



Statement of the U.S. Chamber of Commerce

ON: Examining Legislative Proposals to Modernize Business Development Companies and Expand Investment Opportunities

TO: House Committee on Financial Services, Subcommittee on Capital Markets and Government Sponsored Enterprises

BY: Tom Quaadman, Vice President of the Center for Capital Markets Competitiveness

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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 percent 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 the Chamber represents.

Before I address the subject of the hearing, I would like to thank Chairman Garrett, Ranking Member Maloney and the members of the Capital Markets and Government Sponsored Enterprises for your continued laser focus on removing obstacles that prevent businesses from accessing the capital needed to grow and create jobs. These efforts to improve the efficiency of capital markets balanced with investor protections are the necessary building blocks for the American economy to grow and compete in a global arena. This hearing is one of several that the Subcommittee has held this year on these important issues and can result in a bi-partisan package of bills that can become law. Accordingly, the Chamber is hopeful that the subcommittee can put together a JOBS Act 2.0 to help America’s small and mid-size businesses grow and for more firms to become public companies. We stand ready to work with this subcommittee to make that effort a reality.

1. Diversity and Access to Capital Needed for America to Compete in a Global Economy

Earlier this year, the Chamber released a study by Professor Anjan Thakor of Washington University entitled, [*International Financial Markets: A Diverse System Is the Key to Commerce*](#) (the “Thakor Report”).

Businesses need diverse forms of financing to support business operations provided by banking institutions, as well as non-bank market based financing. In studying this complex and growing global financial system, the Thakor Paper found the global financial system:

- Creates money and facilitates cross-border capital flows;
- Facilitates specialization and trade;
- Promotes global risk management for individuals and companies;

- Mobilizes resources, creates new resources and promotes economic growth by encouraging innovation;
- Promotes transparency by obtaining information for the evaluation of businesses and individuals leading to more efficient allocation of capital; and
- Increases the growth opportunities available to companies, entrepreneurs and individuals.

With diversity, the financial system is more efficient, more new companies are launched, the larger the number of publicly listed companies, the better overall management of risk and greater availability of consumer credit. In other words a diverse, well-developed and efficient system of capital formation is necessary for robust economic growth and increased employment.

Over the past several years we have seen our capital markets lose efficiency. At the same time, we have seen a reduction of traditional means of business financing and cash management. The Basel III Liquidity Coverage Ratio Rules, as one example, create disincentives for banks to accept business cash deposits, while reducing loans and cutting commercial lines of credit. Therefore, we are reducing the diversity needed for America to compete. Indeed, it should be noted that the European Union is exploring ways how they can expand non-bank forms of business financing.

Therefore, we need to work on how to make our capital markets efficient and stable, to provide our businesses with the ability to compete in a world where 95% of consumers live outside of our borders.

The bills before us today are an important part of the process started by the JOBS Act. With the JOBS Act, Congress helped to modernize existing regulations and establish new systems to provide the opportunities to allow Emerging Growth Companies (“EGCs”) to grow into public companies. The different bills and legislative concepts that have been the subject of the previous hearings held by the Subcommittee this year build on the foundation of the JOBS Act. The proposals before us today continue that tradition and are important as they help small and mid-size businesses continue on the path to becoming EGCs.

2. Legislative Proposals

a. Small Business Credit Availability Act

I would like to address the draft bill proposed by Mr. Mulvaney entitled the Small Business Credit Availability Act.

Over the past several years, mid-size and small businesses have had a harder time accessing capital and the liquidity needed to grow and operate. While larger businesses can afford a higher cost of capital, others have been forced to find alternative means of financing. Since 2010, we have seen a large increase in financing to businesses, primarily mid-size firms, by Business Development Corporations (“BDCs”).

BDCs are a unique form of financing, similar to private equity, venture capital or Real Estate Investment Trusts. They have become increasingly popular as the credit cycle and regulatory reaction to the financial crisis have made accessing debt financing more challenging. It is important to keep in mind that BDCs are open to retail investors and not just accredited investors. BDCs tend to have higher yields, but also greater risks than fixed-income products. Since the creation of the BDC in 1980, BDCs have been limited in their activities and have a large degree of regulatory oversight. This oversight can be direct as to BDC operations and investor protections, or indirect through the types of financing that BDCs can access to fund their activities.

In 2013, the Chamber testified in support of a number of bi-partisan bills that would have allowed for increased activities by BDCs. At the time the Chamber also called for the Securities and Exchange Commission (“SEC”) to re-examine disclosures to ensure that investors are properly aware of the risks of investing in BDCs.

