Statement of the U.S. Chamber of Commerce

ON: Capital Formation and Reducing Small Business Burdens

TO: Senate Subcommittee on Securities, Insurance, and Investments

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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.

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Chairman Crapo, Ranking Member Warner and members of the Securities, Insurance and Investments 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.

I. Need for Diverse Forms of Capital in a Free Enterprise System

In 2011, the Chamber released a study by Professor Anjan Thakor of Washington University entitled, ***Sources of Capital and Economic Growth: Interconnected and Diverse Markets Driving U.S. Competitiveness*** ("Thakor Study").[1] The Thakor Study found that a key factor for small business success and resulting growth and job creation is their ability to access capital. The Thakor Study had five key conclusions:

1. A robust, efficient and diverse financial system facilitates economic growth;

2. In terms of their financing choices individual entrepreneurs are largely limited to debt financing for raising capital;

3. As businesses grow they can access both debt and equity financing and the mix of these two, called the "capital structure" decision, is an important choice every business makes;

4. A rich diversity of financing sources is provided by the U.S. financial system; and

5. The U.S. financial system is highly connected and what happens to one financing source causes spillover effects in other parts of the system. So for example, if excessive regulation restricts access to, or the operation of, the IPO

[1] The Thakor Study can be accessed at: http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/sourcesofcapital_report1103.pdf

and secondary markets for publicly traded companies, the resulting loss of liquidity will act as a disincentive to private equity and venture capital activity as well.

Therefore, the more efficient and diverse capital markets are , the more new companies are launched, the larger the number of publicly listed companies, the better overall management of risk, greater availability of consumer credit and more people that have well-paying jobs. 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 with a resulting decline in the number of businesses becoming public companies, as well as a sharp drop in the number of public companies overall. Many reasons exist for these outcomes—the financial crisis, stale regulatory systems that fail to keep up with the needs of a 21st century economy and legislative and regulatory initiatives that are changing fundamental practices that have been in place for decades.

What has not changed is the need for new businesses and growing businesses to acquire capital. However, if those capital needs are not met, the next big idea or next successful business will simply wither on the vine and blow away with the wind.

We had 14 straight years of a decline in the number of public companies in the United States. Last year was the first year since the tech bubble burst that a resurgent IPO market allowed the number of public companies in the United States to grow. The Jumpstart Our Business Startups Act ("JOBS Act") was an important factor in that turn around. But more needs to be done as our economy is not hitting its long-term growth potential. The Chamber welcomes this hearing and supports the bi-partisan effort to take the next step and remove some of the roadblocks that are inhibiting growth by America's Main Street businesses.

II. Legislative Proposals

1. Regulation A Bill HR 701 Setting Rulemaking Deadline

The modernization of Regulation A ("Reg. A") has the potential to be a real game changer for businesses that wish to seek public financing but may not be prepared to bear the full costs of an initial public offering. The current $5 million cap for Reg. A offerings—originally set in 1992—has proven to be too low to elicit serious consideration from companies. In fact, as the Securities and Exchange Commission ("SEC") pointed out in its proposal to implement Title IV of the JOBS

Act, from 2009 through 2012, there were only 19 qualified Reg. A offerings, for a total offering amount of $73 million.[2]

Moreover, the complexity and inconsistencies between various state registration requirements has proven to be a major impediment to Reg. A offerings. This was one of the central findings from a Government Accountability Office report in 2012 and has been a consistent message coming from small businesses looking to gain access to public markets.[3]

The Chamber understands that a coalition of state securities regulators has proposed a multi-state "coordinated review program" intended to streamline state registration under Reg. A by completing registration reviews within 21 days. While this initiative is commendable, we are concerned that reliance upon an untested and unproven review program will only add complexities and further delay any kind of widespread utilization of Reg. A. As a general matter, we have also found through experience that, despite the best of intentions, achieving the concurrence of multiple regulators within 21 days is just not a reasonable expectation. The SEC's Reg. A proposal also included a number of important disclosure and investor protection provisions which makes registration in multiple states unnecessary and unduly burdensome.

Indeed, as Reg. A offerings open the pathway for businesses to access capital markets that are national in nature we believe that deference should be given to the SEC. However, the SEC has failed to act and we think that it is important for Congress to set a policy goal and prevent a needed modernization from dying a bureaucratic death.

