Statement of the U.S. Chamber of Commerce

ON: Legislation to Further Reduce Impediments to Capital Formation

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

BY: Tom Quaadman

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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, and I am 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 of all sizes, sectors, and regions. I appreciate the opportunity to testify before the Subcommittee today on behalf of the businesses that the Chamber represents.

This hearing, "Legislative Proposals to Enhance Capital Formation for Small and Emerging Growth Companies," is an important step to remove barriers of growth to small- and mid-size businesses. The Chamber would like to thank Chairman Garrett, Ranking Member Maloney, and the Members of the Capital Markets and Government Sponsored Enterprises Subcommittee for your continued and sustained focus on legislation to improve capital formation opportunities for America's small- and mid-size businesses. The ability of a person with a good idea to start a business and have the chance to grow it into a large one is a critical component of what has made America the most prosperous nation in history. Your efforts in passing the JOBS Act two years ago and in pressing forward with proposals that are the subject of today's hearing are vital to preserving the American dream in the 21st century.

I. FAR Agenda

Regulation for efficient and orderly capital markets has been an important priority for the Chamber since before the financial crisis. In 2007, the Chamber created the Center for Capital Markets Competitiveness to promote a financial regulatory structure for the United States to compete in a 21st century global economy. The warning signs on Americas declining competitiveness have been persistent:

- American businesses continue to have difficulties raising capital;
- There was, and continues to be, a steady decline in the number of public companies in the United States;
- New businesses are eschewing traditional forms of public company financing in favor of more private forms of financing; and

- We need diverse public and private company capital markets, but the regulatory trends are trying to create a homogenous system, which is not beneficial for the American economy.

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 are not working properly;

Add those issues that were not 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. The Chamber is pleased that many of the legislative proposals being discussed today reflect the principles laid out in the FAR Agenda. Let me take this opportunity to discuss those legislative proposals in greater detail.

II. Legislative Proposals

The Chamber is supportive of the following bills the Subcommittee is considering today. As with the JOBS Act, we appreciate these proactive legislative measures as the Securities and Exchange Commission (SEC) could have taken action to modernize existing reporting standards, but has failed to do so. Recent activities and statements by SEC Chair Mary Jo White point to a new mode of thinking—reviewing current regulations and updating them if necessary, and removing regulations whose time has passed—but the issues raised in today's hearing can be tackled even before such a review is underway.

a. H.R. 4200, the "SBIC Advisors Relief Act of 2014"

H.R. 4200, introduced by Mr. Luetkemeyer, would correct an unintended consequence of current law that triggers registration under the Investment Advisers Act of 1940 for advisers of small business investment companies (SBICs) and venture capital funds. Congress has consistently provided an exemption under the Advisers Act for individuals who advise SBICs or venture capital funds, however someone who

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

acts as an adviser to *both* an SBIC and venture capital fund is currently required to register under the Advisers Act. The exemptions for advisers to SBIC's and venture capital funds are there for good reason, and there is no valid logic for requiring someone to register under the Advisers Act simply because they advise both.

H.R. 4200 would therefore codify Congressional intent regarding these exemptions, and would allow advisers acting in a dual capacity to maintain their exempt status. Additionally H.R. 4200 would exclude SBIC assets from the calculation to determine whether someone who advises a private equity fund should have to register with the SEC. This is a common sense measure that would help avoid costly and unnecessary registration for advisers which would limit the positive impact that private equity and SBICs have on our economy. H.R. 4200 also includes sensible provisions that would prevent regulatory duplication at the state level, which can be harmful for small businesses that often times do not have the vast resources to deal with legal complexities.

b. A bill to amend the securities laws to improve private market offerings

This bill, introduced by Mr. Mulvaney, stems from a recommendation of the 2012 SEC government/small business forum. In 2007, the SEC reduced the holding period for restricted securities under Rule 144 from one year to 6 months; this bill would further reduce it to 3 months, allow investors to access the secondary market, and also add Rule 144A securities to the definition of a "covered security." Since these are securities of reporting companies, there is already sufficient public information about the companies themselves, which allows for investor protection through regulatory oversight. Reducing holding periods would make these securities more attractive to investors, and surround private market offerings with more liquidity, thereby promoting competition and capital formation.

