offerings, the JOBS Act also helped provide a regulatory path forward for capital raising methods that have become increasingly popular. And in 2015, Congress included measures to modernize corporate disclosure, simplify registration requirements, and improve the trading of private market securities as part of the Fixing America's Surface Transportation (FAST) Act.

Congress passed the JOBS Act and subsequent legislation in large part because the SEC had abdicated its statutory responsibility to facilitate capital formation. It is also worth keeping in mind that the most successful part of the JOBS Act – Title I, which created the IPO “on-ramp” – was a self-effectuating provision that did not need to be implemented via SEC rulemaking. This stands in contrast to other parts of the JOBS Act which have yet to reach their full potential because the SEC has not carried out the clear intent of Congress. As this Committee considers entrepreneurship legislation, we believe it is important to either include self-effectuating language, or to give clear, unambiguous directives to the SEC for implementation. Leaving too much discretion up to regulators can lead to unnecessary uncertainty for market participants, and water down the impact of pro-growth legislation.

Last year, the House of Representatives took a major step towards bringing our capital markets into the 21<sup>st</sup> Century by passing the JOBS and Investor Confidence Act of 2018. This legislation – negotiated by then-Rep. Jeb Hensarling and Rep. Maxine Waters – is a compilation of several individual bills, many of which have passed the House of Representatives by wide bipartisan margins. Several of its provisions also have had bipartisan Senate counterparts. While I will discuss the Chamber's position on some of the individual components of this bill below, we strongly supported passage of the JOBS and Investor Confidence Act, and we remain optimistic that the 116<sup>th</sup> Congress can work across the aisle to move similar legislation forward.

SEC Chairman Jay Clayton and SEC leadership also deserve a tremendous amount of credit for re-focusing the agency on its core competencies. Over the last

two years, the SEC has, amongst other things, taken steps to modernize corporate disclosure and make it easier for companies to complete an IPO. Chairman Clayton has also positioned the SEC to act in the coming months on important issues related to standards of conduct for financial advisors as well as reforms to our outdated proxy system.

Historically, capital markets issues and reforms to make our markets more competitive have been done on a bipartisan basis. The 2012 JOBS Act was case in point that a divided Congress does not have to become a legislative graveyard for capital markets reforms. We are hopeful that the 116<sup>th</sup> Congress will continue to build upon the successes of the last two years and enact into law meaningful, bipartisan legislation that will strengthen our economy, grow jobs, and create more opportunities for millions of Americans.

The Chamber's thoughts on these issues and relevant legislation are discussed in greater detail below.

### **The Decline in Public Companies and Its Consequences**

One of the more pressing problems that has afflicted our capital markets has been the drastic decline in public companies over the last two decades. The United States is now home to roughly half the number of public companies than existed twenty years ago, and while the IPO market has recently shown signs of life, the Chamber remains concerned that the long term trajectory of this issue is not on a good path. The JOBS Act certainly helped make the public markets marginally more attractive to a number of companies, but Congress and the SEC must do more to revive the public company model.

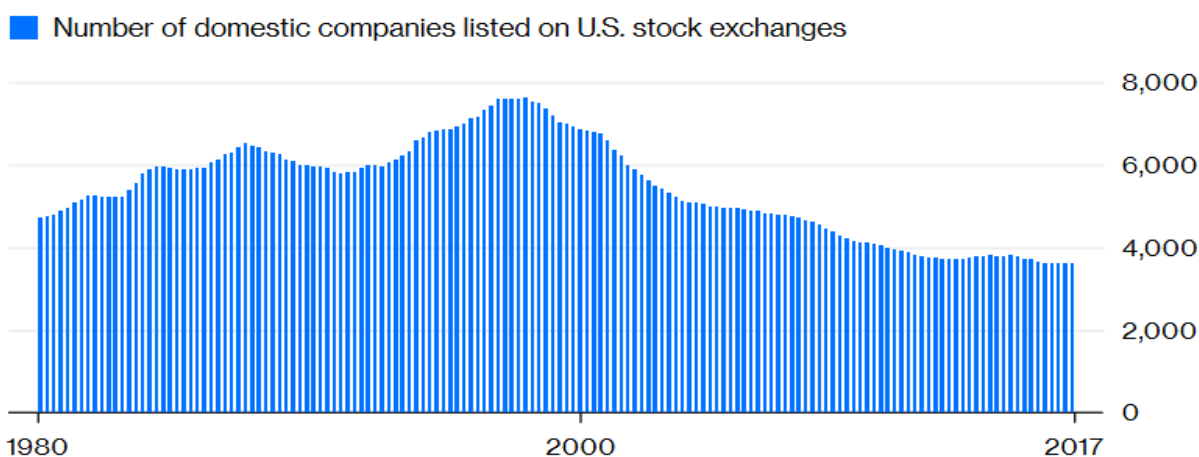
The decline in public companies matters because of the evidence which shows that both job creation and revenue accelerate after a company completes an IPO. A 2012 Kauffman Foundation report found that the 2,766 companies that went public from 1996-2010 cumulatively increased employment by over 2.2 million workers, and that revenue increased by over \$1 trillion during that period.<sup>1</sup> And a report by the IPO Task Force – a group whose recommendations contributed greatly to passage of the JOBS Act – found that the post-IPO job growth for companies is 92%.<sup>2</sup> Whatever the exact impact on hiring and growth may be, there is little doubt that an

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<sup>1</sup> Post-IPO Employment and Revenue Growth for U.S. IPOs June 1996-2010, available at: [https://www.kauffman.org/-/media/kauffman\\_org/research-reports-and-covers/2012/05/post\\_ipo\\_report.pdf](https://www.kauffman.org/-/media/kauffman_org/research-reports-and-covers/2012/05/post_ipo_report.pdf)

<sup>2</sup> Rebuilding the IPO On-Ramp: Putting Companies and the Job Market Back on the Road to Growth, available at: [https://www.sec.gov/info/smallbus/acsec/rebuilding\\_the\\_ipo\\_on-ramp.pdf](https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf)

IPO greatly increases a company’s ability to expand its workforce and grow from small to large.



Sources: Jay R. Ritter, Warrington College of Business Administration, University of Florida; University of Chicago Center for Research in Security Prices

Not only does “going public” benefit the economy from a jobs and growth standpoint, but it also affords Main Street investors and employees of companies that IPO greater opportunities to invest in America’s next great companies. During the 1980s and 1990s, stories of the Microsoft executive assistant or the UPS driver becoming a millionaire were not uncommon after a company went through the IPO process. And millions of retail investors and retirees can benefit directly by owning stock in individual companies, or more indirectly when stock is owned by their pension or 401(k) plan.

By contrast, when more companies choose to stay private, the investment returns generated are largely reserved for wealthier “accredited investors” and certain institutional investors. Main Street investors are typically left out. So the decline in public companies – and the dearth of investment options it leaves to most households – can actually exacerbate wealth disparities in the United States. It should also be noted that investors in general benefit from the transparency and disclosure requirements that are hallmarks of our public company regulatory regime.