The Chamber supports the Small Business Credit Availability Act as it would allow BDCs to meet the growing capital needs of businesses and addresses some of the concerns raised during the 2013 hearing and by the SEC. The Small Business Credit Availability Act will allow BDCs to increase their activities while maintaining the historic levels of regulatory oversight and investor protection.

The Small Business Credit Availability Act would increase the capital available to BDCs and their ability to provide small and mid-size businesses with the funding needed to grow. For example, some BDCs could be treated as “well known, seasoned issuers” and thus be permitted to issue securities more quickly. BDCs would be able

to use a modestly higher level of leverage, which would permit them to invest more capital to portfolio companies. BDCs would also have more flexibility in their investments.

The Chamber also believes that the trigger to ensure that regulatory action is taken in a timely manner is a creative way to give the SEC the opportunity to make the rules necessary to effectuate the legislation's intent. This will prevent an endless rulemaking cycle that may harm the benefits BDCs can provide to capital formation and investors. Therefore, we can avoid a re-run of the seemingly endless JOBS Act Regulation A implementation. The Small Business Credit Availability Act also gives the SEC rulemaking authority to craft disclosures of conflicts of interests and other rulemakings to promote investor protections.

Accordingly, we believe that the Small Business Credit Availability Act strikes the appropriate balance by:

- Giving BDCs the ability to become bigger market participants;
- Giving businesses new alternative means to raise capital;
- Giving the SEC the ability to oversee BDC activities to ensure certainty, efficiency and competition; and
- Providing the SEC with the ability to enhance investor protection and increase investor opportunity.

The Chamber supports the Small Business Credit Availability Act and hopes this hearing can be the first step towards it being enacted into law.

b. H.R. 2187 Fair Investment Opportunities for Professional Experts Act

The Chamber also appreciates the opportunity to testify on H.R. 2187, the Fair Investment Opportunities for Professional Experts Act.

Ensuring investors have the right to access suitable investment vehicles is critical for markets to operate efficiently. This 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 and these are objective standards that have served well in determining who should be allowed the designation of accredited investors.

The Chamber believes that Mr. Schweikert has also identified an important issue, namely that one may not meet these objective tests but could still fit the criteria of a sophisticated investor. Such a person, in limited circumstances, could be considered an accredited investor. If that issue is addressed appropriately, more investors can access markets and the potential for capital formation for businesses can be expanded.

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 to be an accredited investor. This is also an objective test that could be easily codified. One option is to cap the level of investments such a person could make in complex instruments. This will allow individuals to become accredited investors concurrent with their actual financial ability to withstand losses.

While we understand the intent behind the creation of a test to determine the level of knowledge for an individual to be considered an accredited investor, we believe that it is important first to understand the characteristics and sophistication of what an accredited investor should be. This can give a better understanding of the requisite characteristics before authorizing a test. We believe that the bill should be amended to direct the SEC to study the issues and the necessary makeup of accredited investors and determine what innovative ways may be used to reasonably reassess these definitions and apply them in limited circumstances.

The Chamber is also concerned with section of the bill that allows the use of a financial intermediary to convey accredited investor status upon a natural person. It is important to remember that the accredited investor definition is used to create limits on activities to prevent unnecessary investor harm. This allows complex investments to be marketed and sold in manners appropriate to the sophistication and wherewithal of investors. This boosts capital formation by expanding the pool of investments that

are well regulated and have certainty. This section of the bill may place an unsophisticated investor at risk while creating liability for financial intermediaries.

Again we believe that the Fair Investment Opportunities for Professional Experts Act is an innovative way to take a look at accredited investor definitions and responsibly expand them in a limited manner to bring more sophisticated investors into the marketplace. However, we believe that the changes we have suggested are necessary to prevent unsophisticated investors from being involved with products they don't understand. Also, our suggestions would allow the SEC to determine the right path forward and who should be eligible for a limited expansion of an accredited investor definition.

Without this adherence to investor protection, the capital markets may be harmed and the legislation not meet its true intent. We stand ready to work with Mr. Schweikert and the Subcommittee on this innovative bill to achieve a balance between the needs of potential sophisticated investors and investor protection.

3. Conclusion

The Chamber views these bills, along with our proposed improvements, as important steps to provide the diverse capital structure our free enterprise system needs and to allow for the dynamic changes the market place demands in order to provide the life blood necessary for entrepreneurs to start a business and for small and mid-size businesses to grow into larger ones. This has been the formula for success that has allowed the United States economy to grow at unprecedented levels throughout its history. These proposals are also needed for America to compete in a global economy. We believe that it is important for the Small Business Credit Availability Act and a modified form of the Fair Investment Opportunities for Professional Experts Act to be included in a JOBS Act 2.0 to provide American businesses with the capacity to access the resources needed to compete, thrive and create jobs.

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