This is a simple change that would lead to more efficient capital markets facilitating economic growth and job creation.

c. A bill to direct the Securities and Exchange Commission to revise its rules so as to increase the threshold amount for requiring issuers to provide certain disclosures relating to compensatory benefit plans

I would like to thank Mr. Hultgren for introducing this bill. This is a simple legislative tweak that would help the JOBS Act 12(g) cap raising meet its potential.

In 1988, SEC adopted Rule 701, which allows private companies to sell securities to employees without incurring the costs of registration for offers and sales of securities under certain compensatory benefit plans or written agreements relating to compensation. As a result, private companies were able to offer their employees the benefits of ownership without undertaking the costly registration process that is generally intended to protect publicly-traded securities. Under its current form, Rule 701 mandates disclosures that treat employee sales above $5 million more like capital-raising than compensation. These disclosures raise the cost of providing these securities and require private companies to risk the disclosure of confidential financial information. Moreover, this now-dated approach is one that does not account for the JOBS Act's 12(g) employee exemption or the effects of inflation.

This bill would raise the Rule 701 and adjust it for inflation every five years. This change would allow the employees working for privately-held businesses ranging from relatively new start-ups to mature companies to take full advantage of the JOBS Act 12(g) employee shareholder provisions.

d. A bill to require the Securities and Exchange Commission to revise the definition of a well-known seasoned issuer to reduce the worldwide market value threshold under the definition

This bill, introduced by Mr. McCarthy, would revise the well-known seasoned issuer ("WKSI") definition to lower the threshold from $700 million to $250 million. WKSIs are a class of issuers created by the SEC in 2005, which are eligible for less burdensome registration requirements for certain offerings made to the public. It should be noted that WKSIs have a track record, are known issuers by the SEC, and have acted in accordance with the various securities laws. All companies are not eligible for WKSI status, but those who have good track records are.

Accordingly, WKSIs are eligible to use shelf registration statements which become effective immediately upon filing—this allows companies to issue securities at a time they deem is beneficial for shareholders. Currently, companies with less than $700 million of market cap are ineligible for WKSI status. By lowering this threshold to $250 million, a greater number of companies would be eligible to use shelf registration. This would give businesses more flexibility to meet their capital needs, and would allow them to fully consider market and economic conditions in deciding when to access the public markets.

The combination of a proven track record of compliance by the company combined with continued SEC oversight means that investor protections would remain in place while making capital formation more efficient.

e. **A bill to allow smaller reporting companies to raise capital more easily by expanding the availability of short-form registration of a public offering on Form S-3**

This bill, introduced by Rep. Wagner, would allow smaller reporting companies to incorporate on their S-1 registration statement any filings that are made after the date the S-1 becomes effective. This bill would also modernize use of the Form S-3 and allow more small issuers to take advantage of the simplified registration statement. The SEC would also be required to submit a recommendation to Congress regarding preemption of blue sky laws for certain securities that do not trade on a national exchange. State securities regulators certainly have a place in our diversified financial structure. The Chamber has supported the role of states with organic regulatory roles, such as with corporate governance. However, as the JOBS Act recognized, the way business structures have been used has changed and there may exist companies that access national capital markets even though they may not be listed on national exchanges. The use of national capital markets should allow for the SEC to have a primary oversight function to insure consistency and clear rules of the road. We have seen similar federal-state models work with financial reporting with Financial Accounting Standards Board, Public Company Accounting Oversight Board, and National Association of State Boards of Accountancy performing different yet important roles.