To be clear, we do not seek to minimize the strength of our private markets and do not believe that financing for businesses is a “zero sum game.” Our economy clearly benefits when both public and private markets are strong. However, we believe that the roadblocks which have been placed in front of the public company model are largely self-inflicted, and it is completely within the control of Congress and the SEC to address them.

For the first time, the United States is also now facing real competition for venture capital investments from around the world. In 2018, the amount of venture capital invested in China was nearly equal to that of the U.S.<sup>3</sup>, and the highest growth rates for venture investments is largely occurring in cities outside the United States.<sup>4</sup> Venture capital has played a critical role in helping companies grow from small to large, and many companies have been able to go public over the last several decades because of venture backing they received early in their lifecycle. The competitive edge that the United States has had in both venture capital and in our public markets cannot be taken for granted; it is time for policymakers to address this fundamental problem and get capital flowing back into American businesses.

The legislative mandates of the 2002 Sarbanes-Oxley Act and the 2010 Dodd-Frank Act have also contributed to the “federalization” of corporate governance and a one-size-fits-all regulatory approach that harms capital formation. Businesses are also increasingly having to grapple with the social and political agendas of well-funded special interests. These activists are becoming increasingly aggressive in their calls for businesses to solve issues that are better left debated in the halls of Congress. Furthermore, the SEC has historically failed to provide oversight over proxy advisory firms, modernize corporate disclosures, update information delivery methods, or reform proxy plumbing systems.

Legislation such as the JOBS Act made progress in scaling disclosure requirements for smaller issuers, however annual and quarterly reports of public companies have still grown massively in size and complexities over the years. Material information for investors is a vital component of our capital markets, but it’s clear that more progress can be made to reduce obsolete or duplicative disclosures so that investors can better determine the most salient information about a company.

While the SEC has recently sought to improve the shareholder proposal process under Exchange Act Rule 14a-8, in the past it has receded from its duty as a gatekeeper of shareholder proposals under Exchange Act Rule 14a-8 which has allowed special interest agendas to work their way into board rooms and shareholder meetings. At the same time, businesses are facing increasing pressure to engage with shareholders on environmental, social, and governance (ESG) issues – many of which investors have deemed immaterial.

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<sup>3</sup> China Rises to 38% of Global Venture Spending in 2018, Nears US (Forbes) January 14, 2019, available at <https://www.forbes.com/sites/rebeccafannin/2019/01/14/china-rises-to-38-of-global-venture-spending-in-2018-nears-us-levels/#7c0171105a5c>

<sup>4</sup> See e.g. Rise of the Global Startup City (Center for American Entrepreneurship) October 2018, available at: <http://startupsusa.org/global-startup-cities/report.pdf>

To make matters worse, businesses now look out on the horizon and see proposals such as the Accountable Capitalism Act (S. 3348 from the 115<sup>th</sup> Congress), which would impose a bureaucratic merit review system that allows Washington to determine whether or not a company is worthy of doing business in the United States. The legislation would fundamentally alter the relationship between government and business in this country and, contrary to what its proponents say, the Accountable Capitalism Act would only serve to concentrate wealth and power within a few favored industries instead of providing economic opportunity to millions of Americans. Businesses are already accountable to their shareholders, employees, customers, politicians, the communities they serve and operate in, and the laws and regulations that apply to them. The great irony of the Accountable Capitalism Act is that it grants unlimited power to a vast, entrenched bureaucracy that has little incentive to promote innovation, and which is accountable to nobody. Legislation such as this does not serve the interests of our free market economy, which has done more to help individuals climb the economic ladder than any other system in the history of the world.

In recent years, the Chamber has issued a number of reports and recommendations calling upon the SEC and Congress to do more to improve the public company model. These reports include:

- 2013: *Best Practices and Core Principles for the Development, Dispensation, and Receipt of Proxy Advice*, a report that helped kick-start an important debate over the broken proxy advisory system in the United States;
- 2014: *Corporate Disclosure Effectiveness: Ensuring a Balanced System that Informs and Protects Investors and Facilitates Capital Formation*, a report that included two dozen specific recommendations to modernize the SEC's disclosure regime;
- 2017: *Essential Information: Modernizing Our Corporate Disclosure System*, which emphasized the importance of the longstanding "materiality" standard for corporate disclosure;
- 2017: *Shareholder Proposal Reform: The need to Protect Investors and Promote the Long-Term Value of Public Companies*, which outlined seven recommendations on how to fix the outdated shareholder proposal system under Rule 14a-8 of the Securities Exchange Act;
- 2018: *Expanding the On-Ramp: Recommendations to Help More Companies Go and Stay Public*, a joint organization report which included 22 recommendations that would expand upon the success of the JOBS act.



The JOBS and Investor Confidence Act incorporated many of the Chamber’s past recommendations, and we are eager to work this Committee and members of Congress to enact pro-growth policies.

### **Proxy Advisory Firms: A Broken Industry in Need of Reform**

The Chamber continues to believe that the most impactful action policymakers can take to improve the public company model is to reform the broken proxy advisory system in the United States. The proxy advisory industry is an oligopoly dominated by two firms – Institutional Shareholder Services (ISS) and Glass Lewis – that control roughly 97% of the market share. Notwithstanding their influence and their status as *de facto* standard setters for corporate governance, ISS and Glass Lewis are both riddled with conflicts of interest, provide little transparency into their research or how they arrive at vote recommendations, and are prone to making lapses in judgement or, in many cases, outright errors when developing vote recommendations.<sup>5</sup>

These firms by some estimates can “control” up to 38% of the shareholder vote because some of their clients automatically follow vote recommendations.<sup>6</sup> According to ISS, the firm covers more than 20,000 companies around the globe, and executes 9.6 million ballots, representing over 3.7 trillion shares. Such an unfettered role in the public capital markets demands an oversight function to ensure that investor returns are always a top priority.

In addition, the economic interests of proxy advisory firms are not always aligned to ensure the firms are best equipped to research and understand the conditions of the companies they are rating. These factors combine to create an incentive system that does not prioritize accurate recommendations or to provide accountability throughout the rating process. Ultimately, investors can be harmed when the shoddy work of proxy advisory firms influences investment and voting decisions in the marketplace.

Fortunately, policymakers are increasingly aware of the magnitude of this issue and its implications for our capital markets. In recent years, both the SEC and Congress have taken steps to reform the industry:

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<sup>5</sup>See e.g. Are Proxy Advisors Really a Problem? Recent Data Analysis and Survey Results Demonstrate the Validity of Common Concerns. Frank M. Placenti, Commissioned by American Council for Capital Formation (October 2018). Table of issuer supplemental proxy filings detailing issues with proxy advisory firms found here: [http://accfcorgov.org/wp-content/uploads/2018/10/Analysis-of-Proxy-Advisor-Factual-and-Analytical-Errors\\_October-2018.pdf](http://accfcorgov.org/wp-content/uploads/2018/10/Analysis-of-Proxy-Advisor-Factual-and-Analytical-Errors_October-2018.pdf)

<sup>6</sup>ISS 24.7% Glass Lewis 12.9% Source: Ertimur, Yonca, Ferri, Fabrizio, and Oesch, David *Shareholder Votes and Proxy Advisors: Estimates from Say on Pay* (February 25, 2013).

