Statement of the U.S. Chamber of Commerce

ON: Legislative Proposals to Improve Small Businesses' and Communities' Access to Capital

TO: House Committee on Financial Services, Subcommittee on Capital Markets, Securities and Investment

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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 Huizenga, Ranking Member Maloney and members of the Subcommittee on Capital Markets, Securities, and Investment: My name is Tom Quaadman, executive 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 invitation to testify today on behalf of the businesses that the Chamber represents.

The Chamber commends the continued work of this subcommittee and the full Financial Services Committee to modernize our nation's securities laws and to create opportunities for American households, businesses and investors. Over the last seven years, the Financial Services Committee has advanced dozens of pieces of bipartisan legislation, many of which have been enacted into law. Most notably, the Jumpstart our Business Startups ("JOBS") Act, signed by President Obama in April 2012, has successfully helped a number of business go public in addition to creating more ways for businesses to raise capital through private channels.

The 2008 financial crisis and the ad-hoc legislative and regulatory response that followed the crisis made clear that the financial regulatory system in the United States is badly out of date and in need of serious reform. Elements of our regulatory framework date as far back as the Civil War, and many agencies that were created in response to a particular historical event have struggled to meet the modern needs of an economy as dynamic as the United States. It is little wonder that instead of a strong rebound to the 2008-2009 financial crisis–which typically occurs after a severe financial downturn–our economy has meandered along between one and two percent growth over the last decade.

The time to pursue pro-growth policies is now. The historically weak recovery has left millions behind in our economy, exacerbated our national deficits and debt, and resulted in an alarmingly low number of business startups as compared to previous recoveries. While fundamental tax reform remains the Chamber's top priority to spur growth and opportunity, we believe that Congress and regulatory agencies should ultimately pull every lever possible to modernize our regulatory systems for the 21st Century.

To put our economic potential into perspective, if the economy moved from 2% to 3% annual growth, that would mean doubling gross domestic product (GDP) per capita 12 years faster (23 years vs. 35 years); it would also reduce our annual deficit by over $3 trillion over the next decade. If our economy went from 2.5% growth to 3% growth, average annual incomes would rise by $4,200 and 1.2 million jobs would be created over the next decade. That is the top-level perspective, but underlying these macro statistics is the opportunity for millions of Americans to create a better life for themselves and their families.

It is also worth noting that not only has the post-crisis recovery been historically weak, it also been remarkably uneven from a geographic standpoint. An illuminating 2016 report from the Economic Innovation Group showed that while certain pockets of the country have rebounded economically, others continue to struggle. For example, fully 50% of the net national businesses created from 2010-2014 are located across only *twenty* counties in the United States, despite these counties only representing 17% of the U.S. population. Moreover, nearly three in five counties saw more businesses close than open from 2010 to 2014. And the overall level of business creation is well below previous recovery levels: while the rebound from the recession of 2001-2002 saw 400,500 businesses created, the post-crisis number has only been 166,500.[1]

The Chamber believes that it is by no means a coincidence that these anemic economic numbers have coincided with a massive expansion of the regulatory state, particularly in the wake of the 2008 crisis. Modernization of our financial regulatory structure is sorely needed, and we appreciate this opportunity to have the voice of the Chamber's members heard in this important debate.

1. Modernizing our Financial Regulatory Structure

In September 2016, the Chamber released a reform plan entitled *Restarting the Growth Engine: A Plan to Reform America's Capital Markets* (*Restarting the Growth Engine Plan),* which has over 100 recommendations for creating a regulatory system that embraces stability and growth. The Chamber was pleased to see that the Financial CHOICE Act approved by the Financial Services Committee during the 114th Congress included a number of the recommendations in the Restarting the Growth Engine Plan, including but not limited to:

- Structural and managerial reforms to the Securities and Exchange Commission (SEC), as well as streamlining SEC enforcement authorities to ensure fair treatment and due process during the course of investigations.

- Congressional oversight of the regulatory policy functions for all financial regulators through the appropriations process.

[1] "The New Map of Economic Growth and Recovery" Economic Innovation Group, May 2016

- Recognition that several provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, including addressing arbitrary thresholds for regional and mid-size banks, capital, liquidity, and other requirements, are creating a severe drag on the economy and damaging the health of the capital markets.

- Structural and authority modifications to the Financial Stability Oversight Council (FSOC), as well as greater transparency requirements for U.S. participants in Financial Stability Board (FSB) decisions and actions, as well as the actions of other international standard setters and regulators that report to the FSB.

- Repeal of the Volcker Rule, as it has created impediments for non-financial businesses to enter the debt and equity markets. The Volcker Rule has placed market participants operating in the U.S. at a global competitive disadvantage.

- Incorporation of several bills that passed this Committee or the full House of Representatives during the 114th Congress. These bills would help foster capital formation by expanding opportunities for investors and ensuring that regulators focus on the need of small and growing businesses.