Again this bill derives from recommendations made from the SEC government small/business forum to reduce some of the unnecessary compliance costs of issuers

f. **The Disclosure Modernization and Simplification Act**

Our capital markets could not operate without the disclosure and dissemination of relevant and appropriate information that is decision useful. This is true for investors who are seeking vehicles for return and businesses who are seeking to raise capital to grow.

However, over the course of time proxies have become voluminous, some required disclosures have become obsolete, and the delivery of information has changed though the legal mandated forms of disclosure have not. This situation has commonly been referred to as disclosure overload and it is apparent that investors are not being given information in a decision useful manner and in some cases overwhelmed with non-relevant information. Even SEC Chair Mary Jo White has on several occasions stated that a review of our current disclosure system is a top priority for the Commission this year. This bill would help augment the SEC's efforts by requiring the Commission to first eliminate wholly unnecessary or outdated disclosure requirements, and to allow issuers to include a summary of material information in their form 10-k).

While an overhaul and review are critical for the long-term viability of the proxy system, authorization of a summary is an important first step to streamline information in such a way that it is accessible, useable and relevant for investors.

III. Need for Action

In this testimony and other hearings we have talked about the need for the removal of these barriers to spur job growth and encourage entrepreneurs. It should be remembered these bills are necessary because the SEC has been slow to modernize these regulations in the past. While the SEC has a renewed focus, legislation is still needed to keep the regulators feet to the fire and prevent inertia from asserting itself. Regulatory inertia would mean that the problems will continue grow and American competiveness will fall even further behind.

IV. Conclusion

The Chamber views these bills as important blocks building on the foundation of the JOBS Act. These bills would keep our economy vibrant allowing businesses to grow and create jobs. But these bills could do more than that, as they could also push the regulators to be more forward leaning and proactive in keeping up with the dynamics needed to create and sustain an atmosphere conducive for growth. This formula would allow entrepreneurs to take the reasonable risks to start new businesses forged on the anvil of innovation. This would help keep current what has been the formula for success allowing the United States economy to grow at unprecedented levels throughout its history. More importantly, these bills, along with the full implementation of the JOBS Act, are necessary for American businesses to succeed in an ever increasing competitive global economy.

I am happy to take any questions that you may have at this time.

FAR

Fix. Add. Replace.

AGENDA 2014

Ensuring Competitive Markets and Preserving Access to Capital

Center for Capital Markets Competitiveness

2014 FAR Agenda: Ensuring Competitive Markets and Preserving Access to Capital

America needs transparent, liquid, efficient, and well-regulated markets to ensure job creators have access to diverse sources capital and the tools needed to manage their financial risks and liquidity needs. The ultimate test of any financial regulatory reform should be if it is helping achieve these goals by providing clear, predictable rules and a level playing field for all market participants.

More than three and a half years into Dodd-Frank implementation, the law's complexity and overlapping, even conflicting, requirements are still challenging both regulators and regulated entities. Last year, the U.S. Chamber's Center for Capital Markets Competitiveness (CCMC) prepared the *Fix. Add. Replace. (FAR) Agenda* outlining areas of concern that needed to be addressed. Unfortunately, while progress has been achieved in some areas, other issues remain unaddressed—or even worse—have been exacerbated. This year's **FAR Agenda** seeks to answer the following basic questions:

- Are there areas where Dodd-Frank or other regulations are simply not working as intended or where regulators need further clarity from Congress? How do we **fix** this?
- What **add**itional steps should we take in areas that were left unaddressed in Dodd-Frank?
- Are there regulations that simply don't work and need to be **replace**d?

While there will be honest disagreements about particular provisions, almost everyone can agree that today's financial regulatory structure and oversight is still **FAR** from what is needed.

In particular, there are still too many conflicting or diverging approaches between U.S. and global regulators. Some regulators are attempting to de-globalize the financial markets while others are trying to export regulations to other countries and refusing to accept other approaches.