- In 2014, SEC staff issued Staff Legal Bulletin 20 (SLB 20)<sup>7</sup>, which provided guidance to public companies, proxy advisory firms, and investment advisers regarding their duties related to developing or receiving proxy advice. This guidance clarified the scope of a portfolio manager's obligations when exercising a vote on proxy issues and reiterated that fiduciary duties permeate and govern all aspects of proxy advice.
- In 2017, the House of Representatives passed H.R. 4015, the Corporate Governance Reform and Transparency Act, bipartisan legislation that would require proxy advisory firms to register with the SEC and become subject to an oversight regime intended to produce greater accountability and transparency within the industry.
- In 2018, SEC staff withdrew two no-action letters<sup>8</sup> issued in 2004 to ISS and Egan-Jones. The Chamber had long called for the withdrawal of these letters, which had led to an overreliance on proxy advisory firm recommendations and helped entrench the position and influence of the two largest firms.
- In November 2018, a bipartisan group of Senators on this Committee – led by Sen. Reed - introduced S. 3614, the Corporate Governance Fairness Act. This legislation would require proxy advisory firms to register under the Investment Advisers Act of 1940, and grants the SEC authority to conduct inspections of proxy advisory firms.
- Also in November 2018, the SEC held a roundtable on the entire proxy process, which included a significant discussion regarding the role of proxy advisory firms and potential changes to the system.

The Chamber and Nasdaq also last year released our [fourth annual proxy season](#) survey to help better understand the public company experience with proxy advisory firms. This survey was completed by 165 companies of varying sizes and across several industries. The major findings were that a lack of communication and a

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<sup>7</sup> Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms, available at <https://www.sec.gov/interps/legal/cfslb20.htm>

<sup>8</sup> Statement Regarding Staff Proxy Advisory Letters (September 13, 2018), available at <https://www.sec.gov/divisions/investment/imannouncements/im-info-2018-02.pdf>

general concern over the quality of voting recommendations remain the top concerns of public companies.

For example, when companies requested the opportunity to meet with a proxy advisory firm in order to discuss issues subject to shareholder votes, that request was denied 57% of the time. Companies also reported being given insufficient time to provide input both before and after a firm's recommendations were finalized, a problem compounded by "robo-voting" practices that lead to the automatic casing of large blocks of proxy votes in the immediate aftermath of the proxy advisory firms' recommendations. Some companies reported that 10-15% of their shares would automatically vote in line with an ISS recommendation, while others estimated that between 25-30% fell into that category.

The amount of time granted to provide input ranged from 30 minutes to two weeks, with 1-2 days being the most common response. And only 39% of companies believe that proxy advisory firms carefully researched and took into account all relevant aspects of a particular issue for which it was providing a vote recommendation. Much like our past proxy season surveys, this year's report demonstrates that proxy advisory firms are not prepared to implement changes on their own, highlighting the need for action by policymakers.

Last month, Chairman Clayton announced that he has directed SEC staff to develop recommendations related to the proxy advisory system for the full Commission to consider, citing a "growing agreement that some changes are warranted."<sup>9</sup> Chairman Clayton also emphasized the importance of proxy voting advice and research being "company or industry-specific" and not one-size-fits-all. We believe that the bipartisan consensus and growing momentum for reforms to this industry presents a unique opportunity to address some longstanding concerns, and the Chamber stands ready to assist both Congress and the SEC as the reform agenda moves forward.

### **Legislation**

The Committee has asked the Chamber for its views on a host of bills, which are discussed in detail below.

#### **Corporate Governance Fairness Act (S. 3614 from 115<sup>th</sup> Congress)**

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<sup>9</sup> SEC Chairman Jay Clayton: SEC Rulemaking Over the Past Year, the Road Ahead and Challenges Posed by Brexit, LIBOR Transition and Cybersecurity Risks (December 6, 2018), available at <https://www.sec.gov/news/speech/speech-clayton-120618>

The Corporate Governance Fairness Act, introduced in November 2018 by Sens. Reed, Perdue, Heitkamp, Tillis, Jones, and Kennedy, would require proxy advisory firms to register with the SEC under the Investment Advisers Act of 1940, subject to *de minimis* exceptions for a company which may provide proxy advice as an ancillary service. The bill requires the SEC to conduct periodic inspections of proxy advisory firms to determine whether a firm has knowingly made any false statements or omitted material facts in reports to its clients, and to examine the policies and procedures firms have in place to manage conflicts of interest. The legislation also requires the SEC to periodically report to Congress its findings from examining proxy advisory firms and to recommend whether any additional regulations are necessary to better serve investors.

The Chamber commends this bipartisan group of Senators for introducing the Corporate Governance Fairness Act, which would improve upon the status quo and provide some uniformity to the regulation of proxy advisory firms. However, we believe that some improvements to the legislation are necessary for it to effectuate meaningful change within the industry. As currently drafted, it could allow the SEC in the future to take a “check the box” approach to proxy advisory firm examinations, while still leaving future regulatory decisions in the hands of Congress.

By contrast, H.R. 4015 – which passed the full House of Representatives in December 2017 and which the Chamber strongly supports – included meaningful, baseline standards for proxy advisory firms to follow. The legislation incorporated several provisions of SLB 20, and so in many ways simply codifies into law things that the SEC has already said proxy advisory firms should be doing. H.R. 4015 would require proxy advisory firms to disclose to both the SEC and their clients any potential or actual conflict of interest the firm has, and how it plans to address or mitigate those conflicts. The legislation also would require proxy advisory firms to demonstrate that they have the requisite expertise and capabilities to provide accurate and objective voting recommendations, and grants issuers a sufficient amount of time to provide feedback on recommendations. H.R. 4015 would also end some of the worst practices that the current system allows for, such as conditioning vote recommendations on an issuer purchasing consulting or other services from a proxy advisory firm.

If Congress does ultimately choose a regulatory path that includes registration under the Investment Advisers Act (as envisioned under the Corporate Governance Fairness Act), it should at a minimum seek to incorporate some of the baseline, carefully developed standards that were included as part of H.R. 4015. For example, proxy advisory firms should be required to eliminate (where possible) conflicts of

interest, and provide transparency as to how they are mitigating other conflicts. They should also be required to provide greater transparency into how their voting policies and recommendations are developed, and provide issuers the opportunity to engage with them on errors or serious disputes with voting recommendations. We look forward to working with the sponsors of the “Corporate Governance Fairness Act” to strengthen the bill in these areas in order to bring needed reform to the proxy advisory firm industry.

