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LEGISLATIVE PROPOSALS TO ENHANCE CAPITAL FORMATION FOR SMALL AND EMERGING GROWTH COMPANIES

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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CONTENTS

	Page
Hearing held on:	
April 9, 2014	1
Appendix:	
April 9, 2014	41

WITNESSES

WEDNESDAY, APRIL 9, 2014

Burton, David R., Senior Fellow in Economic Policy, The Heritage Foundation	9
Coffee, John C., Jr., Adolf A. Berle Professor of Law, Columbia University Law School, and Director of the Center on Corporate Governance, Columbia University Law School	11
Hahn, Brian, Chief Financial Officer, GlycoMimetics, Inc., on behalf of the Biotechnology Industry Organization (BIO)	13
Quaadman, Tom, Vice President, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce	15

APPENDIX

Prepared statements:	
Burton, David R.	42
Coffee, John C., Jr.	58
Hahn, Brian	72
Quaadman, Tom	79

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Fitzpatrick, Hon. Michael:	
Written responses to questions submitted to Brian Hahn	97
Luetkemeyer, Hon. Blaine:	
Law360 article entitled, "SBIC Relief Act Will Be Good For Advisers—And Business," dated April 7, 2014	101
Written statement of the Small Business Investor Alliance (SBIA)	104
Article from The Wall Street Journal entitled, "Dodd-Frank Interfering With Small Business Investment," dated April 9, 2014	107
Wagner, Hon. Ann:	
Written statement of Protea Bioscienes Group, Inc.	109
Written statement of Richardson Patel LLP, dated April 4, 2014	111

LEGISLATIVE PROPOSALS TO ENHANCE CAPITAL FORMATION FOR SMALL AND EMERGING GROWTH COMPANIES

Wednesday, April 9, 2014

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS AND
GOVERNMENT SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:02 a.m., in room 2128, Rayburn House Office Building, Hon. Scott Garrett [chairman of the subcommittee] presiding.

Members present: Representatives Garrett, Hurt, Neugebauer, Huizenga, Stivers, Fincher, Mulvaney, Hultgren, Wagner; Maloney, Sherman, Lynch, Scott, Himes, Peters, Foster, and Kildee.

Ex officio present: Representative Hensarling.

Also present: Representatives Luetkemeyer and Fitzpatrick.

Chairman GARRETT. Good morning. Today's Subcommittee on Capital Markets and Government Sponsored Enterprises hearing entitled, "Legislative Proposals to Enhance Capital Formation for Small and Emerging Growth Companies," is hereby called to order.

We thank the panel for being with us for this important hearing. And, as we always do, we will start with our opening statements, and then look to the panel, so you can sit back and relax for a few more minutes, and listen to the words of wisdom from up here. I now yield myself 4 minutes for an opening statement.

Today's hearing will examine a variety of legislative proposals to enhance capital formation for small and emerging growth companies (EGCs). I want to thank all of our Members today, especially those who are sponsors of the legislation that will be coming before the subcommittee.

The United States has the most fair, most efficient, and the deepest capital markets in the world. Now, the primary function of this market is to what? To help facilitate the appropriate flow of capital from investors to companies that need funds to create jobs and to grow their businesses. Today, America's startups and small businesses continue to encounter difficulties accessing U.S. capital markets to finance their operation. Moreover, the costs to these companies of going and staying public remains unacceptably high.

In an effort to continue to help small businesses raise much-needed capital, we have the legislative package that is before us today. These measures seek to help companies raise capital, and comply with regulations in three specific areas: first, some of the

bills help small businesses go public, so we call them pre-IPO; second, some of the bills help small businesses be more competitive after they have gone public, so we call them post-IPO; and third, some of the bills help small businesses attract more investment in the private market, so we call them no-IPO.

By focusing on the pre-IPO, the post-IPO, and the no-IPO markets, these legislative proposals span the main areas where companies raise capital from investors. These proposals hope to strike a delicate balance of lowering the overly burdensome cost of capital for some companies, while retaining the important safeguard for the investors. Specifically, this package includes a number of other reforms to the securities laws that will make it easier for small companies to attract much-needed capital.

First, the post-IPO. The gentleman from Pennsylvania, Mr. Fitzpatrick—I think he is here—has introduced H.R. 2629, the Fostering Innovation Act. It broadens the number of companies that can qualify under SEC rules as nonaccelerated filers, which are subject to certain exemptions under the securities laws and under the Sarbanes-Oxley Act (SOX).

Second, the gentleman from Illinois, Mr. Hultgren, has circulated a discussion draft to enhance utility of SEC Rule 701, which exempts the SEC from registration of certain securities offerings by companies to its employees as part of a written compensation agreement.

Third, the gentleman from Missouri, Mr. Luetkemeyer—who will be back later on—has introduced H.R. 4200, the SBIC Advisers Relief Act, to include small business investment companies in the class of venture capital funds and private funds that are exempt from SEC registration.

Fourth, we have the gentleman from California—who will be joining us later—Mr. McCarthy. He has circulated a discussion draft to broaden the number of companies that can qualify as well-known seasoned issuers (WKSIs). This is a class of issuers created by the SEC, which are able to take advantage of certain regulatory benefits.

Fifth, we have the gentlemen from South Carolina, Mr. Mulvaney. He has circulated a discussion draft to enhance the liquidity of restricted securities sold to the public in other qualified institutions through SEC Rules 144 and 144A, respectively.

Sixth, the gentlelady who is making the last bit of introductions this morning, the gentlelady from Missouri, Mrs. Wagner, has circulated a discussion draft of the Small Business Freedom to Grow Act, and that would do what? It would reduce the burdens on smaller reporting companies seeking to register securities offerings with the SEC.

And, finally, me. I have circulated a discussion draft of the Disclosure Modernization and Simplification Act. What would it do? It would direct the SEC to tailor regulations, S-K disclosures rules as they apply to emerging growth companies and smaller issuers to eliminate other duplicative, outdated, and/or unnecessary disclosure rules.

So, in all this it is important to remember that capital formation and investor protection is not an either/or proposition. When inves-

tors have additional investment options to earn a return, and invest their money, that additional choice is significant protection.

Again, I want to thank all the Members for their hard work on these important pieces of legislation, and I again urge our colleagues in the Senate, who have so far completely ignored the important capital formation efforts that have been done in a bipartisan manner here in the House, to quickly consider these measures in the interest of small business, and the interest of investors, and of hard-working Americans across the country. And I look forward to the testimony of all of our witnesses today.

With that, I yield back, and at this point I yield to the ranking member of the subcommittee, the gentlelady from New York, Mrs. Maloney, for 5 minutes.

Mrs. MALONEY. I thank the chairman for holding this hearing. The U.S. capital markets are the envy of the world. They offer investors liquidity, transparency, and flexibility, and they offer companies access to capital in the form of a deep pool of investors who stand by and are willing to invest in promising businesses. While the ecosystem of financial regulations in the United States is complex, the central tension underlying the entire system is simple: investors want as much information as possible on the companies they are investing in, as quickly and as accurately as possible.

The issuing companies, on the other hand, want to keep as much information as possible about their business practices confidential. Companies also want to spend as little time as possible preparing the disclosures that their investors crave. It is the job of public policy to strike the right balance between these two competing desires. Whether public policy should favor the investors or the issuers often depends on the specific situation. Sometimes, more disclosure is appropriate. Other times, the burden on the company of the additional disclosure outweighs the benefits.

I am concerned, however, that we are in danger of tipping the scales too far in favor of the issuing companies, and away from the investors. No one disputes that preparing audited financial statements is a time-consuming, labor-intensive process. But that by itself does not mean that preparing audited financial statements is overly "burdensome." So, I think it is important to remember that reducing "burdens" for public companies can sometimes come at the expense of investors, the very investors we need to keep our capital markets strong and competitive. We would do well to remember that it is, after all, the investors' money that is on the line.