Main Street businesses—from the small start-up to the mature global enterprise—have a large stake in the outcome of financial regulatory reform and the issues raised in this report. The **FAR Agenda** we are proposing is not an exhaustive list of all the challenges or the changes needed, but it does reflect the areas that have the broadest impact on the American economy and the millions of businesses that rely on an effective capital formation system.

Legislative and Regulatory Fixes to Dodd-Frank and Other Regulations

FIX.

As with any broad legislation, Dodd-Frank has left gaps between regulations and created unintended consequences. In addition, as regulators have scrambled to meet statutory deadlines, they have been constrained by the rigidity of the statute in some areas or misinterpreted Congressional intent in others. And, in some cases regulators have simply created unworkable regulatory regimes. CCMC is advocating for the following statutory and regulatory **FIXES** to ensure well-functioning, robust capital markets.

FSOC Reform: Enhance Transparency and Achieve Better Coordination Among Financial Regulators

- Support efforts to increase the transparency of the Financial Stability Oversight Council (FSOC) when it acts in a regulatory capacity to ensure the Council benefits from public input to achieve a better regulatory outcome.
- Empower the FSOC to streamline or eliminate duplicative regulatory regimes and harmonize conflicting regulations among agencies. For example, limit the extent that regulators continue to issue divergent and conflicting regulations.
- Reform the FSOC structure so the view of the agency and not the individual FSOC member is represented on the Council.
- Change the voting threshold to an affirmative vote of at least three quarters of the FSOC and strengthen the role of the primary regulator in the systemic risk process.
- Require a cost-benefit analysis to be performed by FSOC when the Council votes to proceed with a Systemically Important Financial Institution (SIFI) designation or any other regulation.

Systemic Risk: Reform the Designation Process by Establishing Clear Rules of Due Process

- Ensure that systemic risk regulation and orderly liquidation authority for non-bank financial companies are not bank-centric but are tailored to the business model of a specific company to prevent policies that may cause unnecessary market disruptions.

- Create a path for un-designation. The FSOC should determine the appropriate criteria and processes for nonbank SIFIs to reverse their designation and no longer be subject to enhanced prudential standards and heightened supervision by the Federal Reserve.

OFR: Strengthen Evidence-Based Analysis

- Implement appropriate Congressional oversight by bringing the Office of Financial Research's (OFR) budget within the formal appropriations process.
- Improve the quality and process of the OFR's analyses and reports to better inform the FSOC. For example, require the OFR to undergo a notice-and-comment process to help inform research.
- Ensure that the OFR coordinates and streamlines data collection among agencies to prevent duplicative collection of information and safeguard the confidentiality of proprietary and consumer information gathered from requests and examinations across all regulators.

CFPB: Preserve Consumer Choice and Access to Credit

- Ensure the Consumer Financial Protection Bureau (CFPB) protects and informs consumers and does not limit consumer choice and access to credit by dictating how credit will be allocated.
- Require the CFPB to follow fair, transparent processes, including notice-and-comment periods, when substantially altering or creating new rules.

CFPB: Establish Structural Checks and Balances

- Replace the single director leadership structure at the CFPB with a bipartisan commission to ensure continuity and a balanced approach to policymaking.
- Restore Congressional funding oversight by bringing the CFPB's budget within the formal appropriations process, similar to most independent agencies.
- Ensure more effective coordination with safety and soundness regulators to guarantee that CFPB regulations do not conflict with other regulations or otherwise undermine the diversity and soundness of the banking system.

Money Market Mutual Fund Reform: Preserve and Further Strengthen an Essential Liquidity Management Product for Companies, States, and Non-Profits

- Ensure further regulatory changes to Money Market Mutual Funds (MMMFs) seek to strengthen these funds while preserving their utility to investors and issuers.
- Target reforms so they effectively address clearly defined problems and conduct a thorough analysis of potential reforms to MMMFs to understand the broader economic impacts.
- Ensure reforms take into account company specific operational impacts, notably the accounting, tax, and operational issues that would ensue from floating the net asset value.