Both Congress and the SEC have now been examining this issue for some time – we believe the evidence of deficiencies within the proxy advisory system is already strong enough to justify bold action.

### **Cybersecurity Disclosure Act (S. 536 from 115<sup>th</sup> Congress)**

There is no question that cybersecurity has become a critical issue for both businesses and government. Cybercriminals in the U.S. and overseas continue to target both government and private institutions, and are increasingly aggressive in their tactics. While we are generally supportive of efforts to combat such efforts, we have concerns with the Cybersecurity Disclosure Act.

Regulators have worked aggressively to deal with cyber threats. The SEC has become very proactive in its regulatory efforts, and we generally support these activities intended to keep our capital markets safe. The SEC’s Division of Enforcement has formed a dedicated Cyber Unit, and has been actively pursuing cases involving cybersecurity and data security. Even before the formation of the Cyber Unit, the SEC began to bring a series of cases against broker-dealers, investment advisers, and other market intermediaries for violations of SEC rules regarding safeguarding of customer data involving hacks and other cybersecurity shortcomings.<sup>10</sup> To its credit, FINRA (the Financial Industry Regulatory Authority), which also regulates the conduct of securities broker-dealers, has likewise been highly engaged on the issue.<sup>11</sup>

The SEC also in 2018 recently issued Commission-level guidance (the “Guidance”) that clearly lays out the disclosure expectations for public companies on

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<sup>10</sup> A lengthy list of SEC cybersecurity enforcement cases appears at <https://www.sec.gov/spotlight/cybersecurity-enforcement-actions>.

<sup>11</sup> See Finra’s web page describing these efforts at <http://www.finra.org/industry/cybersecurity>

this important topic.<sup>12</sup> Central to the Guidance is the concept that material cybersecurity risks must be disclosed to investors. The Guidance also encourages public companies to adopt comprehensive policies and procedures related to cybersecurity and to assess their compliance regularly, including the sufficiency of their disclosure controls and procedures as they relate to cybersecurity disclosure.

To that end, the SEC urges companies to assess whether they have sufficient disclosure controls and procedures in place to ensure that relevant information about cybersecurity risks and incidents is processed and reported to the appropriate personnel, including up the corporate ladder, to enable senior management to make disclosure decisions and certifications. Additionally, the Guidance recommends that public companies adopt policies and procedures designed to prohibit directors, officers, and other corporate insiders from trading on the basis of material nonpublic information about cybersecurity risks and incidents.

Of particular relevance to today's hearing, existing SEC regulations already require a public company to disclose the extent of its board's role in the risk oversight of the company.<sup>13</sup> To the extent cybersecurity risks are material to a company's business, the Guidance makes clear that this disclosure should include the nature of the board's role in overseeing the management of that risk. Additionally, the Guidance reiterates the SEC's view that disclosures regarding a company's cybersecurity risk management program and how the board of directors engages with management on cybersecurity issues will allow investors to assess how a board of directors is discharging its risk oversight responsibility.

Investors have also begun to express concerns to public company boards and management over cybersecurity risks and disclosures. According to PricewaterhouseCooper's most recent Global Investor Survey<sup>14</sup>, cyber threats were the most common concern of investors when asked to rank potential business, economic, policy, social, and environmental threats to a company's growth prospects. Not surprisingly, cybersecurity preparedness has become a common topic of discussion among public companies and their investors during shareholder engagement sessions.

We are also concerned that the "comply or explain" model envisioned under the bill conflates the responsibilities of a board of directors with that of management.

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<sup>12</sup> The complete text of the Commission Statement and Guidance on Public Company Cybersecurity Disclosures is available at <https://www.federalregister.gov/documents/2018/02/26/201803858/commission-statement-and-guidance-on-public-company-cybersecurity-disclosures>.

<sup>13</sup> For example, see Item 407(h) of Regulation S-K and Item 7 of Schedule 14A.

<sup>14</sup> <https://www.pwc.com/gx/en/ceo-survey/2018/deep-dives/pwc-global-investor-survey-2018.pdf>

We believe that the best practices this legislation is intended to foster are duties that are largely the responsibility of management, with the board playing its role overseeing how management is carrying out those duties.

We believe existing SEC regulations and market practices already provide the kinds of disclosure that the Cybersecurity Disclosure Act seeks to address. Nevertheless, we understand the importance of this issue and are ready to work with Sen. Reed and all members of the Committee to reach a workable solution.

### **The Brokaw Act (S. 1744 from the 115<sup>th</sup> Congress)**

The Brokaw Act would direct the SEC to amend the Section 13(d) reporting rules in a number of notable ways. First, the Brokaw Act would reduce the 10-day filing deadline for an initial Schedule 13D filing to four business days. Second, it would require the disclosure of short positions over 5 percent on Schedule 13D. Third, it would expand the definition of beneficial ownership to include a direct or indirect pecuniary interest, in addition to voting or dispositive power. As a practical matter, in making this determination, investors would therefore have to include shares held in swaps and other cash-settled derivatives, not merely equity securities or securities convertible into equity securities. Finally, the Brokaw Act would specifically require the disclosure of activity by hedge funds and groups of hedge funds under Section 13(d). The explicit inclusion of “hedge fund” in the definition of “persons” is a clear signal that the SEC is directed to pay close attention to activist investors and to concerted activity among them.

There remains a vigorous debate about the propriety of the Brokaw Act. On one side of the issue, its supporters contend that the Act would bring an additional layer of transparency to our capital markets, particularly as it concerns the public disclosure of short positions. On the other hand, we have heard from many institutional asset managers that the Brokaw Act’s accelerated Schedule 13D reporting requirements and new short position disclosures would have a chilling effect on their ability to run proprietary investment strategies. Many of these investors contend that they would change their market behavior as a result, which over the longer term could impede liquidity and price discovery in our capital markets.

The Chamber has long called on the SEC to address abusive practices related to short sales, including our call to put an end to “naked short selling” during the height of the financial crisis. We also have very serious concerns regarding “short and distort” schemes which involve spreading false or misleading information about a company in order to drive its stock price down and return a profit for the short seller. However, we are sympathetic to concerns that adoption of a broad short sale

disclosure regime could hamper a legitimate market activity that increases liquidity and price discovery.

Even if the SEC were to determine that a new short-sale disclosure regime is in the public interest, the Chamber doubts as to whether modeling such a regime on Schedule 13D reporting would prove optimal. The Brokaw Act makes no distinction between a short seller who has taken a net short position in a company because they believe the stock will decline in value, and a short seller who may be short the company as a hedge against an existing long position. Making such a distinction would require Congress or the SEC to determine the motivation and investment strategy of market participants – a difficult if not impossible task that speaks to the complexities of adopting a short sale disclosure regime.

Because of the wide range of opinions held by market participants about the Brokaw Act, and the commensurate lack of consensus in the marketplace, we support continued study of these issues, and would urge the SEC to take the lead in assessing whether future modifications to its rules on these issues are necessary or prudent.