Of course, there are situations where the benefits of reducing the burdens on issuing companies outweigh the costs to investors, and in those situations I would wholeheartedly support eliminating those burdens. But, we need to engage in a careful, balancing test with all of the bills that we are considering today. And I have always said that our markets run more on trust than on capital, and really these regulations are there to build the trust of the American people so they continue investing, and I would say the world, in our capital markets, which are the strongest in the world.

One of the bills, which I am pleased to co-sponsor along with Mr. Luetkemeyer, easily passes that test, in my view. H.R. 4200, the SBIC Advisers Relief Act fixes an unintended consequence of the Dodd-Frank Act. Under Dodd-Frank, an investment adviser that

only advises a venture capital fund is exempt from SEC regulation. Similarly, an investment adviser that only advises small business investment companies (SBICs) is also exempt, but an investment adviser that advises both a venture capital fund and an SBIC is, for some reason, not exempt.

This makes little sense and it provides no additional protections to investors. And it encourages sophisticated investment advisers who have experience advising successful venture capital funds from bringing that expertise to small business investment companies, which restricts small businesses access to sophisticated investment advice. Our bill fixes this problem by clarifying that investment advisers that advise both venture funds and SBICs are also exempt from SEC registration.

I look forward to hearing from all of our distinguished witnesses today, and I would note that one, Professor Coffee, is from the great City of New York. He has testified before Congress at least 25 times. That may be close to a record. We are very happy to see him. He also is from New Jersey, so he is from both, and we welcome him. Columbia is one of the great universities in the district and city that I am privileged to represent. So welcome, Professor Coffee, and everyone else.

Chairman GARRETT. Thank you, and I share the gentlelady's comment: At the end of the day, it is the investors' money that is on the line. I think that is a good takeaway from however we address these points. It is a very good point.

I now yield 2 minutes to the vice chairman of the subcommittee, Mr. Hurt.

Mr. HURT. Thank you, Mr. Chairman. I want to thank you for holding today's hearing on the legislative proposals to further enhance capital formation. I thank all of the witnesses for being here as well.

This subcommittee's work on the issue of capital access for small and emerging growth companies has resulted in the bipartisan passage of numerous bills in the full Financial Services Committee and in the House. I look forward to their enactment so we can continue to expand upon the successes of the Jobs Act that we have witnessed over the last 2 years.

Even with those successes, I continue to hear from companies—both public and private—in my district about the impacts of outdated and burdensome regulations on their ability to access capital. As our markets and the needs of participants continue to evolve, it is necessary for our regulatory structure to reflect those new realities.

Today, I especially look forward to testimony from our witnesses regarding Chairman Garrett's Disclosure Modernization and Simplification Act, and reforming our corporate disclosure regime. I am encouraged by the comments of a majority of the Commissioners at the SEC, including Chair Mary Jo White, about the need for the SEC to engage in a comprehensive review of our disclosure requirements. They have noted that disclosure overload is having negative impacts on investors, public companies, and the SEC itself.

Fostering capital formation in our capital markets requires consistently reliable information on public companies, however, too much information, for the sake of information itself, can create in-

efficiencies and confusion, especially among investors unable to make informed decisions. Streamlining our disclosure regime to better reflect the SEC's three missions will lead to benefits for both businesses and investors.

I appreciate this committee's continued focus on ensuring that our small businesses and startups have the ability to access the necessary capital in order to innovate, expand, and create the jobs our local communities need. I look forward to the testimony of our witnesses and thank you, again, for your appearance before this subcommittee. Thank you, Mr. Chairman, I yield back the balance of my time.

Chairman GARRETT. Thank you. At this point, I yield 2 minutes to Mr. Peters.

Mr. PETERS. Thank you, Mr. Chairman, and thank you to our witnesses for being here today. During my time in Congress, my top priority has been ensuring that small businesses have the tools they need to grow, especially access to capital. I appreciate the efforts of my colleagues who have put forward the bills that we will be discussing today, and I hope that our witnesses will help us balance the potential improvements in capital formation that these proposed changes would yield against any decrease in the quality or the availability of information investors need to make decisions about where to invest.

Michigan, my home State, has some of the fastest growing venture capital communities in the Nation. Both Detroit and Grand Rapids have become hubs of innovation with flourishing start-up communities. I look forward to our witnesses' discussion of how H.R. 4200, the SBIC Advisers Relief Act, introduced by my colleague, Representative Luetkemeyer, addresses the interactions between venture capital advisers and small business investment company advisers.

I hope our witnesses will touch on how this legislation could improve advice available to small businesses and fast-growing startups, and whether any potential conflicts could arise from these proposed changes. Thank you, and I yield back my time.

Chairman GARRETT. The gentleman yields back. Thank you very much. Mrs. Wagner for 2 minutes.

Mrs. WAGNER. Thank you, Mr. Chairman, and thank you for this hearing. I appreciate you all being here today. Small businesses are the primary engine of job growth in America. The tightening of credit, as a result of the financial crisis and Dodd-Frank reforms, has made access to capital in the public securities all the more important. Yet, even in one of the strongest stock markets in years, small companies struggle to raise money because of overburdensome regulation.

Today, we will discuss a number of proposed bills, including my bill, the Small Business Freedom to Grow Act of 2013, which is based on recommendations by the SEC Government-Business Forum on Small Business Capital, which included participants such as Staples, from St. Louis in my home State of Missouri, and also another great Missouri company, CrowdIt, LLC.

My bill would allow smaller reporting companies to access the public securities markets more efficiently, by allowing them to use the shorter form of registration, form S-3, thus reducing costly com-

pliance. The SEC said that the proposed expansion of Form S-3 should not adversely impact investors. In addition, my bill would allow smaller reporting firms, who have registered using an S-1 form, to use forward incorporation to automatically update their registration statement. According to the SEC, this change would allow companies to avoid additional delays in the offering process, and could reduce or even eliminate costs associated with filing amendments to the registration statement.

Lastly, my bill would preempt all securities issued by smaller reporting companies, and emerging growth companies, lessening the burden of having to comply with 50 different sets of States' securities laws that require considerable compliance costs. These smart reforms are an important follow-up to the Jobs Act, and will improve the environment for small business capital formation, consistent with other public policy goals, including investor protection. I thank you, and I yield back.

Chairman GARRETT. I thank the gentlelady. We now yield 2 minutes to Mr. Lynch.

Mr. LYNCH. Thank you, Mr. Chairman. I thank the ranking member, and I thank the witnesses for offering their assistance with the subcommittee's work. Mr. Chairman, I just wanted to give you a heads up, well, I would ask unanimous consent within the next 48 hours to submit a letter to the chairman, but I would like to circulate it to the Members on both sides of the aisle here, regarding our ability to hold a hearing on high frequency trading, and especially how that high frequency trading operates within dock pools.

As you know, there has been considerable concern in the last week or so about whether or not high frequency trading has rigged the system. So, just to let you know that letter is coming, and I appreciate any consideration you might give to that. I would also like to thank the witnesses here today.

Today's hearing has seven bills that are intended to reduce barriers to capital formation for businesses. Unfortunately, I am concerned that the bills before the committee do not fully strike the right balance and may do serious damage to investor protection. It is important to remember that the SEC rules that these bills seek to roll back serve important investor protection purposes that could be thwarted by restricting or repealing those rules.

What we are talking about here is a zero-sum game. Reducing regulatory requirements for businesses seeking to access the capital markets generally means that investors will have less information on which to base investment decisions. Less information also increases the likelihood of securities fraud and abuse. We have to be careful to strike the right balance between the burden on issuers and the need to protect investors.