Derivatives: Ensure End-Users are Able to Manage Financial Risks

- Enact bi-partisan legislation (which passed the House 411-12 and has 20 cosponsors in the Senate) to exempt non-financial end-users from onerous, costly, and unnecessary margin requirements, consistent with the Congressional intent when Dodd-Frank was passed.
- Clarify that non-financial companies that use centralized treasury units to hedge risk will be eligible for the end-user clearing exception.
- Limit the extraterritorial reach of domestic derivatives regulation to ensure U.S. dealers are not disadvantaged overseas and to ensure that Main Street non-financial companies' cross-border counterparty relationships are not undermined by overlapping regulation.
- Ensure that the Federal Reserve's review of Bank Holding Companies' authority to engage in commodities activities does not lead to restrictions that will impede end-users' ability to hedge their commodities exposures.

The Volcker Rule: Fixing Unintended Consequences and Ensuring Uniform and Transparent Implementation

- Establish a marketplace participants working group to work with regulators to identify unintended consequences and craft effective solutions before the end of the conformance period.
- Harmonize, amongst the five separate regulators, the enforcement, interpretation, and implementation of the Volcker Rule.

Fiduciary Standard: Preserve Choice and Affordability for Retail Investment and Retirement Savings

- Preserve individuals' ability to save for retirement through access to affordable saving products.
- Coordinate related fiduciary rulemakings at the Securities and Exchange Commission (SEC) and Department of Labor (DOL) to avoid regulatory conflict and stakeholder confusion.
- Ensure that only plan sponsors and service providers to ERISA-based plans are subject to ERISA's fiduciary duty.

Whistleblower Regulation: Ensure Enhanced Whistleblower Programs Do Not Undermine Strong Company Compliance Programs

- Amend the SEC and Commodity Futures Trading Commission's (CFTC) whistleblower programs to make any wrongdoer convicted of a crime ineligible for an award and to provide consistency with Sarbanes-Oxley compliance programs by requiring internal reporting of the alleged misconduct, either before or simultaneously reporting the information to the various Commissions.

The Unresolved

ADD.

CCMC believes that to ensure our markets are the most competitive in the world and our system is better positioned to foresee the next crisis, the following must be **ADDED** to the financial regulatory agendas of the administration and Congress.

Proxy Advisory Firm Transparency and Reform: Ensure Transparent, Evidence-Based Standard Setting

- Hold proxy advisory firms, principally Institutional Shareholder Services and Glass Lewis, to standards that move the industry towards a more accountable, transparent, and evidence-based policymaking process while eliminating core conflicts of interest.
- Require proxy advisory firms to disclose if a client is a sponsor or supporter of a shareholder proposal when the firm is making a recommendation.

Enfranchise Retail Investors: Make it Easier Rather than Harder for Average Investors to Vote Their Shares

- Promote retail investor participation in proxy voting through examining possible interpretive guidance to give retail shareholders access to Client Directed Voting and encourage greater use of web-based communications and technology, such as enhanced broker internet platforms
- Educate retail investors on the distinction between the roles and the fiduciary responsibilities of investment advisors and broker-dealers.

Corporate Governance: Provide Investors With Decision-Useful Information

- Develop a disclosure framework to prevent information overload from multiple overlapping and sometimes contradictory reporting and disclosure requirements and standards.

Financial Reporting: Further Improve Systems to Better Serve All Users of Financial Statements

- Establish a definition of audit failure predicated upon materiality and the need to restate financial reports.
- Create a consistent global standard for accounting and auditing so investors around the globe are using the same financial reporting "language" and to ensure better investment decisions can be made.
- Require the Public Company Accounting Oversight Board (PCAOB) and Financial Accounting Standards Board (FASB) to follow the transparency requirements of the Administrative Procedures Act (APA) and Federal Advisory Committee Act (FACA) when developing standards and conduct a cost-benefit analysis of proposed standards.
- Create a financial reporting forum made up of regulators, standard-setters, investors, and businesses to proactively identify problems within the financial reporting system and suggest solutions.
- Supplement existing guidance and coordination to ensure that the SEC, FASB, and PCAOB use a common definition of materiality.