### **The Compensation for Cheated Investors Act (S. 2499 from the 115<sup>th</sup> Congress)**

Arbitration is an important means for customers to resolve disputes, and it provides significant benefits to consumers, investors, and businesses. Arbitration forums can provide investors or other injured parties with accessible and fair procedures for obtaining redress for claims that cannot be vindicated in court. Current FINRA rules do not mandate that arbitration be the sole forum for investors to resolve disputes with brokerages, however FINRA does require that arbitration be used if it has been requested by an investor.

According to FINRA statistics, in 2017 2,512 arbitration cases involved customer disputes, but only 14% of these resulted in the customer being awarded compensation, 66% percent settled prior to the award.<sup>15</sup> This distribution of arbitration outcomes has remained fairly consistent over the years, and a relatively low number of cases each year end up as unpaid customer arbitration awards – for example, there were 51 such cases in 2017.<sup>16</sup> Furthermore, 12 of the 51 unpaid arbitration award cases in 2017 involved a pre-award settlement between the customer and a brokerage firm.<sup>17</sup> Other cases of unpaid arbitration awards may include situations involving brokerage firms that are inactive or no longer registered with FINRA, meaning that FINRA does not have jurisdiction over the firm. Additionally,

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<sup>15</sup> <https://www.finra.org/arbitration-and-mediation/statistics-unpaid-customer-awards-finra-arbitration>

<sup>16</sup> *Id.* at 6

<sup>17</sup> *Id.* at 9



last year FINRA on its website published a list of the names of firms and associated persons with unpaid customer arbitration awards in order to provide greater transparency around these individuals to investors.<sup>18</sup>

FINRA's Customer Code states that unless a brokerage firm has a bona fide reason for non-payment of an arbitration award, the firm must pay the award within 30 days. Firms that do not pay within 30 days risk being penalized or suspended by FINRA. The Chamber fully supports such regulatory mechanisms that ensure customers or investors receive the full amount of arbitration awards granted to them.

However, we are concerned that S. 2499, the Compensation for Cheated Investors Act, misses the mark and will actually do more harm than good for investors. The legislation creates an open-ended "FINRA Relief Fund" that is to be funded in part by "sources determined by FINRA." The Relief Fund would ostensibly be created in order to compensate customers that have not received arbitration awards they are entitled to.

The legislation would effectively allow FINRA to assess firms that have done nothing wrong in order to pay out arbitration awards that have been awarded due to the activities of bad actors. It would also establish what amounts to an insurance fund that has no actuarial basis whatsoever for the amounts that should be assessed on FINRA members in order to properly fund it, which will likely lead to the fund becoming insolvent in the future.

More troubling, the legislation would empower bad actors by ensuring them there is a backstop in place – paid for by somebody else – to compensative investors they have cheated. S. 2499 also does not contemplate or take into account the existing Securities Investor Protection Corporation (SIPC) regime that was created to compensate investors in the event of a broker liquidation. We believe that these issues make S. 2499 inherently flawed, and would urge the Committee to reject the legislation.

### **The International Insurance Standards Act (H.R. 4537 from the 115<sup>th</sup> Congress)**

The Chamber believes that international standards and agreements should benefit the U.S. insurance industry, policyholders, and our overall economy. We also recognize there are differences of opinion for how to most effectively achieve this unifying objective.

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<sup>18</sup> <https://www.finra.org/arbitration-and-mediation/members-firms-and-associated-persons-unpaid-customer-arbitration-awards>

The Chamber believes that it is important for the United States to speak with a unified voice when advocating for our system of insurance – including state-based regulation – with other jurisdictions and international standard setting bodies such as the International Association of Insurance Supervisors (IAIS). The Chamber supported the creation of the Federal Insurance Office because it allows the American insurance industry to have a unified governmental entity in the negotiation of international agreements.<sup>19</sup>

The Chamber has expressed concerns with the operation of the IAIS and other international standard setting bodies. The Chamber has noted the governance structure of the Financial Stability Board puts a “low priority on transparency” and that “opaque deliberations are problematic.”<sup>20</sup> As we noted in our Federal Reserve Reform Agenda in 2016, normally, a regulatory mandate comes from the U.S. Congress, but in effect, through these organizations, the Federal Reserve creates its own legal mandate for some of the rules it writes. Therefore, the Federal Reserve, and other governmental representatives, must be transparent to the public and accountable to Congress. Misguided policy effecting the insurance industry has broad repercussions for our capital markets.

The insurance industry is one of the largest investors in the world. The Chamber plans to release a new study next week exploring how the insurance industry invests in the U.S. economy. The investment assets of U.S. life and property and insurance companies totaled \$5.8 trillion as of December 2017.<sup>21</sup> Insurance companies can be direct investors in companies through the purchase of bonds or equity instruments, or they can invest in entities that support businesses, such as commercial real-estate. The insurance industry needs to match its investment portfolio to the long-term nature of many of its products, so by its nature it is a long-term investor. This makes the insurance industry an important funder for infrastructure, real-estate, and corporate bonds that support business operations. Inappropriate regulation would reduce the amount of capital available for investment and limit opportunities for job creation and economic growth.

### **The Consumer Financial Choice and Capital Markets Protection Act (S. 1117 from the 115<sup>th</sup> Congress)**

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<sup>20</sup> U.S. Chamber Report “Restarting the Growth Engine,” available at <https://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/Restarting-the-Growth-Engine-A-Plan-to-Reform-Americas-Capital-Markets.pdf>

<sup>21</sup> EY Report (being released March 5, 2019)

Main Street businesses rely on a variety of financing mechanisms to meet short term financing and liquidity needs. These can include traditional bank loans, lines of credit from financial institutions, or the U.S. commercial paper market. Without access to short-term lending, it is harder for businesses to ramp up production, keep up inventory levels, and meet customer demand.

The Chamber has conducted a number of surveys over the years to understand how Main Street businesses use the financial system in order to meet these short-term obligations. Unfortunately, rules such as the Volcker Rule, liquidity coverage ratio (LCR), net stable funding ratio (NSFR), and countless other requirements have made it harder for businesses to obtain financing.

In 2016, the Chamber released a report, *Financing Growth: The Impact of Financial Regulation* to assess the impact that the compilation of post-crisis rules is having on businesses. 76% of the respondents to a survey completed for the report believe that “the regulations on the financial services sector will not help their companies’ outlook over the next two to three years.” The Chamber is also currently in the field conducting a new survey of corporate treasurers to determine the current state of business financing, and we plan to release the results of that survey this Spring.

One significant rulemaking that impacted large and small Main Street businesses was a new rule for money market funds that was finalized in 2014 by the SEC and became effective on October 14, 2016. While the Chamber and others opposed efforts to fundamentally change the structure of money market funds, which are valuable tools to help businesses manage cash and meet liquidity needs, the 2014 rule made prime funds less prone to a run in times of crisis. Additionally, the short-term funding markets have successfully adjusted to the new rule.

