Statement of the U.S. Chamber of Commerce

ON: **Legislative Proposals to Relieve the Red Tape Burden on investors and Job Creators**

TO: **The Subcommittee on Capital Markets and Government Sponsored Enterprises**

BY: **Tom Quaadman**

DATE: **May 23, 2013**

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.

Positions on issues are developed by Chamber members serving on committees, subcommittees, councils, and task forces. Nearly 1,900 businesspeople participate in this process.

Chairman Garrett, Ranking Member Maloney and members of the Capital Markets and Government Sponsored Enterprises subcommittee. My name is Tom Quaadman, vice president of the Center for Capital Markets Competitiveness (CCMC) at the U.S. Chamber of Commerce (Chamber). The Chamber is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector and region. I appreciate the opportunity to testify before the subcommittee today on behalf of the businesses that the Chamber represents.

The Chamber supports the bills that are the subject of today's hearing— H.R. 1105, the Small Business Capital Access and Jobs Preservation Act; H.R. 1135, the Burdensome Data Collection Relief Act; H.R. 1564, the Audit Integrity and Jobs Protection Act; and a discussion draft, presented by Representative Wagner, to amend Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, regarding the provision of protections for retail customers and their relationship with broker-dealers. These bills address several of the issues the Chamber highlighted earlier this year for further action by Congress and the Administration to provide the financial regulatory structure and oversight that is needed for the American economy to grow and create jobs.

In 2007, the Chamber created the Center for Capital Markets Competitiveness to promote financial regulatory reform needed for efficient capital markets in a 21st century global economy. The Chamber did so because even before the financial crisis, it was becoming more difficult for American businesses to raise capital, there was and continues to be a steady decline in the number of public companies in the United States, and new businesses are eschewing traditional forms of public company financing in favor of more private forms of financing. While we need diverse public and private company capital markets, this overall trend is not a positive one for investors or the American economy.

We can no longer wait to address these issues if we want the American capital markets to be the most efficient and attractive in the world.

In March the Chamber released the **Fix, Add, Replace** Agenda (FAR Agenda) to address financial regulatory reform in the wake of the passage of the Dodd-Frank Act.[1] The FAR Agenda proposes to:

Fix those areas of the Dodd-Frank Act that aren't working properly;

[1] Copy of the FAR Agenda is attached as Exhibit 1.

Add those issues that weren't addressed in the Dodd-Frank Act; and

Replace those provisions of the Dodd-Frank Act that are unfixable.

The FAR Agenda is not an exhaustive list of issues and solutions, but it is a starting place for a dialogue on how to provide the American economy with the tools of capital formation needed to foster growth and job creation for the next generation.

We are pleased that the legislative proposals, which are the subject of today's hearing, are ones that are part of the FAR Agenda and ones that the Chamber supports. Let me take this opportunity to discuss those legislative proposals in greater detail.

1. **H.R. 1135, the Burdensome Data Collection Relief Act**

H.R. 1135, the "Burdensome Data Collection Relief Act,"[2] would repeal section 953(b) of the Dodd-Frank Act which requires public companies to disclose a ratio of the median compensation of all employees to the compensation of the Chief Executive Officer.

The Chamber opposed the inclusion of the pay ratio because it does not provide investors with information relevant to the long-term performance of a company, and it would force companies to spend finite resources to compute the irrelevant ratios.

Such a ratio will contribute to the clutter that has made public company disclosures increasingly irrelevant as a means of providing useful information to investors to make decisions on how to deploy capital with a reasonable expectation of return. For instance, a business that has a large hourly work force, such as a retail or fast food chain, will have a high differential in their ratio, while a Wall Street firm, where it is not uncommon for employees to make an amount comparable to the CEO; will have a much lower differential.

This ratio does not convey information on the performance of a company, the health of a company, or what the long-term prospects of a company are. Indeed, proxy advisory firms have failed miserably in determining peer groups for investors to evaluate comparable CEO compensation. If private firms have failed in this effort, it is hard to see how a government mandated ratio with no relation to investment decisions is any better.

[2] *See* Chamber letter in support of H.R. 1135 attached as Exhibit 2.

Section 953(b) also imposes costly burdensome data collection requirements upon businesses. For businesses that operate in many nations, this would require companies to reconcile differing definitions and practices of compensation and benefits, adjust this compensation to currency fluctuations, and settle potential differences in definitions and practices as to whom employees may actually be. According to the Center On Executive Compensation, one company has estimated that it would cost $7.6 million and take 26 weeks to compile this information, and another has estimated that it would cost $2 million dollars alone to determine the actuarial benefit of pension benefits for employees. To extrapolate those costs among the 10,000 plus public companies in the United States, we could face compliance costs in excess of $1 billion dollars.

That is why the Chamber and the Center On Executive Compensation sent a letter to the Securities Exchange Commission (SEC), signed by 23 trade associations expressing concerns regarding the pay ratio provisions of the Dodd-Frank Act.[3]

Disclosure requirements that fail to convey relevant information to investors and impose costly burdens on companies are by definition immaterial and antithetical to productive capital formation, and therefore, the Chamber believes they should be repealed.