We believe that the SEC should act swiftly to finalize its Reg A rulemaking, and should maintain its proposed definition of a "qualified purchaser" for Tier 2 offerings under the proposal, which would effectively preempt state registration requirements while maintaining the states' ability to enforce against wrongdoing.

H.R. 701 passed the House of Representatives during the 113th Congress by a vote of 416-6. The Chamber strongly supports the 114th Congress taking up a similar bipartisan measure.

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2 See SEC Release Nos. 33-9497; 34-71120; 3902493; File No. S7-11-13 found at: http://www.sec.gov/rules/proposed/2013/33-9497.pdf

3 GAO report can be found at: http://www.gao.gov/assets/600/592113.pdf

2. **Swaps Data Repository and Clearinghouse Indemnification Act (H.R. 742)**

The Chamber is also supportive of language that would help to further harmonize swaps data and reporting rules across jurisdictions by removing an unworkable requirement from the Commodity Exchange Act (CEA). The provision requires foreign regulators that seek to obtain access to U.S. swap data repositories to agree to indemnify swap data repositories, the Commodity Futures Trading Commission ("CFTC") and the SEC for expenses that arise from litigation relating to the information from the U.S. swap data repositories.

This creates a significant barrier to global data harmonization, as foreign jurisdictions are unwilling to agree to the indemnification or have laws or regulations that would prevent them from agreeing to such an indemnification. Accordingly, this legislative correction is crucial for global regulatory harmonization and information sharing and could also reduce complexity and costs for U.S. companies that operate abroad, while still requiring that regulators meet specified confidentiality requirements for such data.

We support the bipartisan language from H.R. 742, the Swap Data Repository and Clearinghouse Indemnification Correction act of 2013, which the House of Representatives passed in the 113th Congress by a vote of 420-2.

3. **Holding Company Registration Threshold Equalization Act (S.972/H.R. 801**

This legislation fixes what could best be described as an oversight regarding Title VI of the JOBS Act. Title VI included a provision modernize the 12(g) shareholder thresholds, which require companies to go public once they hit a certain number of shareholders. For banks, the new registration requirement is set at 2,000 shareholders, while they would be allow to "de-register" if they cross below 1,200 shareholders.

Regrettably, despite the clear intent of Congress, the SEC did not interpret the law so as to allow savings and loan holding companies to take advantage of the new thresholds. Savings and loans perform nearly identical functions as do a bank and, since the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), are overseen by the same regulators. While there may have been historical reasons for a lending institution to structure itself as a savings and loan as opposed to a bank, today there is essentially no difference between the operations or regulatory oversight between the two.

In December 2014, the SEC did propose extending the new 12(g) thresholds to savings and loans, however a rule in this area is not final and savings and loans do not have the same statutory protection under this provision that banks do. H.R. 801 passed the House of Representatives during the 113th Congress by a vote of 417-4. The Chamber fully supports a permanent fix to this oversight from Congress that will ensure Congressional intent is carried out.

4. **Small Business Mergers, Acquisitions, Sales and Brokerage Simplification Act (S.1923/H.R. 2274)**

This bill would allow mergers and acquisitions ("M&A") brokers to electronically register with the SEC and not be subject to the full requirements for registration imposed upon a full-service broker, provided that such M&A brokers limit their activities to transactions involving an "eligible privately held company."

This legislation would simplify registration requirements for such M&A brokers, but also includes a number of important safeguards that provide for investor protection and orderly markets. For example, the bill would require disclosure of relevant information to clients and to the owner of an eligible privately held company who is offered a stock for stock transfer, and would not exempt M&A brokers from the existing prohibitions designed to block securities law violators from entering the business.

H.R. 2274 passed the House of Representatives during the 113th Congress by a vote of 422-0. The Chamber strongly supports the 114th Congress acting on this bipartisan measure.

5. **Improving Access to Capital for Emerging Growth Companies Act (H.R. 3623)**

This legislation would build upon the success of the JOBS Act by providing emerging growth companies (EGC's) with expanded opportunities to raise capital. The bill would facilitate follow-on offerings made by EGC's and also allow business to maintain their EGC status for a period of time following their initial registration with the SEC. It would also reduce the number of days that a business must wait until after its registration to commence a "road show", which would increase the likelihood of a successful IPO launch.