The Chamber has long advocated for retrospective reviews of regulations after a certain period of time. We intend to use the evidence gathered by our current corporate treasurer survey to ascertain, amongst other things, the ongoing impact that post-crisis rules are having on businesses’ financing and the broader economy. We also believe that the ongoing work of both prudential and capital market regulators to review existing regulations should also help better inform the public as to what rules should be revisited to ensure they are not having a harmful impact on Main Street businesses. With the new money market fund rule coming on line only recently in 2016, we believe that a sufficient time should pass to adequately assess impact on market forces and if the resulting costs and benefits have been met.

## **Individual Components of the JOBS and Investor Confidence Act of 2018**

While the Chamber has some reservations regarding certain provisions of the JOBS and Investor Confidence Act (which passed the House in 2018), we strongly supported the bill as a whole as it contains a number of pro-growth measures that will improve the ability of small and midsize businesses to raise capital. A discussion of some of those individual components is discussed below.

### **The Helping Angels Lead Our Startups (HALOS) Act (S. 588 from the 115<sup>th</sup> Congress)**

Title II of the JOBS Act allowed for certain private offerings to engage in “general solicitation” to encourage investment, with the caveat that those who ultimately invested in a company be accredited investors under SEC rules. However, when finalizing rules to implement Title II, the SEC regrettably put in place provisions that would effectively prohibit certain types of communications between startups and angel investors. The HALOS Act would simply clarify that startups and angel investors are permitted to participate in “demo days” or other such events in which no specific investment solicitation is made. No matter their size, allowing companies greater opportunities to engage with investors or potential investors generally leads to positive outcomes. Much like the expansion of the “testing the waters” provisions for public companies that the SEC is now considering, the HALOS act would simply open up communication channels between investors and businesses looking to grow. The Chamber strongly supports this legislation, which is entirely consistent with the original intent of the JOBS Act.

### **The Encouraging Public Offerings Act of 2018 (S. 2347 from the 115<sup>th</sup> Congress)**

One of the more popular provisions of the JOBS Act was allowing pre-IPO issuers the ability to “test the waters” (i.e. engage in certain communications) with potential investors. Currently, the only companies eligible for using these provisions are emerging growth companies (EGCs), a class of issuer that was established by the JOBS Act. However, there is no pressing investor protection or other concern for limiting the type of company which can test the waters with investors. Allowing companies to test the waters with investors pre-IPO helps contribute to a successful public offering, regardless of the size or market capitalization of a company.

In 2017, the SEC expanded a related JOBS Act provision – which allowed EGCs to submit their draft registration statements confidentially – to all issuers for both primary and certain secondary offerings.<sup>22</sup> Just last week, the SEC took the step to expand the “test the waters” provision to all issuers through a rule proposal.<sup>23</sup> While this is a welcome initiative by the SEC, the Chamber strongly supports passage of the Encouraging Public Offerings Act to codify this popular provision into statute.

### **The Small Business, Mergers, Acquisitions, Sales & Brokerage Simplification Act (S. 3518 from the 115<sup>th</sup> Congress)**

The Chamber has long supported this legislation, which would simplify SEC registration requirements and provide a safe harbor for certain financial professionals who assist small and mid-size businesses that are looking to transfer corporate ownership.

The bill would exempt mergers and acquisitions brokers (M&A) brokers, to the extent they limit their activities to transactions involving the transfer of ownership or the assets of an “eligible privately held company,” from the full registration requirements of the SEC. This would allow this narrowly defined set of M&A brokers the ability to assist small and mid-size businesses with transferring ownership, particularly at a time when baby boomers are retiring and looking to sell the businesses they have built over the years to the next generation. Importantly, the legislation also includes a number of strong investor protections such as requiring the disclosure of relevant information to clients as well as the owners of eligible privately held companies. The bill also does not impede in any way upon the ability of the SEC to crack down on bad actors, or to prohibit past securities law violators from taking advantage of the exemption.

### **The Crowdfunding Amendments Act (S. 3213 from the 115<sup>th</sup> Congress)**

The Chambers supports the Crowdfunding Amendments Act, which allows for the creation of “crowdfunding vehicles” to pool investor money in order to acquire securities in a single company. Title III of the JOBS Act created – for the first time – a regulatory framework for equity-based crowdfunding. Over the last decade, crowdfunding – which involves a large number of individuals investing relatively small amounts of money in companies – has become a popular tool for everything from movie financing to startup capital raising.

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<sup>22</sup> <https://www.sec.gov/corpfin/announcement/draft-registration-statement-processing-procedures-expanded>

<sup>23</sup> <https://www.sec.gov/rules/proposed/2019/33-10607.pdf>

Unfortunately, complexities with the statute as well as implementation by the SEC added some unnecessary hurdles and red tape to equity crowdfunding, diminishing its potential as a mainstream way for businesses to find investors. The Crowdfunding Amendments Act would help ease some of these concerns and reduce some of the burden companies have in potentially tracking thousands of investors by allowing money to be pulled together into one vehicle. Crowdfunding vehicles would have to be advised by an SEC-registered investment adviser and the limits for what can be raised under the crowdfunding rules would still apply, so the legislation does not compromise any existing investor protections.

### **The Options Market Stability Act (S. 3283 from the 115<sup>th</sup> Congress)**

The Chamber supports the Options Market Stability Act, which would require the appropriate Federal banking agencies to increase the risk-sensitivity of the capital treatment of certain centrally cleared options. This legislation would mitigate the disincentive for banks to provide clearing services to market participants by appropriately providing an offset using a “delta adjustment” and “netting” of correlated positions in the calculation of the Current Exposure Method used for bank capital rules. Put simply, this bill would help more accurately reflect the actual risk associated with clearing options.

### **The Expanding Access to Capital for Rural Job Creators Act (S. 2953 from the 115<sup>th</sup> Congress)**

The Chamber supports this legislation, which would expand the focus of the Office of the Advocate for Small Business Capital Formation at the SEC to include ways to increase capital access for rural-area small businesses. We believe this is a helpful step to ensure that rural areas are not neglected by the SEC during any future rulemaking process.

A striking 2016 report from the Economic Innovation group found that half of all post-recession business creation in the United States occurred across only twenty counties, and that many rural areas missed out on economic growth following the financial crisis.<sup>24</sup> The benign neglect that regulatory agencies have shown to such areas has hampered opportunity and job creation in the communities that most need it. This bill is an incremental but important step that will help focus the SEC on the needs of businesses in rural communities.

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<sup>24</sup> <https://eig.org/wp-content/uploads/2016/05/recoverygrowthreport.pdf>

## **The Fair Investment Opportunities for Professional Experts Act (S. 2756 from the 115<sup>th</sup> Congress)**

We believe that the Fair Investment Opportunities for Professional Experts Act is an innovative way to expand accredited investor definitions in a limited manner to bring more sophisticated investors into the marketplace. The Chamber supports this bill.