2. H.R. 1105, the Small Business Capital Access and Job Preservation Act

H.R. 1105, the "Small Business Capital Access and Job Preservation Act,"[4] would amend the Investment Advisers Act of 1940 to exempt private equity fund investment advisers from its registration and reporting requirements, provided that each private equity fund has not borrowed and does not have outstanding a principal amount exceeding twice its invested capital commitments. This bill seeks to enhance the capital formation needed to build new businesses, expand existing businesses, and create jobs.

Companies small and large, particularly new businesses, need a mix of capital sources to meet short-term and long-term growth needs. This diversity of capital has provided the liquidity needed for different sized firms to be able to have the opportunity to achieve success. Congress recognized these facts and the need to increase diverse portals of capital access in passing the bi-partisan Jumpstart Our Businesses Startups Act ("JOBS Act") last year.

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[3] Letter to SEC Chairman Mary Schapiro, dated January 19, 2012, is attached as exhibit 3.
[4] *See* Chamber letter in support of H.R. 1105 attached as exhibit 4.

The Small Business Capital Access and Job Preservation Act builds upon the JOBS Act and is itself an important innovation that will help to insure that small businesses continue to have access to diverse forms of capital formation.

Private equity financing is an important form of financing for smaller businesses that are trying to grow. In fact, between 1995 and 2010, over 23,000 companies, employing 3 million people, were backed by private capital. These firms grew jobs at a rate of 64% compared to other companies which only grew jobs at a rate of 18%.[5] It should also be noted that private equity financing was not a cause of the financial crisis and that business models utilizing private equity financing do not pose interconnected risk to the economy. Yet, the Dodd-Frank Act requires that private equity firms must register with the SEC. This places upon the private equity firms onerous reporting requirements through form PF, including the valuation of privately held portfolio companies, as well as expensive custodial requirements for untradeable legend equities.

Requirements such as these are not only costly; they are designed for public company investors, not investors in privately held companies. Thus, the requirements are also a mismatch for the investment model. The costs of these requirements may be prohibitive for smaller firms that specialize in investing in the middle markets. Therefore, the failure to pass this legislation can cut off funding sources for small businesses. This will create a cascading investment inertia that will harm smaller businesses that need assistance to grow. Such investment inertia will create adverse macro growth scenarios for the economy.

The Chamber believes that the bi-partisan Small Business Capital Access and Job Preservation Act is a measured response to preserve the role of Private Equity funding as a conduit of capital for small growing businesses.

3. H.R. 1564, the Audit Integrity and Job Protection Act

H.R. 1564, the "Audit Integrity and Job Protection Act,"[6] would prohibit the Public Company Accounting Oversight Board (PCAOB) from implementing rules requiring public companies rotate audit firms on a mandatory basis. Implementation of mandatory audit firm rotation will harm investors, endanger the competitive position of American public companies, and degrade audit quality.

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[5] Growtheeconomy.org.

[6] *See* Chamber letter in support of H.R. 1564 attached as Exhibit 5.

The PCAOB appears to have embarked on an agenda that is leading far afield from its specific, but important, mandate to regulate auditors. Mandatory audit firm rotation would reduce the supervision and oversight of the audit committee and management, rolling back strong corporate governance policies. Indeed, we must question why the government, or a quasi-government entity, should mandate which vendor a business should use.

Let's take a look at the history of the mandatory audit firm rotation debate:

- Congress, in debating Sarbanes-Oxley, explicitly declined to enact provisions requiring mandatory firm rotation;

- Congress, in passing the JOBS Act, specifically exempted emerging growth companies from being subjected to any potential rules requiring mandatory audit firm rotation;

- The General Accounting Office (GAO) has twice reviewed and rejected the need for mandatory firm rotation. The GAO noted that mandatory audit firm rotation would increase audit costs by at least 20%;

- Academic studies have demonstrated that mandatory firm rotation may harm companies through higher costs and increased incidence of undetected fraud;

- The PCAOB has failed to provide information through the inspections process demonstrating a need for mandatory firm rotation[7];

- Over 90% of commenters on the concept release have opposed the concept of mandatory firm rotation; and

- The majority of investors commenting on the concept release also opposed mandatory firm rotation.

Despite this history and almost universal opposition to mandatory firm rotation, the PCAOB continues to consider a concept release on the subject, one that has been open since August 2011. The PCAOB's failure to demonstrate how the benefits of rotation outweigh the costs or address the cogent and consistent concerns

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[7] *See* Chamber letter to PCAOB Chairman James Doty of October 5, 2012 attached as Exhibit 6 raising concerns about the PCAOB inspections process and the failure of the PCAOB to define audit failure.

raised by investors and businesses lead us to question why valuable resources, time, and monies are being spent on this project.