The Chamber supports each of these innovative provisions and appreciates the Committee's interest in exploring more ways for EGC's to access the capital markets.

As multiple studies have shown, job creation expands significantly once a company goes public. While the number of companies now going public is still below the level seen in the mid-1990's, last year saw the largest number of IPO's since 2000. This is a positive trend that was driven in no small part by the JOBS Act, and we urge Congress to continue focusing on ways to make the public markets more attractive for growing companies.

6. **The SBIC Advisors Relief Act (S.2765/H.R.4200)**

This legislation would correct an unintended yet harmful consequence of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") that triggers registration under the Investment Advisers Act of 1940 ("Advisers Act") for advisers to small business investment companies (SBICs) and venture capital funds. Congress has explicitly provided an exemption under the Advisers Act for individuals for advice either an SBIC or a venture capital fund. However, advisers who happen to advise *both* an SBIC and venture capital fund are currently being required to register under the Advisers Act.

Congress exempted SBIC and venture capital fund advisers for good reason, and there is simply no valid argument for requiring someone to register simply because they advise both. SBIC's and venture capital funds are a vital source of capital in our economy, and unnecessary regulatory requirements inhibit their ability to invest in American businesses. This bill would codify Congressional intent and allow SBIC's and venture capital funds to continue to play their important role in our economy.

The Chamber also supports a provision this legislation that would avoid unnecessary regulatory duplication at the state level, as well as a provision that would exclude SBIC assets from the calculation to determine whether someone who advises a private equity fund should have to register with the SEC. These are common sense measures will address issues that can be harmful to small businesses, which often times do not have vast resources to deal with legal complexities.

7. **The Disclosure Modernization and Simplification Act (H.R. 4569)**

In the eight decades since the securities laws were enacted, public company disclosure requirements have increasingly expanded and more complex, as evidenced by the voluminous annual and quarterly reports filed today. A2012 report by Ernst &

Young estimated that the average number of pages in annual reports devoted to footnotes and Management's Discussion and Analysis (MD&A) has quadrupled over the last 20 years. Should this trend continue, companies would be devoting roughly 500 pages to MD&A by the year 2032.[4]

This expansion and increased complexity of disclosure has contributed to the phenomenon of "disclosure overload", whereby investors are so inundated with information it becomes difficult for them to determine the most salient factors they need to make informed voting and investment decisions. Retail investors are particularly vulnerable, as they typically don't have an army of analysts or lawyers to pore through SEC filings of the companies they invest in. In fact, it is the number one reason why retail shareholder participation has dropped to levels as low as 5%. Effectively, because of this "overload" retail shareholders have become disenfranchised.

And retail shareholders aren't alone. A recent study by Professor David Larcker found that 55% of institutional investors surveyed[5] felt the proxy was too long and 48% believe the proxy is too difficult to read and understand.

The Chamber has welcomed the efforts by SEC Chair White and SEC Corporation Finance Director Keith Higgins to start a project to address these long outstanding issues. Last year the Chamber released a report proposing several disclosures that are obsolete that should be removed or modified.[6] However, we are concerned that the SEC project is being delayed by inertia.

The Disclosure Modernization and Simplification Act would address this issue by requiring the SEC to eliminate any outdated, duplicative, or unnecessary and to further scale disclosure requirements for EGC's and other small issuers. We fully support this approach, as it would focus the SEC on some of the more noncontroversial items that could be addressed and ensure that our disclosure systems are modernized.

8. Encouraging Employee Ownership Act (S.576)

[4] Ernst & Young report can be found at: http://www.ey.com/Publication/vwLUAssets/ToThePoint_BB2367_DisclosureOverload_21June2012/$FILE/ToThePoint_BB2367_DisclosureOverload_21June2012.pdf

[5] The investors surveyed had a total of $17 trillion under management. The study can be found at: http://www.gsb.stanford.edu/faculty-research/publications/2015-investor-survey-deconstructing-proxy-statements-what-matters.

[6] The study on Corporate Disclosure Effectiveness can be found at: http://www.centerforcapitalmarkets.com/wp-content/uploads/2014/07/CCMC_Disclosure_Reform_Final_7-28-20141.pdf.