I am concerned that the subcommittee is moving too quickly to reduce so-called burdens without fully understanding the effect of these reductions and what effect they have on the burdens on investor protections. I am particularly troubled that several of the bills before the subcommittee today completely exempt securities from State registration requirements. A blanket State law preemption is something that this Congress has rejected over and over,

and yet these provisions continue to find their way into legislation before this committee.

Last Congress, we passed the Jobs Act, which significantly reduced limitations on capital formation for all companies. I agree with the testimony of Professor Coffee that this committee seems to be rushing from the first Jobs Act to kind of a "Jobs Act II," without fully understanding the consequences of the first law. Reducing unnecessary burdens is good, and where we can make the securities law simpler and easier to comply with, I think we should. But we should not do so regardless of the cost. I look forward to hearing from the witnesses about whether these bills before us today strike the right balance. I thank you for your indulgence, Mr. Chairman, and I yield back.

Chairman GARRETT. The gentleman yields back, and I thank the gentleman for his recommendation with regard to having hearings on this very important topic. I do wish to remind the gentleman that actually over the last 2 years, we have had 3 hearings and events so far. The gentlelady from New York and I had a field event, to which the gentleman was invited. We have had two other hearings, the last of which was about a month ago. I know the gentleman was obviously invited to all three of these things.

Mr. LYNCH. We have gotten a lot of new information in the last couple of weeks, though.

Chairman GARRETT. Right. So, the gentleman was at the last one, which was just shy of a month ago, and we will continue to have hearings on this topic. And, as the gentleman knows from the hearings that we have held so far, what we have begun to hear is the question being raised and the facts coming out as to whether some of the problems that have come out of late are in fact being driven by, and behavior is a response to, the amount and content of the regulations that are in place right now. So, that is some of the information that has been coming out so far, but to the gentleman's request, yes, we will be having additional hearings on this very important topic.

Mr. LYNCH. I thank the chairman.

Chairman GARRETT. Next, we will be looking to Mr. Mulvaney for 1 minute.

Mr. MULVANEY. Thank you, Mr. Chairman. I will be very brief. I know that many of us here supported the Jobs Act a couple of years ago. I know it passed on a bipartisan basis. I was happy that we had a chance to make SEC registrations a little bit easier, reduce excessive filing, and encourage crowdfunding, which I think has been a tremendous success, and also allow some broader advertising.

I have a discussion draft of a bill today that will make additional changes which would try and do a little bit more. Proposed changes to Section 144 of the SEC rules, to reduce holding periods, provide what we call shell company relief. I am hopeful that as a result of the hearing, we will be able to add to the list of bipartisan bills that will come out of this committee. I don't know if Mr. Lynch had my particular discussion draft in mind when he said it's one of the ones he was concerned about, but I look forward to the discussion, I look forward to the input that the witnesses have here today, as

we try and move towards another round of bipartisan changes that would make access to capital easier.

And with that, I yield back.

Chairman GARRETT. The gentleman from Connecticut is recognized for 1 minute.

Mr. HIMES. Thank you, Mr. Chairman. I just wanted a minute to say thanks very much for holding these hearings. I wanted to thank the panel in advance for their participation. And, in thanking the chairman, I just want to make the observation that like the Jobs Act, I think this is a really important exercise in making our capital markets more efficient, and better at allocating capital, and I encourage my colleagues here to think of this, and perhaps to avoid the all-too-often scenario we fall into of making this partisan, or of making this an argument between the absolute virtues of regulation or the absolute absence of virtue in any regulation.

What we are talking about here with most of these bills, of course, is shifting risk between issuers and investors. Most of these bills do that, and that is a perfectly sane exercise, but we should remember, particularly at a moment in time when investors are wary of the markets—most recently, thank you Michael Lewis and high frequency trading—that we need to preserve the confidence of investors in these markets.

So, Mr. Chairman, thank you very much for holding this hearing. I look forward to hopefully having nice, bipartisan support for some of these bills, and I appreciate your efforts. I yield back the balance of my time.

Chairman GARRETT. I thank the gentleman. We will go now to Mr. Hultgren for 1 minute.

Mr. HULTGREN. Thank you, Mr. Chairman. And thank you, witnesses, for being here to discuss these proposals regarding capital formation for small and emerging growth companies, which are absolutely a key engine for economic growth.

The bill that I have sponsored, the Encouraging Employee Ownership Act of 2014, amends SEC Rule 701, which mandates various disclosures of information for privately held companies selling more than $5 million worth of securities for employee compensation. We raised this threshold from $5 million to $20 million, but still require all issuers to comply with antifraud and civil liabilities requirements.

This bill is a simple update to the bipartisan Jobs Act reforms that exempted employee compensation securities from the requirements for when companies must register with the SEC. Companies that used to only offer employee ownership to top executives because of cost, or because they wanted to avoid distributing confidential information, will now find it easier to provide employee ownership to nonexecutive employees. This will help them attract talented employees by giving these employees a stake in their company, and the large upside that may bring. I urge this committee to support this legislation. I look forward to this hearing. I thank the chairman again, and I yield back.

Chairman GARRETT. Thank you. The gentleman yields back. And, finally, 1 minute to the gentleman from Pennsylvania, Mr. Fitzpatrick.

Mr. FITZPATRICK. Thank you, Chairman Garrett, for allowing me to participate in the hearing. A subject I am interested in is the Fostering Innovation Act, which is a bill I introduced in the last Congress, the 112th, and again in the 113th, responding to concerns of constituent businesses that I represent back home in Bucks County. This is legislation that would update the definition of what is called a nonaccelerated filer. It is important for small companies, because it frees these businesses from extremely burdensome regulations, and as we know, money not spent on questionable regulation is used then for investment and for hiring.

The Jobs Act was the result of a realization that one-size-fits-all regulation hurts the economy. We should be working to reduce job killing regulations across our economy, and even in this divided government there is bipartisan support for lifting burdens from small business and emerging companies. That is what I believe my bill does, and I hope that we get bipartisan support on this committee for it.

All the bills we are going to discuss today are very important for job creation. I would like to take a moment to applaud my colleague, Mr. Hultgren, for his bill, which will update Rule 701, as we just heard. I have heard from constituent businesses in my district that would like to reward their employees by permitting them to invest or have investment opportunities in their companies. These businesses have been constrained from doing so by the current rules, and so I think that the goals of the bill are very worthy, and I hope that we get support for that bill as well. With that, I yield back.

Chairman GARRETT. Thank you. The gentleman yields back, and now we turn to our panel of esteemed witnesses.

So, for those of you who have not testified before, I will just run through this. As always, you will be recognized for 5 minutes, and your complete written statements will be made a part of the record.

I always remind you each time to bring your microphone as close to you as you can, so Mr. Burton, yours looks a little bit far away already. Please remember to turn it on when you begin, and remember to go by the 5-minute rule. The lights are in front of you. Green is 5 minutes, yellow is your 1-minute warning, and red is when time is up and I will be banging the gavel, because the person next to you desperately wants to have their say.

So thank you, Mr. Burton for being with us today, and you are now recognized for 5 minutes.

STATEMENT OF DAVID R. BURTON, SENIOR FELLOW IN ECONOMIC POLICY, THE HERITAGE FOUNDATION

Mr. BURTON. My name is David Burton. I am the senior fellow at The Heritage Foundation, and I would like to express my thanks to you, Chairman Garrett, and Ranking Member Maloney, and members of the subcommittee for the opportunity to be here this morning.

The 2012 Jobs Act was a bipartisan achievement of consequence. Republican and Democratic members of the committee, and your counterparts in the Senate, put aside partisan differences and legislated in the public interest. These reforms will help small busi-

ness entrepreneurial capital formation, innovation, and job creation.