Ensuring investors have the right to access suitable investment vehicles is critical for markets to operate efficiently. Doing so provides certainty and allows investors to engage in a rational and meaningful decision-making process. This of course does not guarantee a return, quite the opposite. But it does allow people to use their capabilities—in terms of resources and sophistication—to make investments. If those preconditions are present, then businesses have the opportunity to try and raise capital in efficient, well-regulated markets.

Therefore, we believe it is appropriate to put in place requirements and tests that correctly define persons who have the sophistication to put their money in complex vehicles and have the ability to withstand loss. Traditionally, this has been done through asset and income tests. The issue with using assets and income to determine who is accredited is that the rule can be both under and over-inclusive at the same time: It can leave out a sophisticated and savvy investor who may not meet the financial thresholds, while including a wealthy person who has no experience whatsoever in the financial markets.

Presumably an individual who has met the educational and licensing requirements to sell securities and investments could be deemed to be of such a level of sophistication that they should be considered an accredited investor. This is also an objective test that could be easily codified. Accordingly, we support the Act's provisions that would lead to this result.

We also support the idea that the SEC should, through notice and comment rulemaking, consider other ways to expand the accredited investor definition. Leaving this decision in the agency's hands will permit it to balance investor protection concerns with those around the need to facilitate capital formation. In this way, the SEC could determine the right path forward and who should be eligible for a limited expansion of an accredited investor definition.

## **The Modernizing Disclosures for Investors Act (S. 3575 from the 115<sup>th</sup> Congress)**

Over the years since the securities laws were first enacted, the annual and quarterly reports filed public companies have continued to grow in size and complexity, which has increased the cost of reporting for companies and made it more difficult for investors to determine the most salient information about a business. The SEC in 2013 estimated that it costs companies on average \$2.5 million in regulatory costs to complete an IPO, then an average of \$1.5 million annually once they are public.<sup>25</sup> This is not an insignificant amount for a small company that is looking to public with maybe a \$30 or \$40 million market capitalization.

According to the 2011 report of the IPO Task Force, 92% of public company CEOs stated that the “administrative burden of public reporting” was a significant challenge to completing an IPO and becoming a public company.<sup>26</sup> This legislation begins to address the issue by requiring the SEC to conduct an analysis of the costs of benefits of requiring public companies to use the Form 10-Q when submitting quarterly financial reports. Importantly, the legislation also requires the SEC to explore alternative ways companies can disclose quarterly financial performance without having to file a lengthy Form 10-Q. For example, companies could use a quarterly earnings press release which would still provide investors with material information while reducing some of the bloat of the 10-Q. While the Chamber continues to support the release of quarterly financials by public companies, we strongly support this legislation which would start a much-needed conversation about alternative methods to providing such information to investors. The Chamber also continues to support the concept of a “company file” to replace the current process for delivering information. Under this type of system, companies would not have to repeat past information that has already been disclosed, but instead would be required to continuously disclose any new material information for investors. Under such an approach, investors would not have to wade through reams of historical information to find the most pressing and timely disclosures about a company.

## **The Developing and Empowering our Aspiring Leaders Act (S. 3576 from the 115<sup>th</sup> Congress)**

The Dodd-Frank Act included an exemption for certain venture capital funds from a requirement to register with the SEC as a registered investment adviser (RIA). However, the SEC’s implementing regulation for this exemption included a definition

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<sup>25</sup> SEC proposed rules on equity crowdfunding, available at <https://www.sec.gov/rules/proposed/2013/33-9470.pdf>

<sup>26</sup> Rebuilding the IPO On-Ramp: Putting Emerging Companies and the Job Market Back on the Road to Growth Available at: [https://www.sec.gov/info/smallbus/acsec/rebuilding\\_the\\_ipo\\_on-ramp.pdf](https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf)



of venture capital fund that was unnecessarily narrow and failed to take into account many aspects of the venture capital industry. For example, many growth equity funds – which often are large investors in EGCs and other small companies – are left out of the definition of a venture capital fund. The Chamber supports this legislation, which would allow shares of EGCs to be considered “qualifying investments” for purposes of RIA exemption determinations. This would allow growth equity and other venture capital funds to continue to play a critical role in providing capital to EGCs around the time they are considering an IPO.

### **The Improving Investment Research for Small and Emerging Issuers Act (S. 3578 from the 115<sup>th</sup> Congress)**

One major issue that has developed in the public capital markets over the last two decades is a steady decrease in the level of analyst coverage of small public companies. According to Capital IQ, 61% of all companies listed on a major exchange with less than a \$100 million market capitalization have no research coverage at all. Notwithstanding provisions of the JOBS Act intended to increase research, EGCs and other small issuers still have trouble obtaining analyst coverage today. The draft legislation would simply direct the SEC to conduct a long-overdue study on this issue and to develop recommendations on how to increase the amount of research that is conducted on small public companies.

The bill would require the SEC to examine its own rulebook, as well as that of FINRA, state and federal liability concerns, and the 2003 Global Research Analyst Settlement. The SEC would also be required to examine the implementation of the Markets in Financial Instruments Directive (MiFID II) in the European Union and its cross-border compliance implications for U.S. brokers and money managers. While the SEC has issued temporary no-action relief that should assist U.S. businesses in dealing with MiFID II<sup>27</sup>, the Chamber remains very concerned about several aspects of MiFID II implementation, including its impact upon research coverage in the U.S.

The Chamber supports this legislation, which will help the public better understand how current regulations may be restricting the flow of information to investors regarding small issuers. The bill should also produce helpful recommendations that Congress or the SEC can act upon in the future.

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<sup>27</sup> SEC Announces Measures to Facilitate Cross-Border Implementation of the European Union’s MiFID II’s Research Provisions, available at <https://www.sec.gov/news/press-release/2017-200-0>

## **The Main Street Growth Act (S. 3723 from the 115<sup>th</sup> Congress)**

The Chamber also supports the Main Street Growth Act, which would establish the legal framework for the creation of “venture exchanges.” There is little doubt that investors have benefited from many of the technological and other changes in our equity markets over the last two decades, which have helped reduce trading costs, increased liquidity, and made markets more efficient. However, many of these benefits have not been distributed evenly across the equity markets. The trading environment for many small and midsize public companies – including EGCs – remains less liquid and fragmented as compared to the overall equity market. We believe that policymakers should move away from a “one size fits all” regulatory model and tailor market structure to help boost the trading of EGCs and other small issuers.

While the JOBS Act did a great deal to help EGCs raise capital in primary offerings, it did comparatively little to address the secondary market trading in these companies. The Main Street Growth Act seeks to remedy this issue by providing a tailored trading platform for EGCs and stocks with thin liquidity. Companies that choose to list on a venture exchange would have their shares traded on a single venue, thereby concentrating liquidity and exempting these shares from rules that are more appropriate for deeply liquid and highly valued stocks. Venture exchanges would also be afforded the flexibility to develop intelligent “tick sizes” that could help incentivize market makers to trade in the shares of companies listed on the exchange. Importantly, both the creation of the venture exchange and the decision to list on such an exchange are completely optional – the bill would not mandate that companies that meet certain criteria trade on a venture exchange. We believe this legislation is an important step towards properly tailoring market structure rules for small issuers.