In 1988, the SEC adopted Rule 701, which gives private companies the opportunity to sell securities to employees under certain compensatory benefit or compensation plans without having to incur the costs of SEC registration. This exemption allows private businesses to offer compensation plans that help incentivize and retain personnel, while employees are given an opportunity to participate in the success of their employer via an ownership stake.

The 1988 rule adopted a threshold level of $5 million for Rule 701 securities sales, above which mandated disclosures are required that treat employee sales more like public offerings. Such disclosure of confidential financial information to the public could have deleterious consequences and raise the costs of such offerings for private companies. Moreover, the current threshold —now nearly three decades old—does not account for the JOBS Act's 12(g) exemption. Modernizing the rule would therefore help the 12(g) provisions included in the JOBS Act to reach their full potential.

Importantly, S. 576 also includes a provision that would index Rule 701 for inflation once the new threshold is enacted. The Chamber strongly supports this provision as it would help Rule 701 keep continuous pace with the growth and size of the American economy, and mitigate the chances that the exemption again becomes outdated in the future.

Modernizing Rule 701 will produce benefits for American private businesses as well as workers who will have increased opportunity to build wealth by investing in the companies that they work for.

9. Treatment of Affiliates of Non-Financial Firms that use a Central Treasury Unit

The Chamber supports legislation that would prevent swaps executed by a centralized treasury unit ("CTU") of a commercial end-user from being subject to clearing requirements for market-facing swaps. Specifically, we support the language of H.R. 1317, a Moore-Stivers-Gibson-Fudge bill whose predecessor passed the House of Representatives by voice vote in the 113th Congress with no member speaking against or expressing opposition to the bill. Without this critical bipartisan language, end-users and consumers would face increased costs and companies may be forced to abandon proven and efficient methods for managing their risks through CTUs. This language would not assist financial companies and would not apply to speculative trades.

Many nonfinancial end-users utilize CTUs as a risk-reducing, best practice to centralize and net the hedging needs of their non-financial affiliates. Section 723 of the Dodd-Frank Act makes the end-user clearing exception available only to those separate CTUs that "act[] on behalf of the [affiliate] and as an agent." However, most end-user CTUs act in a "principal" capacity in order to net exposures and consolidate hedging expertise and would not be eligible for the relief provided in Section 723.

While the Commodity Futures Trading Commission staff has issued no-action relief allowing some end-user CTUs to use the clearing exemption, the relief does not correct the problematic language in the Dodd-Frank Act. Staff no-action relief does not provide the certainty that corporate treasurers need to plan, as it can be removed or modified by the staff at any time. Further, the existing language in Section 723, which is referenced in regulatory proposals on margin for uncleared swaps, puts corporate boards in the difficult position of approving the decision not to clear swaps despite the inapplicability of the statutory exemption.

III. Need for Action

It should be remembered these bills are necessary because the SEC has been slow or unwilling 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 fester and American competiveness will fall even further behind.

If these bills are not passed and if the JOBS Act is not fully implemented economic growth and job creation will continue to underperform and stagnate for years to come. The problem that has existed before, during and after the financial crisis is that our securities regulations reflect a pre-World War II economy at worst or the stagflation economy of the mid-1970's at best.

In other words our current regulatory apparatus for capital formation is at least two to four generations removed from the realities of today's economy and wholly unprepared for the competitive demands for the next decade.

The bills today are geared towards increasing IPOs and early stage financing, but more should also be done to address the precipitous and relentless decline of the number of public companies in the United States. The SEC must undertake a review and action to address policies and regulations that are obsolete in a 21st century economy. As we have seen with the JOBS Act and with the proposed legislation that is the subject of today's hearing, Congress sometimes has to direct the SEC to take action that it may not want to do, but that it should do.

IV. Conclusion

The Chamber views these bills as important blocks building on the foundation of the JOBS Act. This package of legislation will help our economy reach its full growth potential allowing businesses to grow and create jobs. But these bills can do more than that, they can also push the regulators to be more forward leaning and proactive in keeping up with the dynamics needed to create and sustained an atmosphere conducive for growth. This formula will allow entrepreneurs to take the reasonable risks to start new businesses forged on the anvil of innovation. This will 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.