I had the good fortune to attend the rose garden signing ceremony, when President Obama signed the Jobs Act into law. It was a reminder that important constructive change can still be accomplished when policymakers resolve to craft genuine solutions to the problems that face the American people.

There remains, however, much to be done. SEC implementation of the Jobs Act is much too slow, in some cases nearly a year and a half behind the pace required by Congress. And the rules being proposed by the Commission are often so voluminous and complex that they will undermine the laudable purposes of the Jobs Act. There are also significant statutory reforms which are still required if we are to give genuine rebirth to the spirit of enterprise, innovation, and dynamism necessary for a lasting and widespread prosperity, providing opportunity and better incomes for all Americans.

I have been asked to provide my perspective on a number of legislative proposals to enhance capital formation for small and emerging companies. In my written testimony, I also address the Commission's implementation of the Jobs Act, and suggest about a dozen specific policy changes that would promote small business capital formation and entrepreneurship.

Regulation S-K is the regulation governing nonfinancial statement disclosures of registered companies. Along, with Regulation S-X, it imposes the vast majority of the costs incurred by public companies. The SEC has estimated that the average cost of achieving initial regulatory compliance in an IPO is $2.5 million, and following on about $1.5 million a year in annual compliance costs. For small and medium-sized firms, seeking to raise capital, these costs make access to the public capital markets prohibitively expensive.

In my written testimony, I show on a table that these costs are likely to reduce a small company's return on equity by 20 to 100 percent, depending on the firm's size and return on equity. Another way of looking at this is to capitalize the $1.5 million annual costs using a discount rate of 10 percent; this is the equivalent of erasing $15 million in shareholder's equity. Using a discount rate of 15 percent, it would be the equivalent of erasing $10 million in shareholder's equity. This kind of shareholder's equity erasure simply cannot be justified by the higher price earnings ratio that a public company commands, until the expected risks to adjusted earnings are quite high.

Chairman Garrett has drafted very constructive legislation designed to address this important problem, and there is reason to believe that the Commission itself is serious about addressing the problem. And the legislation may well launch a process that would substantially reduce unneeded impediments to smaller firms being able to access public capital markets.

I have three suggested improvements. The legislation should require an SEC survey of smaller reporting companies. It should seek to determine which aspect of Regulations S-K and S-X are major cost drivers, and seek input about what should be changed. In addition, the Commission should begin to collect and publish data regarding its enforcement actions, and I have specific recommendations about how to go about that.

Commissioners, Congress, and this committee need actual information, not anecdotes, about what type of disclosures, misrepresentations or omissions are the source of enforcement actions and other problems. I will move on to some other things.

I support the SBIC Advisers Relief Act. They are, in effect, venture capital funds and it is appropriate to treat them as such. I support the legislation increasing the threshold to $20 million with respect to Rule 701 in compensatory benefit plans. That will help them compete with larger companies. I support, particularly, Section 4 of the Small Business Freedom to Grow Act; it is laudatory. These companies are already public companies making full reporting, so it is not reasonable to require them to comply with 51 different sets of blue sky laws. I support, also, the Fostering Innovation Act, and in particular, exempting these companies from Sarbanes-Oxley 404(b), and that was in the bipartisan act during the last Congress.

Thank you very much.

[The prepared statement of Mr. Burton can be found on page 42 of the appendix.]

Chairman GARRETT. And I thank you, very much. Professor Coffee, good morning, and welcome.

STATEMENT OF JOHN C. COFFEE, JR., ADOLF A. BERLE PROFESSOR OF LAW, COLUMBIA UNIVERSITY LAW SCHOOL, AND DIRECTOR OF THE CENTER ON CORPORATE GOVERNANCE, COLUMBIA UNIVERSITY LAW SCHOOL

Mr. COFFEE. Chairman Garrett, Ranking Member Maloney, and members of the subcommittee, I am honored to be here. Thank you for inviting me.

I have been specifically asked to review seven bills. These seven bills range in my judgment from ones that are entirely reasonable, to ones that are debatable, reasonable people could disagree, and some that I think have unintended consequences that are dangerously overbroad. I will focus more on the latter. That doesn't mean that I am opposed to everything that is before you.

Chairman GARRETT. Why don't you just start with the good stuff, maybe?

Mr. COFFEE. I have to focus on—I only have 5 minutes.

Chairman GARRETT. Okay, I'm sorry. I will give you an extra 15 seconds for that.

[laughter]

Mr. COFFEE. Among the good ones, of course, the simplest and the most unobjectionable one has been proposed by Chairman Garrett, who says we should put a facing page on the Form 10-K that would allow you to cross-reference the rest of the documents with electronic links. I don't see how anyone could be opposed to that, although I think you probably can do it under existing law.

In any event, I have one other comment. These seven bills sort of tweak very small parts of our total Federal security system. They are not terribly coordinated, there is a certain ad hocery here. I would suggest that if you are really concerned about what I think seems to be the underlying theme that you are most concerned about, the integration of our 33 act disclosure system and our 34 act disclosure system, which are not perfectly integrated or coordi-

nated. Then, if that is your concern, and if your concern is also about public offerings and private placements, you really should ask the SEC to conduct a serious study that maps the entire terrain, rather than sort of looking around the edges. There is a certain quality here of the seven blind men, roaming around the elephant, and reporting little problems. There should be a mapping of the entire terrain, to have a fuller look at all this.

Now, with that statement, let me talk about the specific areas where I have problems. First of all, I have a problem with the downsizing of the definition of the well-known seasoned issuer, called the WKSI in the parlance. It is going to be reduced under this bill to what I will call down to the level of a slightly known, modestly sized issuer, what I will call an "SKMI." I am not sure that you understand all the consequences.

Reasonable people can debate whether it is desirable to lower this level, so you can test the waters, whether you want to end the quiet period for a larger group of companies, but there is another consequence that you don't seem to have realized.

Once you say that small companies with only a $250 million public float can be WKSIs, then they are automatically entitled to use something called Automatic Shelf Registration. What is that? That is a system under which the minute you file with the SEC, you can sell to the public with no SEC prior review.

It means that the SEC is cut out of the process of reviewing the registration statement, and also that the board of directors, underwriters, counsel, auditors, and accountants do not have any opportunity to conduct a meaningful due diligence inquiry. Both of those things are disadvantageous to the interests of investors.

It really is amazing to me that probably the largest division at the SEC is Corporation Finance, which is full of hundreds of people who review registration statements. They are about to lose two-thirds of the companies they review, if you move WKSI down this far, without changing some of the consequences of being a WKSI. That is point one.

Let me move on to H.R. 2629, the Fostering Innovation Act. This is another attempt to cut back on Section 404 of Sarbanes-Oxley. I understand that Section 404 is not popular, and that its requirement of an annual audit of internal controls is costly. But at least when you passed the Jobs Act, there was a rationale here, and there was a limited period of the suspension of Section 404. Emerging growth companies were exempted for an up to 5 year period, under the rationale that they were going to be accommodated and put on this learning curve, this onramp. That I can understand.

H.R. 2629 exempts not emerging growth companies, but basically old and stale companies. Companies that have never gotten to $100 million in revenues, even if they have been around for 50 years, and it also exempts companies that have a public float below $250 million. You have to meet both of those standards. That means there will be a lot of companies out there that will be exempted from the internal controls, and the other companies that may need exactly that.

I can understand trying to shorten Rule 144, but I don't think you understand that what will probably happen, because we had this experience with Regulation S, is if it is only a 3-month holding

period, the arbs will come in. They will buy the privately placed stock, which will be sold at a discount to the public offering price, and they will lock in the difference through hedging. And once they lock it in, they will then dump the stock once the 3-month period is expired, and it is free for the public market.