Global Regulatory Coordination: Ensure International Regulatory Efforts Do Not Produce Conflicting Regulations That Are Unworkable

- Ensure greater regulatory coordination on key areas of financial regulation, such as derivatives and systemic risk to ensure a level playing field and globally compatible approaches to regulation when appropriate.
- End efforts to apply domestic regulations extraterritorially and create mechanisms to ensure effective coordination among international regulators to resolve cross-border issues.

Private Sector Housing Financing: Allow the Private Sector to Return to the Housing Market

- Enact reform that will enable a robust and responsible return of the private sector to the broader housing finance market.

Regulatory Streamlining and Structural Reform: Improve Regulatory Process to Consolidate or Better Coordinate Regulators

- Ensure that regulators follow existing statutorily required economic analysis such as the Riegle Act.
- Extend the requirements for enhanced cost-benefit analysis under the Unfunded Mandates Reform Act and Executive Orders 13563 and 13579 to all independent agencies.
- Create systems in all financial regulatory agencies to regularly review and update existing regulations and, if necessary, sunset obsolete regulations.
- Create a post-implementation requirement for a new regulation to undergo a cost-benefit analysis two years after promulgation to assess the real-world costs and allow for a correction of unintended consequences.
- Streamline, rationalize, and consolidate regulatory structure by consolidating the SEC and CFTC and explore potential additional changes.

Restore Securitization Markets

- Address issues that continue to impede the development of liquid, efficient, and well-regulated securitization markets that are critical to efficient debt financing for businesses.

SEC Modernization: Create a World-Class 21st Century Securities Regulator

- Enhance the existing enforcement programs to ensure fair and consistent examinations and investigations that lead to more effective regulations and law enforcement.
- Develop a bold and clear plan on how to make rulemaking, supervision, inspections, and enforcement operations within SEC more effective.
- Appoint a deputy chairman to develop and implement a transformational reform plan to break down silos, develop priorities for agency action, and instill managerial accountability and discipline.
- Link increased funding and resources to timely and clear progress towards achieving a transformational reform plan.
- Put in place procedures to ensure that necessary technology improvements can be effectively incorporated in furthering the SEC's mission.

The Unfixable

Replace.

The Center for Capital Markets Competitiveness is committed to keeping the United States as the global leader in capital formation. To accomplish this goal, some recent regulatory proposals, including a handful of provisions in Dodd-Frank that undermine rather than strengthen capital formation and well-functioning markets, need to be **REPLACED** or abandoned. CCMC believes the following issues must be resolved to ensure our competitiveness.

Corporate Governance: Ensure Compliance Requirements Add Shareholder Value and Don't Discourage Companies from Accessing Public Markets

- Repeal Conflict Minerals and Resource Extraction rules that place costly burdens on American businesses while failing to achieve foreign policy objectives. Empower appropriate foreign policy apparatus to resolve international conflicts.

- Support appropriate corporate governance and executive compensation provisions and disclosures that promote long-term shareholder value and allow for reasonable risk-taking while replacing ones, such as Pay-Ratio disclosures, that provide little value to shareholders.

Financial Reporting: Mandatory Auditor Rotation Is Unworkable

- U.S. and foreign regulators have been considering mandatory audit firm rotation, which would reduce audit quality, diminish the role of audit committees, increase the incidence of undetected fraud, and raise costs. Regulators on both sides of the Atlantic should abandon this proposal.

Financial Transaction Tax: Stop Disincentives for Investment and Retirement Savings

- Oppose legislative and regulatory actions that would impose a tax on financial transactions, disproportionally hurting Main Street investors and the ability of businesses to raise capital.