## **The Expanding Investment in Small Businesses Act (H.R. 6319 from the 115<sup>th</sup> Congress)**

The Chamber supports this bill which would require the SEC to study the current limits on how much a mutual fund can hold in a single security and still maintain status as a “diversified” fund. Currently, mutual funds qualify as diversified under the Investment Company Act of 1940 if they hold no more than 5% of their assets in any single company, or 10% of the voting shares in an individual company. Mutual funds provide an important source of capital and liquidity for the shares of EGCs and small companies, however the 10% limit on an investment in a single company constrains the ability of funds to provide this capital. As explained in a 2017 paper on small IPOs, “As a diversified fund’s [assets under management]

grows, efforts to deploy new fund flows into a small issuer will increasingly be constrained by this 10% position limit, meaning a large fund's investment in the company will represent a diminishing fraction of the fund's AUM."<sup>[1]</sup> We believe that exploring whether the current 10% limit should be raised will start an important conversation and ensure that mutual funds can continue to invest in small issuers even as their assets under management continue to grow.

### **The Promoting Transparent Standards for Corporate Insiders Act (H.R. 624)**

The Promoting Transparent Standards for Corporate Insiders Act would require the SEC to study whether the ability of issuers to establish preset trading plans corporate insiders should be limited. These plans, known as Rule 10b5-1 plans, are established so that individuals at public companies who are likely to have access to material, non-public information (MNPI) can still have shares in the company traded on their behalf in accordance with a preset written plan.

In order to enter into a 10b5-1 plan, an individual must demonstrate that they have entered into the plan in good faith and not as a means to evade insider trading prohibitions based upon their possession of MNPI. The plan must also specify the amount and price of the security, as well as the dates for when future buys or sells of the company's securities will take place, and individuals cannot direct others or have any input into future transactions after the 10b5-1 plan was established. It must also be determined that all buys or sells for an individual occurred under the plan.

10b5-1 plans offer a transparent way for corporate insiders to transact in the company's stock without running afoul of the securities laws. Companies already disclose a good amount of information regarding the establishment of 10b5-1 plans as well as transactions that occur under them, and investors generally understand the parameters of insider transactions under these plans. 10b5-1 plans are also an important means to protect against insider trading by corporate executives on MNPI and so carry an important investor protection aspect as well.

The legislation calls for an SEC study of the issue, however it also mandates that the SEC issue regulations based on the findings of the study. Such an approach is deeply misguided – without knowing for certain the results of the study, Congress should not be in a position of delegating such broad authority to an agency. At the same time, we also are seriously concerned that the language in the bill attempts to

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<sup>[1]</sup> The Small IPO and Investment Preferences of Mutual Funds (Robert Bartlett III, Paul Rose, Steven Davidoff Solomon) July 28, 2017 at 9.

“lead” the SEC study to predetermined conclusions. Limiting 10b5-1 plans could result in a lack of transparency surrounding trading by corporate executives, thereby depriving shareholders of important information. Accordingly, we cannot support the bill as drafted but are open to engaging with members of this Committee in order to find a workable alternative.

### **The Enhancing Multi-Class Stock Disclosure Act (H.R. 6322 from the 115<sup>th</sup> Congress)**

One of the more curious criticisms that has arisen in recent years has been over more companies adopting dual or multi-class share structures when going public. These structures reserve voting rights for certain equity holders – often company founders – while other equity holders retain economic but not voting rights.

Given the rise and increasing aggressiveness of activist investors, it is little wonder that more companies are choosing to go public under such a structure. Founders who have built a company from scratch and wish to maintain some control are rightfully wary about allowing special interests to hijack their annual meetings, or to outsource effective control over their company’s voting to opaque and conflicted proxy advisory firms. If market participants are truly concerned about the rise of dual and multi-class share structures, it is better to focus on fundamental proxy reforms that would disincentivize company founders from adopting such structures in the first place.

Furthermore, companies should not have to submit to some myopic view of corporate governance when they go public. There is no greater discipline than market discipline – if dual-class companies are truly viewed with skepticism by the market, then they will pay a price with their valuation. Then companies can determine whether the benefits of retaining voting rights outweighs the ‘penalty’ imposed on them by the market.

The Chamber has concerns about this legislation being put forward against the backdrop of calls to restrict or eliminate the ability of companies to adopt the share structure of their choice. We believe that it is better to allow companies to choose the structure they feel is in their best interest, and for investors to take into account their ability (or non-ability) to vote, and factor that into their investment decisions.

## The Middle Market IPO Underwriting Cost Act (H.R. 6324 from the 115<sup>th</sup> Congress)

The Chamber also has concerns with the Middle Market IPO Underwriting Cost Act. While this bill calls for another study by the SEC, we worry again that the underlying premise is misguided and misses the mark about why companies are choosing not to go public. The legislation seeks to question the underwriting fee that companies pay when they go public, which many observers have noted has remained around the same level (roughly 7%) for decades.

While there may be legitimate questions as to whether companies are paying too much or too little in order to public, it is better left to market negotiators to determine the optimal price. It should also be noted that the price paid by issuers has remained roughly the same through periods when we had a very high level of IPOs (late 1980s and 1990s), as well as periods when there was a dearth of public offerings. So the underwriting spread itself historically has not appeared to be a reason to forego an IPO.

FINRA Rules also require that underwriters file information with FINRA prior to the commencement of an offering to ensure that the terms and arrangements of a deal are fair. Underwriter economics take into account the multiple departments of an underwriter that can be involved in a deal, including corporate finance, retail brokerage, institutional sales trading, research, as well as legal and compliance. Public companies to our knowledge have not made an argument that underwriting fees are too high are present a significant impediment to completing an IPO.

Furthermore, the underwriting fee for companies is a *one-time, known* cost that companies pay in order to access the public markets. In our conversations with companies, it is more a fear of the *unknown* that disincentivizes an IPO: When and how will special interests target us through the proxy rules? Will proxy advisory firms understand our unique, specific business model and adjust their vote recommendations accordingly? Is Congress going to pass further costly and harmful disclosure mandates such as pay ratio and conflict minerals? Are we going to be mandated at some point to comply with one-size-fits-all ESG disclosure mandates?

These are the types of hard questions companies grapple with when deciding whether or not to IPO, and we are concerned that this legislation takes the focus away from Congress and the SEC addressing these concerns.

## **Conclusion**

The Chamber appreciates the Committee's ongoing work to improve corporate governance and explore ways to help American businesses raise capital so they can innovate, expand, and hire new workers. We stand ready to assist members of this Committee and all members of Congress in moving a number of these initiatives through the legislative process.