I think that will produce volatility and it had such adverse consequences that the SEC barred hedging when there was a 3-month period under Regulation S, which is a similar problem. All I am saying is we had experience with this, and it has had more adverse consequences.

I will close now, but I want to say again, what Congressman Lynch said, "I don't think preempting the blue sky laws creates jobs." Preempting State regulation, which is focused on local companies with local problems, I think exposes investors to local scandals. The SEC is resource-constrained. The SEC doesn't have the funds it needs and it tends not to focus on the smaller companies.

Those companies that fly under the SEC's radar screen are still subject to the blue sky regulators and these bills, several of them, would preempt that. I have other things that I would say, but, again, I think a number of other ideas here are quite sensible. Thank you.

[The prepared statement of Professor Coffee can be found on page 58 of the appendix.]

Chairman GARRETT. I thank you, professor. Good morning, Mr. Hahn. You are recognized for 5 minutes, and welcome.

STATEMENT OF BRIAN HAHN, CHIEF FINANCIAL OFFICER, GLYCOMIMETICS, INC., ON BEHALF OF THE BIOTECHNOLOGY INDUSTRY ORGANIZATION (BIO)

Mr. HAHN. Good morning, Chairman Garrett, Ranking Member Maloney, and members of the subcommittee. My name is Brian Hahn, and I am the CFO at GlycoMinetics, a 30-employee biotech company in Gaithersburg, Maryland. GlycoMinetics raised $64 million through an IPO in January, the first public offering in 2014, and one of many enriched by the Jobs Act.

I am here today representing BIO and the biotech industry. Roughly 90 percent of BIO's 1,100 members are pre-revenue emerging businesses. Product sales do not fund their research, which can cost upwards of $1 billion. Instead, companies turn to external investors to finance drug development. The capital markets play an important role in biotech capital formation, and it is vital that small public companies are given the opportunity to succeed on the market.

In 2003, I was part of the management team that took Advance Pharmaceutical public. We had only 40 employees and no product revenue, but 2003 was well before the Jobs Act instituted the IPO onramp. From day one on the market, Advance was hit with a full-blown reporting burden. We faced the same compliance requirements as the rest of our IPO brethren from 2003, including Colonial Bank, TempurPedic, and Orbitz. Compliance with Sarbanes-Oxley (SOX) became my full-time job.

Because small biotechs do not have product revenue, burdensome regulations like SOX have an outsized effect on them. One-size-fits-all compliance requirements divert funds from the lab and slow

down the development process. The Jobs Acts has led to a sea change in the regulatory landscape and has shown that a commonsense reporting standard can support capital formation. Nearly 80 biotechs have gone public in the last 2 years, compared to just 30 in the 2 years before the Jobs Act.

I strongly support transparency for investors. Jobs Act testing-the-waters meetings have been universally praised by my biotech colleagues, largely because the additional time with investors allows for increased dialogue and greater information flow. But the key is to share the right information that investors want to know.

Congressman Fitzpatrick's Fostering Innovation Act will help emerging innovators strike that balance. GlycoMimetics will likely still be in the lab, in the clinic when the 5 year onramp in SOX exemption expires. When the ECG clock runs out, small biotechs will still be relying on investor capital, but will face a full-blown compliance burden identical to that faced by commercial leaders.

Investors would be better served by analyzing clinical trial results, but pre-revenue biotechs will instead be forced to issue costly reports that do not tell the true story of their business. The Fostering Innovation Act would provide the SEC with more accurate company classifications in order to institute a commonsense regulatory burden outside of the EGC onramp. The bill recognizes the pre-revenue reality of many small businesses by incorporating a revenue test into SEC Rule 12B2, which is used to determine a public company's regulatory burden, including SOX compliance. This bill will allow small biotech companies to focus on delivering medicines to patients rather than time-consuming and costly reporting.

I am encouraged that the subcommittee is considering legislation today to further enhance the capital formation potential of the markets, which is key to financing the search for breakthrough treatments. Expanded WKSI and Form S-3 eligibility will increase access to capital through cost-effective follow-on and shelf offerings. Meanwhile, reforms to Reg S-K, Rule 701, and conflict minerals reporting will move capital market regulation away from one-size-fits-all standards.

Improving the secondary market liquidity for private offerings will build on another success of the Jobs Act, the expansion of Reg D and Reg A. Overly burdensome regulatory standards present a unique challenge for pre-revenue biotechs. Their investors stress the importance of resource efficiency, because spending capital on compliance diverts funds from the lab and could delay drug development.

The Jobs Act allowed enhanced access to investors, increasing the capital potential of an offering. And it then instituted relaxed regulatory burden, decreasing the amount of capital diverted from research. This one-two punch is critical for biotech innovators, and has increased the viability of the public market. I am thankful that the legislation being considered by the subcommittee today mirrors this approach.

If the smaller issuer is having increased access to investors and is not forced to siphon off innovation capital to spend on costly compliance burdens, they will be able to fund their growth, and in the biotech industry, further research that will change the lives of pa-

tients and their families. Thank you for your time and I look forward to answering any questions you may have.

[The prepared statement of Mr. Hahn can be found on page 72 of the appendix.]

Chairman GARRETT. And I thank you.

Last, but not least, Mr. Quaadman, welcome again. You are recognized for 5 minutes.

STATEMENT OF TOM QUAADMAN, VICE PRESIDENT, CENTER FOR CAPITAL MARKETS COMPETITIVENESS, U.S. CHAMBER OF COMMERCE

Mr. QUAADMAN. Thank you, Chairman Garrett, and thank you, Ranking Member Maloney. I would like to thank all the members of the subcommittee for your continued leadership on issues important to capital formation.

What this subcommittee realizes is that the opportunity to succeed includes the opportunity of small businesses to grow into large businesses. However, not all companies are going to make it, but with that opportunity to succeed, along with the right to fail, those are the important ingredients for our economy to grow for the long term and create jobs.

With the success of the Jobs Act, we are beginning to see a rise in IPOs, and for the first time last year since 1998, we actually saw a rise in the number of public companies in the United States. However, the long-term trends are not good. For young entrepreneurs, the public company model is not the preferred business structure for them for the long term. Additionally, while we have concentrated on the IPO issues, we continue to have an outflow problem, where we have mature public companies that are restructuring themselves into different business formations.

The bills that are before us today are important. The SEC has not acted on the issues that are before us today, despite numerous recommendations from the Small Business Committee, under the leadership of both Democratic and Republican SECs, as well as the fact that many of the issues that are before us today could have been taken care of independently by the SEC in terms of trying to modernize our regulatory systems.

We welcome the new emphasis on these issues by Chair White, however we believe that the passage of this legislation will set forth public policy directives that the SEC will have to follow by statue. I think one example that was a positive one was the proxy advisery firm hearing that this subcommittee held last June, which led to a roundtable by the SEC in December, and then, just last week, their recommendations that the SEC staff has given to Chair White for further action.

Let me talk about some of the bills that are before us today. The draft Disclosure Modernization and Simplification Act by Chairman Garrett, which is also in the same vein as the XBRL bill that Congressman Hurt has championed, would change our 1930s disclosure model and update it and create one for the 21st Century. This will allow for easier access of information for investors and their ability to make decisions and enter the capital markets.

The modernization study for all businesses is an important means of overhauling our corporate governance disclosure process

to allow American businesses to be competitive in a global economy. The draft compensatory benefit program by Congressman Hultgren is an important change because Rule 701 needs to be changed in order for the 12G Jobs Act changes to be effective. This is important for employee retention that allows small businesses to grow into larger ones.