The Chamber has been especially supportive of Title X of the CHOICE Act, which would modernize securities regulation in a manner similar to the JOBS Act. We would also note that there were several recommendations in the Restarting the Growth Engine Plan that were not included in the previous version of the CHOICE Act. As the Financial Services Committee continues its important work during the 115th Congress, we look forward to collaborating with you on many of these important issues.

2. Legislative Proposals

a. Small Business Credit Availability Act (Discussion Draft)

One of the unfortunate developments in the wake of the financial crisis has been the difficulty for small and medium-sized businesses to obtain the capital and liquidity they need to grow and serve Main Street America. While large corporations often times face their own financing challenges, the obstacles that smaller firms face are particularly acute. Given the slow rate of business creation in the wake of the crisis, it is no exaggeration to say that the very survival of thousands of businesses depends on the ability of our capital market to serve them.

In 2016, the Chamber released a report, *Financing Growth: The Impact of Financial Regulation* ("Financing Growth Report") which highlighted the financing challenges faced by the middle market, and the need for businesses to have access to a variety of financing mechanisms. For example, 79% of the 300 professionals surveyed in the report have seen their business affected by changes in the financial services markets, and as a result nearly one-fifth of respondents had delayed or cancelled planned investments. And 20% of all small and midsize companies said they use four or more financial institutions to issuer commercial paper, raise debt, or access trade financing.

Business development companies ("BDCs") are a critical source of financing for small and middle market companies. BDCs offer a unique form of financing with certain attributes similar to private equity, venture capital, or hedge funds, but in a registered, highly-regulated and transparent investment vehicle. BDC lending has become increasingly popular as the credit cycle and regulatory reaction to the financial crisis have made accessing debt financing more challenging. Importantly, BDCs are actually mandated to invest 70% of their assets in small and medium-sized U.S. operating businesses.

Since their creation in the 1980's BDCs have been highly regulated entities, where oversight can occur either at the regulatory level, or indirectly through the types of financing that BDCs are able to access in order to finance their investments. BDCs also tend to provide investors with a higher yield and, because they are publicly registered, are open to non-accredited investors. In fact, there are now 93 BDCs total with over 50 publicly traded in the United States, affording ample opportunities for investors to participate in the growth of middle market companies.

Investment vehicles such as BDCs are all the more important given the above-referenced geographic unevenness of the economic recovery. While credit has tightened and business creation has languished in some parts of the country, BDCs have made sizeable investments throughout the Rust Belt and other areas that have not enjoyed a strong recovery from the 2008 crisis. For example, BDCs have made investments of $1.6 billion in Ohio, $1.06 billion in Michigan, and $1.8 billion in Tennessee.[2]

The Small Business Credit Availability Act would increase the capital available to BDCs and increase their ability to provide small and medium-sized businesses with

[2] Small Business Investor Alliance BDC Modernization Agenda for the 115th Congress

the funding they need to grow. For example, the legislation would allow for a modest increase in the use of leverage available to BDCs which would ultimately permit them to deploy more capital to portfolio companies. Additionally, the legislation would allow some BDCs to be treated as "well-known seasoned issuers" under the securities laws which would allow them to issue securities more efficiently, and reduce some of the unnecessary cost burdens that are ultimately passed on to portfolio companies or investors.

Additionally, we believe that the Small Business Credit Availability Act also strikes an appropriate balance by allowing BDCs to expand without compromising investor protection. The SEC would maintain full oversight of BDCs to ensure that transparency, efficiency, and competition remain hallmarks of the market.

The Chamber strongly supports the Small Business Credit Availability Act and urges the Committee to take up the legislation as soon as possible.

b. Expanding Investment Opportunities Act (Discussion Draft)

The Chamber also supports the Expanding Investment Opportunities Act, which would allow certain qualifying closed-end funds to be eligible for status as a well-known seasoned issuer (WKSI) and therefore subject to a host of filing and proxy requirements that would allow them to operate more efficiently. For example, by allowing certain funds to achieve WKSI status, they would be eligible to use 'short form' registration statements, as well as communications mechanisms with their shareholders that they are currently prohibited from using.

At mid-year, closed end funds held over $270 billion in assets,[3] providing an attractive investment option for investors and serving as an important liquidity provider for issuers of securities. But the SEC's rules regarding closed end funds have not kept pace with rules governing securities offerings by other public companies. Closed end funds were largely excluded from the SEC's 2005 securities offering reform initiative. This asymmetry has created an unnecessary and expensive regulatory burden for closed end funds, which must regularly petition the SEC and its staff for exemptive relief to permit such funds to engage in capital-raising activities that other public companies can do automatically without the need for special relief. We believe these additional regulatory hurdles also stifle capital formation in the closed end fund industry. CCMC supports the Expanding Investment Opportunities Act as a sensible response to this situation. We believe if enacted the bill will place

[3] https://www.ici.org/research/stats/closedend/cef_q2_17

closed end funds on even footing with other public companies and stimulate capital formation in that sector without harming investors.

c. Consumer Financial Choice and Capital Markets Protection Act of 2017

Main Street businesses rely on a variety of instruments to meet their short term financing and liquidity needs, including lines of credit from financial institutions as well as the U.S. commercial paper market. The nature of many businesses places a significant amount of importance on obtaining short term financing–without it, orders may have to be cancelled, production could ground to a halt, and inventories could run low or become depleted. The importance of vibrant, competitive, and liquid short term financing markets for Main Street businesses cannot be overstated.