The Chamber believes that the PCAOB can better spend its time, effort, and resources on other projects such as updating auditing standards or developing a basic definition of audit failure. With the continued consideration of the concept release on mandatory audit firm rotation, the Chamber is concerned that the PCAOB is leaving the realm of audit regulation and crossing the threshold of regulating corporate governance, a subject area that has been left to state corporate law and the Securities Exchange Commission.

The Chamber supports independent standard setting; however, we believe that the recent proposal on mandatory firm rotation weakens audit committees, is outside the bounds of audit regulation, and enters an area outside the PCAOB's authority – corporate governance. H.R. 1564 reaffirms the line of demarcation, as established in Sarbanes-Oxley, that the PCAOB's jurisdiction is limited to that of an audit regulator, while corporate governance and executive compensation reside with the SEC, state corporate law, and boards of directors.

4. A discussion draft to amend Section 913 of the Dodd-Frank Act

Section 913 of the Dodd-Frank Act requires the SEC to study and, if necessary, develop a rulemaking to address issues surrounding the standard of care for broker-dealers and investment advisors in the dispensing of investment advice and services for retail customers. It should be noted that the Department of Labor (DOL) is engaged in a similar rulemaking under its jurisdiction.

The discussion draft presented by Representative Wagner requires the SEC to satisfy certain requirements before moving forward with any rulemakings under Section 913. Specifically, the discussion draft requires that the SEC identify the harm to retail customers due to brokers or dealers operating under different standards of conduct than those that apply to investment advisers. Furthermore, the SEC must conduct a rigorous cost-benefit analysis and determine that this analysis 1) demonstrates that the benefits of the rule justify the costs; 2) identifies and assesses alternatives to the rule and determines that the rule is the most effective path; and 3) ensures that the rule improves current regulations.

These are reasonable requirements; however, past regulatory failures justify this legislative mandate.

The D.C. Circuit Court of Appeals has repeatedly invalidated SEC rulemakings, most recently in *Business Roundtable & U.S. Chamber of Commerce v. Securities and Exchange Commission*, because of a faulty cost-benefit analysis. Systemic issues have prevented the SEC from determining the costs of a proposed regulation, what the benefits of a proposed regulation are, and if the costs outweigh the benefits. Similarly, President Obama's executive order on regulatory reform[8] requires non-independent agencies to clearly identify a problem and then to regulate, with the least burdensome impact on society, if no alternatives to regulation exist. Finally, with many joint rulemakings required under the Dodd-Frank Act, the SEC has historically been a laggard, making the joint regulatory process disjointed and uncoordinated.

In addition, the discussion draft calls for the SEC to coordinate its rulemaking on retail customer standards of conduct with other federal agencies, including the DOL, to minimize any conflicts among related regulations. We couldn't agree more. As there has been increasing overlap between the DOL and SEC in the area of retirement plans, we strongly urge these two agencies to work together to create a coordinated fiduciary standard.

Although the DOL withdrew its proposed rule in late 2011 and intends to re-propose a similar rule, the original proposed rule covered persons who are investment advisers as defined in the Investment Advisers Act of 1940. The DOL noted that this reference to the Investment Advisers Act definition also includes the various exclusions from that definition. However, an entity that is exempt under the Investment Advisers Act may still be a fiduciary under one of the other alternative definitions in the DOL regulation.

Different sets of rules and requirements applicable to the same assets will lead to additional costs and complexities for the underlying participants and account holders. This issue is further complicated to the extent that an individual may have several accounts at the same financial institution, some of which may be only subject to the SEC rules, and others of which may be subject to the new ERISA requirements as well as the SEC rules. Inconsistent rules will be confusing to investors and problematic for service providers to implement. Without coordination between the agencies, plan sponsors and plan professionals will spend significant resources unnecessarily trying to comply with two different sets of rules that are trying to reach the same goal. This situation could result in retail customers, plan participants, and beneficiaries not receiving the necessary tools and assistance necessary to achieve a

[8] Executive Order 13563

financially sound retirement at a time when this is critically important, or only receiving such investment support at an additional cost.

In short, the Wagner discussion draft imposes common sense requirements, as the SEC Regulatory Accountability Act does, on a potential area of rulemaking of importance to retail investors and the businesses they provide capital to. Indeed, the Chamber has been disappointed with the benign neglect that the SEC has shown to retail investors who have been disenfranchised by past rulemakings. The Chamber believes that the Wagner discussion draft should be introduced and passed and requests that the Subcommittee look into other issues regarding retail shareholders, particularly the sharp decline in participation by retail shareholders in voting in director elections and shareholder proposals.

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The Chamber believes that these bills are important steps in promoting strong policies conducive to long-term economic growth and job creation. We need to have a diverse capital market system to sustain a varied set of business structures. Similarly, we must also preserve the public company structure, which is a unique and successful form of wealth creation for employees, as well as retail investors. This package of legislative proposals strikes the appropriate balance in achieving those goals.

I will be happy to take any questions that you may have.