H.R. 4200, the bipartisan SBIC Advisers Relief Act by Congressman Luetkemeyer, is a commonsense reform that codifies congressional intent. The draft Small Business Freedom to Grow Act by Congresswoman Wagner, the draft bill to improve private market offerings by Congressman Mulvaney, and the draft bill on definitions of well-known seasoned issuers by Mr. McCarthy—I think if you look at them together in a package, each of them remove barriers to capital formation, because investors have more access to information with more disclosure and transparency, they will be able to make more informed decisions on a quicker basis.

Businesses will have easier access to capital, as well as scalable costs for regulatory burdens. And what is important to note here, too, is that these businesses that can avail themselves of these changes, the SEC has a track record, they will have continued oversight of these businesses, and they will have tools for investor protection. I believe that the Wagner change in terms of preemption is an important one, as we are talking about a small number of businesses that are accessing the national capital markets, and I think we need to look at this as the Garrett bill as the key that is unlocking the door, and that these three bills are then opening that door.

And one thing I would just like to also point out with some of the statements that have been said here today is that we do have an unbalanced system today. We have more inefficient capital markets than we had 15 years ago, but we also have a situation where retail shareholders or investors are effectively disenfranchised from the proxy system. And they are disenfranchised from their ability to access the capital markets, and that runs to counter to the democratization of our capital markets that started with President Kennedy's efforts to do away with the financial transactions tax in the 1970s.

So, with that, Mr. Chairman, I would like to conclude my remarks. I am happy to answer any questions you may have.

[The prepared statement of Mr. Quaadman can be found on page 79 of the appendix.]

Chairman GARRETT. Great. I thank all of the panel members for your testimony, and I will now recognize myself for 5 minutes for questions and comments. And, thank you, Mr. Quaadman. I think that was overstating the case that my bill is the one that is the key to opening the door and the rest follow. I appreciate the comment, though.

Okay. Mr. Hahn, you made a couple of comments that I noted down from your testimony, and maybe they sort of jibe together. One, could you elaborate a little bit on the revenue component, and the effect on industry by the costs of this current system and how it affects your industry? You use the expression, "diverting from the labs," is the language I just picked up now, but also the language I just picked up now is that your task and your role, your

responsibilities have now changed, that this is now a full-time job, was what I wrote down, as far as compliance. Do you want to jibe those two, connect those two together maybe?

Mr. HAHN. The full-time SOX issue was with Advance back in 2003. So, we were a 40-person company. We had a finance staff of two and a half FTE, and when we had to do a full blown SOX implementation, we had to increase our staff to seven, and that diverted FTEs away from the lab.

When we talk about costs, currently at GlycoMimetics, it is still—we have to comply with 404(a), but not 404(b). Our costs now, annual costs to be a public company have increased by $1.6 million a year, just in auditors' fees, legal fees, and other fees by being a public company. To put that into perspective, our current payroll, base payroll for 2014 will be $4 million. So, that $1.6 million in additional annual costs could be 10 additional R&D folks who could be working in the lab to help advance our programs.

Chairman GARRETT. That is significant. Thank you.

Mr. Burton, can you—and you touched on this a little bit in your testimony—provide us with a few more thoughts on the Jobs Act that we already have in place, as implemented, are there other things that should be done, as far as implementation goes, to maximize job creation through it?

Mr. BURTON. There are a number of issues. First, is actually implementing the regulation so that certain aspects of the Jobs Act like crowdfunding can take place. Second, to make the rules appropriate in complexity for smaller firms. The Jobs Act proposed rules, an example of that, Regulation A Rule, while it has very positive aspects, also has some aspects that are very troubling. And then lastly, the proposed Regulation D Rules, as a follow on to the general solicitation and verification regulations, are extraordinarily problematic and are unnecessary in almost all of their respects.

Chairman GARRETT. I guess this will jump around to Mr. Quaadman. So, in Professor Coffee's testimony he sort of indicated, and we see this in some of the economic activity in that and capital allocation is going through the private less to slows market than it is through the public. Can you say, is that happening because of any bad or nefarious reasons? Or is that happening largely because of what the other two witnesses have stated, because of the regulatory costs or other reasons as well?

Mr. QUAADMAN. In our view, it is primarily the regulatory costs and burdens that are a part of it. If you take a look at any one regulation or any one burden, they are not necessarily going to cause somebody to leave the public company space. But when you take them all together, they make the more efficient, inefficient, and less likely for businesses to want to become public. So, when you take a look a the public company model in a different way, if you have an investment dollar, you have a whole array of different places to put it, and increasingly investors are going away from public company investments, and that also is why businesses are also beginning to move away from that as the preferred business structure.

Chairman GARRETT. And I just saw something in the paper this morning, I am not going to name the company, but one of the larg-

er institutions is saying that they may be closing some of their dark pool type of arrangements. Would you like to respond to that?

Mr. QUAADMAN. Yes, I do think we are beginning to see that some of the financial institutions are beginning to move away from certain forms of financing. We have seen that, we have had a discussion here in this room about CLOs as an example of that as well.

Chairman GARRETT. Okay.

Mr. QUAADMAN. While we need a diverse financial structure, some of the burdens that we have here in terms of regulation are impeding that.

Chairman GARRETT. All right. And I was going to, my time is almost up, I was going to say press a copy. I think we are on the same page on some of this. Your very opening comment was regarding a—you didn't use the word, but I will use the word—holistic or broad approach, as far as looking back to the 1933 Act, and looking at the whole thing. I will close my time with, we agree on that, and we have asked for the SEC, this Administration, and the last Administration to do the same thing, so there is no question there. But I think we are on the same page, just what we should be doing in the meantime, I guess, is why we have some of this legislation. But, thank you for that comment on that point.

We now yield to the gentlelady from New York, Mrs. Maloney, for 5 minutes.

Mrs. MALONEY. Thank you so much, Mr. Chairman, and I thank all of the panelists today. I would like to start with Professor Coffee. Some of these bills are aimed at allowing more companies to take advantage of the so-called shelf registration. Can you describe the benefits of shelf registration? And are there major drawbacks for investors when companies use shelf registration? You pointed out in your testimony that the proposed legislation, the $700 million standard would be reduced to $250 million, at which point the majority of the issuers from both the New York Stock Exchange and NASDAQ would become WKSIs, and could use an automated shelf registration. Can you elaborate on what that means for investor protections?

Mr. COFFEE. Let me begin with the irony here. Under these bills, many companies could be both emerging growth companies and well-known seasoned issuers. And, it is really hard to see how you are both young and immature and old and seasoned at the same time. Language is being tortured a bit.

I understand that there are high costs for many companies, particularly because of Section 404, but we keep talking about an all or nothing choice. You are covered or you are not covered. I believe it is possible to scale this requirement.

You could tell certain kinds of companies whether they are emerging growth companies or slightly larger that they only had to do a 404 audit once every 3 years. But if you don't do it at all, sooner or later you are going to get burned, because if a company doesn't examine its internal controls with outside auditors, something is going to go wrong, in many cases, sooner or later. So, I think there should be a search for scaling this obligation.

In terms of shelf registration, when it was originally adopted the level was $150 million because that was the level that the SEC

thought was the beginning of the efficient market. Now, we have gone down to $75 million for shelf registration, that is probably below the efficient market, and there are proposals that some of the bills would say, any company that is a reporting company can use shelf registration.

That would include some companies now traded on what are called the pink sheets, or companies that are traded in the over-the-counter bulletin boards. I don't think those companies have an adequate following, even among secure—either among securities analysts or other informed commentators that the public knows what is going on.

And if you permit universal shelf registration to these companies, it would also be possible for them to do secondary offerings as well as primary offerings. That is, the insiders could dump their stock without any prior disclosure.