Regrettably, the post-crisis onslaught of dozens of new rules designed to strengthen the health of the financial system have in many cases made it more difficult for businesses of all sizes to obtain the short-term liquidity and financing that is so vital to their long-term health. These rules have included the Volcker Rule, the liquidity coverage ratio (LCR), net stable funding ratio (NSFR), as well as a host of other Basel capital rules that have made it more difficult for banks and other financial service providers to serve business. Indeed, 76% of respondents to the Chamber's Financing Growth Report believe that "the regulations on the financial services sector will not help their companies' outlook over the next two to three years."

This is why the Chamber has long called for the financial regulators to conduct a study of all major post-crisis regulatory initiatives in order to determine the full impact of these rules not just on the health of the banking system, but on the ability of nonfinancial companies to obtain credit. Fortunately, we are beginning to see recognition on behalf of regulators that these rules have come at a significant cost. The President's executive order earlier this year regarding core principles for regulating the U.S. financial system was a welcome start, as was the Office of the Comptroller of the Currency (OCC) announcement in August that it was beginning to conduct a review regarding the impact of the Volcker Rule.

One significant post-crisis regulatory development was adoption by the SEC of new rules for money market funds that went into effect on October 14, 2016. Along with corporate treasurers and many other market participants, the Chamber expressed significant concerns during the rulemaking process that the new rules would significantly impact the ability of corporate treasurers to manage liquidity and to raise cash in the commercial paper market. Specifically, we believed that the requirement for prime money market funds to float their net asset value ("NAV") and have it reported to the nearest hundredth of a cent would significantly hamper investments in such funds and also make recordkeeping much more complicated. Additionally, the imposition of liquidity fee and redemption "gate" provisions in the rules have also created significant deterrents for institutional investors to participate in institutional prime funds, as these provisions could limit liquidity during times of market stress and create the potential for loss of principal.

As the Chamber testified at a hearing of this subcommittee last year, during the 12 months prior to the October 2016 implementation date, prime fund purchases of corporate commercial paper declined significantly, while a number of institutional prime funds have also closed during the same time period. This has created further pressure upon corporate treasurers and businesses that have historically relied upon the liquidity provided prime institutional money market funds. A recent Treasury Strategies report stated that prime money market funding for businesses dropped from $460 billion to $88 billion from 2015 to 2017. This has caused a shift to bank funding which leads to a crowding out of bank lending to smaller businesses.

As with any major regulation, the Chamber strongly believes that agencies should first identify a problem, limit unintended consequences and address a specific issue in a targeted manner. We have advocated for regulators to review regulations after a certain period of time to determine if the problem is being addressed and to identify and correct unintended consequences.

We also appreciate legislative efforts such as H.R. 2319, the Consumer Financial Choice and Capital Markets Protection Act of 2017, which highlights an issue of importance to the funding of businesses. We look forward to working with this subcommittee and H.R. 2319's co-sponsors to address these issues.

Additional Efforts to Spur Capital Formation

The Chamber believes that the Committee should look at additional ways to build upon the success of the JOBS Act and help more companies access the capital markets. While the JOBS Act was a positive step forward, in some ways it is not reaching its full potential. For example, as the Chamber pointed out in testimony earlier this year, the "Regulation A+" market (created by Title IV of the JOBS Act) has not taken off in the manner that Congress envisioned, and many deals still lack underwriters. Reg A+ offering compliance has proven to be costly relative to the amount of securities allowed under the current exemption. Congress should consider increasing the current threshold for offerings above the current $50 million threshold in order to incentivize more market participants to use this valuable exemption.

Additionally, while the JOBS Act did a great deal to ease the burdens related to the offering of securities, it did relatively little to address secondary market trading issues for small public companies. In order to create a competitive and liquid trading environment for these companies, Congress should look at creating the legal framework to allow for "venture exchanges," based on legislation from H.R. 4868 in the 114th Congress, the "Main Street Growth Act." We believe that creating venture exchanges and allowing issuers to choose where they want to list would provide a positive alternative to today's market structure that often times favors large, liquidly traded companies over smaller ones.

Looking Forward

We appreciate the work of the Capital Markets, Securities and Investment subcommittee on these important bills and issues. The Chamber is prepared to work with the subcommittee on a bi-partisan basis to achieve the reforms necessary to help American businesses and their customers. We must be success in these efforts to spur economic growth to stimulate long-term economic growth and create well-paying jobs.