When the insiders are dumping their stock under a new exemption, that is not creating jobs; that is creating bailouts. So I think we should be a little more focused. I am not saying that you cannot expand the scope of Form S-3, or that you cannot facilitate more shelf registration, but I think the over-breadth is when you let very small companies do secondary offerings, and when you go well below the level of the lowest possible level of the efficient market, that is when I think you need the more formal procedures of ordinary registration.

Mrs. MALONEY. Thank you. You also mention in your testimony that shortening the holding period in Rule 144 from 6 months to 3 months could invite abuses. It would allow investors to quickly resell securities that they bought in private transactions, usually at prices that are well below the public trading price. And, as you know, the minimum holding period in Rule 144 used to be 2 years, and was only recently shortened to 6 months. So my question is, do you think that a 6-month holding period is sufficient to deter investors? And what do you feel about this shortening period?

Mr. COFFEE. Maybe I didn't explain it adequately. But in my time, if I was going from 3 years to 2 years to 1 year to 6 months for reporting companies, if we would go to 3 months, that greatly reduces the cost of hedging. It is very expensive to try to hedge something for 6 months or 1 year. Three months is more possible. What I think we would see happen is that companies would do an initial IPO, and then would do no more public offerings, they would do all private placements, and they would do private placements to investors in what are called pipe transactions. Pipe transactions are private investment and public equity. You sell to the investor in a private transaction at a price somewhat below the public market price.

So, if the market price were $20 a share, you might sell in a private placement to $19 a share, because the private placement is so much cheaper, with so much less liability, and so much advance planning. You would do it that way. The investor would buy at $19 and immediately hedge to lock in the spread between $19 and $20, and at the end of the 3 months, the arbs would dump into the market, which would produce volatility, and I think we would be pretty much ending public registry offering by seasoned companies. I don't

think you want to do that without mapping the total train. I think there should be ways that we—

Mrs. MALONEY. Thank you. So, it would increase pumping and dumping. My time is up, but maybe you could get back to me in writing. Ideally, what do you think the holding period should be, if you would create a holding period?

Mr. COFFEE. I think 6 months was probably a reasonable compromise as it is now. If you were to go lower, what I would say to minimum is that you forbid hedging, because hedging is, right now—

Chairman GARRETT. I think we will leave it at that answer right there.

Mr. COFFEE. Okay.

Mrs. MALONEY. Thank you.

Chairman GARRETT. Thank you. The vice chairman of the subcommittee, Mr. Hurt, is now recognized for 5 minutes.

Mr. HURT. Thank you, Mr. Chairman. And I thank each of you for being here. Obviously, one of the parts of the Jobs Acts required that the SEC study Reg S-K, and how that can be improved to reduce unnecessary costs to companies that wish to go public, and that are public. I guess my question is for Mr. Burton, to begin with, I am interested in the chart that you have included in your testimony relating to the percentage decrease in return on equity by going public. Can you talk about that? Is that data that is reflected there, based on information that is pre-Jobs Act?

Mr. BURTON. The cost data is from the SEC and it would be pre-Jobs Act. It was included in the economic analysis discussion of the crowdfunding rule, I suppose. The Jobs Act did a lot of very positive things, but it didn't dramatically reduce the cost of being a smaller public company.

Mr. HURT. What is the best way to describe the disproportionate effect, assuming that there is, and I believe that there is, a disproportionate effect that these disclosure requirements have on emerging growth companies? Can you talk about that?

Mr. BURTON. Absolutely. And there is—some of these bills address that question, particularly backing off the costs related to Sarbanes-Oxley 404B, the internal control reporting for smaller companies, I think that is genuine; it is extraordinarily expensive. And it is also genuinely misguided in that, in a small company, with a small C-suite, it is not going to have a meaningful, positive impact or at least a significant positive impact on the ability of those people to abscond with company money if they want to. The fact is a nice fancy internal control loose-leaf binder on the shelf isn't going to stop them from ripping off investors. It will be other things that stop them.

But the long and short of it is, there is a need to fundamentally rethink the way we do disclosure, the way we scale disclosure. Whether some disclosure is having a positive impact on protecting investors, or it is just a waste of money, and we have very little information to go on. And there is a need for the SEC to review this.

I think the chairman's legislation would be a very positive step. I think the SEC acknowledges a need to review this, but there is also the need to collect information, and by that I mean two things.

First, what is causing the most cost? And second, what areas are causing the most problems with respect to enforcement, with respect to fraud? And we don't really have that information, nor, for that matter, does the SEC. They don't collect it, they don't collate it, they don't report it to the Commissioners. I know for a fact that the Commissioners are frustrated themselves that they don't have that information. And, it is very difficult to make policy in a data vacuum, and that is where we are right now.

Mr. HURT. Do you think, are you able to say because the SEC has indicated that it wants to study the issue relating to reg S-K more, are there areas that you think they can focus on immediately? And what would those areas be? And then, second, what areas do you think, specifically, they can look at long-term?

Mr. BURTON. I think that right now I am not in a position to give you much more feedback on that other than 404 is the biggest single problem. I have put together a securities regulation working group at The Heritage Foundation, which includes people from all over the country, in many different professions, and we are developing a solution and an answer to that question. And I hope to be in a position to provide that to the committee in 6 to 9 months.

Mr. HURT. Professor Coffee or Mr. Quaadman, do you all have any thoughts on that question, about what the SEC can focus on immediately—what areas the SEC could focus on immediately in terms of trying to reform some of these disclosure requirements?

Mr. COFFEE. One of the proposals was that they should focus on regulation S-K. I think it was a little unrealistic to ask them to do that in, I think, it was something like 180 days, I think they would need a little bit more time than that. But I think that is perfectly reasonable to ask them to focus on scaling Regulation S-K. I think too often we are talking about all or nothing here, and I do understand that scaling some of these requirements can be justifiable.

Chairman GARRETT. All right.

Mr. HURT. I think my time has expired, unless, Mr. Quaadman?

Chairman GARRETT. Ten seconds.

Mr. HURT. Ten seconds.

Mr. QUAADMAN. Yes, Mr. Hurt, just, I think the delivery of information is important, because we are currently trying to deliver information in booklets like this, whereas we actually use something like this. So, just one example, companies have to publish historical stock price, which was fine in its day, but, you know what? Alcoa's stock price on July 7, 1972, was $49.25. I found that not in an SEC filing, but by going on Yahoo! Finance in about 30 seconds.

Chairman GARRETT. Here you go. Thank you. Mr. Lynch is recognized for 5 minutes.

Mr. LYNCH. Thank you very much. And, again, I thank the witnesses. Professor Coffee, the premise of some of these bills seems to be that we need to assist some of these companies in capital formation, in raising money, and that we can accomplish that by providing less information to investors.

But I can note several examples—WorldCom, Enron, AIG, Lehman Brothers—where in times of uncertainty, people actually fled from those companies where it was more opaque, and there was less information available and fled to companies where they felt they knew about the internal controls within those companies. And

so, I don't buy that. I don't buy that we need to help companies by providing investors with less information. And I just want to get your sense on that.

Mr. COFFEE. The first thing I would say is there is a lot of evidence, empirical evidence that the more you reduce informational asymmetries, the more you reduce the company's cost of capital. If investors aren't sure, you report the share at $10 a share, but if they are not really sure whether it was $5 to $20 or where it was, that company is going to have a much higher cost of capital than a company where they are fairly certain it was $10 a share. Plus, there are costs, of course, to disclosure but there are benefits.

And we have the capital markets that have the deepest liquidity and the greatest efficiency in the world because we have gone far in reducing informational efficiencies. It may cost $1.5 million a year for the average company, as Mr. Burton's evidence suggests, but I think there are probably benefits that are greater than that when we look at how distinctive our capital markets are and how uniquely well they do in financing startups. The rest of the world cannot finance startups. They are dependent upon bank capital. And I think that is partly the success of our securities markets.

Mr. LYNCH. Thank you. I want to talk to you about, there are a couple of bills here that actually take State regulators out of the business of regulating these small companies. I know that across our country, a lot of governors are doing great work on job creation and we are all competing. In my district we have an innovation district, which tries to bring in biotech companies and other high tech companies. We provide infrastructure, and we provide, in some cases, financing bond assistance so there is a local risk in, especially workers; obviously, I have a lot of universities and hospitals in my district, so the workers there are all local.

There is a tremendous local interest and a local risk that is far beyond what the general market faces. And my problem is that now, under Mr. Mulvaney's bill and under another bill—and I have great respect for my colleagues—it takes the State regulator, ironically the person who knows the company best, out of the regulatory regime, and really puts the local economy, and the State economy at greater risk than would otherwise be the case. And, by the way, we have Bill Galvin in our State, he is my Secretary of State, and he does a great job on this. He is all over these local companies, and it has actually enhanced our ability to attract these small start-up companies. But I just want to hear your opinions on the effect of boxing out the State regulator.

Mr. COFFEE. I think there is some unexplained suspicion of the State regulators, who are typically the State attorneys general. The State attorney general does not dislike, and is not hostile or suspicious of small businesses. The attorneys general have the same attitudes as the governors of the States, typically. I think that the State and the local regulators know the most about local companies, and as long as the SEC is very resource-constrained, those will be the companies they give the least attention to, because they can barely handle, if they can at all, their current assignment, their current docket. So, we are removing the only sentry that looks at the smaller and local company. I think that is ill-advised.

Mr. LYNCH. I appreciate that. Thank you. I only have 25 seconds left, so I will yield back. Thank you.

Chairman GARRETT. I thank the gentleman for yielding back. Mr. Huizenga for 5 minutes.

Mr. HUIZENGA. Thank you, Mr. Chairman. I appreciate this opportunity to ask a few questions, and Professor Coffee, I do have a couple of things that you have brought up, some of the more problematic elements that you have with some of these bills. I am curious on Mr. Mulvaney's bill, the 6 months going to 3 months, what is so magical about the 6 months versus the 3 months?

Mr. COFFEE. I don't say that there is anything magical about it. I say two things. First, the consequence, again, will be that we will see only private placements done by public companies. They will not go to the SEC. They will simply do private placements, and there will be some loss of transparency in the system if there are very few public offerings in the future by seasoned companies.

Second, the difference between 6 and 3 months, as I tried to say, is that it is much more feasible to finance hedging for 3 months than for 6 months. It is quite expensive. Now, it may well be that you can solve that problem by barring hedging for a 3-month holding period, which is what has been done under Regulation S, which is quite analogous.

I would suggest again, that rather than just tinker and play with these, we should ask either the SEC or some blue ribbon group to give us their map of what the future should look like in terms of the relationships between public and private offerings. It might be that you would want to tell some company that it could not go to the private placement market again, because it had done it for 10 straight years, until it went to the public market one more time. I do want there to be some continuing transparency, which going to the public market does enhance.

Mr. HUIZENGA. Okay. So, having an organization like the SEC's Government-Business Forum on Small Business Capital Formation is beneficial?

Mr. COFFEE. I have no hostility towards that body. I point out that one body you should also talk in this process is the securities analysts. They have views about what they want. You should also talk to the State regulators. I don't think they have been consulted about some of the bills, and the blue sky preemption. All of those people have a view.

Mr. HUIZENGA. My concern is—and I have some personal experience with this because I have a bill dealing with mergers and acquisitions which passed this committee and passed the House unanimously—in the same situation as I am looking at Mr. Mulvaney's bill, and Mrs. Wagner's bill, these are all recommendations from the SEC's own working group that had been put forward multiple times, yet the SEC doesn't do anything about it. And, it is this constant drip, drip, drip of people saying we have to handle this, and the SEC says, yes, we will get to it, yes, we will get to it, yes, we will get to it. And then in my case, with my mergers and acquisitions bill, the SEC says, we don't need to do that.

We don't need a law to do that, which was one of the arguments I am not sure that we need do this, and codify it, but the problem is we can't get the SEC to move on some of these issues, and it

seems to me that one of the only ways is possibly through this legislative process. Professor Coffee, you put forward the notion about your concerns about the WKSIs, and a company being both an emerging company as well as a WKSI, does anybody else have that same concern? Mr. Quaadman, you are shaking your head, so, if you don't mind addressing that?

Mr. QUAADMAN. Sure, Mr. Huizenga, I think the question, first off with the Small Business Committee, is a process the Chamber has participated in, and it is a process investors have participated in. So, that is just not the business community saying that; it is a well-rounded group.

What we are looking at here, and I think this is also what the WKSIs are looking at, as well, is that our capital markets are different, and they are out of balance, right? So, if we can lower some of the thresholds, we live in an age where there is more information that is available, we need to fix those delivery systems so that there is more information that investors have, and that they can actually act in a decision-useful way in their own interests. I think we are sort of losing sight of that fact.

This is not an us-or-them proposition. This is a two-way street. Businesses need to disseminate that information into the marketplace to raise capital. If investors are burned unnecessarily, it is going to be more difficult for businesses to raise that capital. So, we need to make sure that delivery systems are in place. This is also something where the SEC has a track record with these businesses, and they have continuing oversight over them, so this is just not going to be the wild, wild west out there. Not by any stretch of the imagination.

Mr. HUIZENGA. Mr. Burton or anybody else? 15 seconds?

Mr. BURTON. Professor Coffee's point shows the need to integrate and rationally re-think how we do scaled disclosure. Because he is right. You can't be, in concept, an emerging growth company and a well-known seasoned issuer simultaneously. So there is a need to re-think that, and I think that we all need be part of that process.

Mr. HUIZENGA. I am just concerned that we are going to let this grind on and on here. We have to address it, and I think we need to do that legislatively. So, thank you, Mr. Chairman.

Mr. COFFEE. Congressman, I understand your frustration. You might suggest that you give the SEC a specific grant to do this study, and put a 1-year time limit on it. They are a very resource-constrained body, and they are overworked, but if you gave them the funds for doing that kind of study, I don't think they would hesitate to take it on, and meet your deadline, because they would be embarrassed otherwise.

Chairman GARRETT. I guess they would be embarrassed in a lot of ways because we have given them deadlines by law, and the money has been given them to under law to do things, and they have failed to make deadlines on numerous occasions. So, I guess they must be one embarrassed organization.

With that, I will look to the gentleman from California for 5 minutes.

Mr. SHERMAN. Mr. Chairman, I look forward to the SEC finally implementing the Frank and Sherman Amendment, so that we have the bond rating agencies selected by a system other than the

current system, which is that the issuer selects and pays the bond rating agency. If I could have selected the umpires for every little league game I was in, I would be in the major leagues right now.

Mr. Chairman, these have been good hearings, but I think they lack the excitement that we would have if we focused the next 5 minutes on accounting issues. And so, that is the excitement I am going to try to provide.

Mr. Coffee, there has been a proposal to increase the exemption from Section 404 audits of internal control, in spite of the fact that investor advocates, State regulators, State pension plans, and the Chair of the SEC think that we shouldn't relax those standards any further. Now, of course, there are costs to an audit of internal control, but you also get more assurance that the financial statements are accurate. Should we be relaxing further? We already exempt 60 percent of the publicly traded companies from this standard. Should we relax it even more?

Mr. COFFEE. I share your concerns. I would point out one compromise that rather than doing it all or nothing, the proposal here would say any company that earns less than $100 million annually would not have to do a 40(b) internal audit. I would suggest you could scale this. You might say some smaller companies could do such an audit once every 3 years. That means you are at least occasionally looking at your internal controls, and it would reduce the cost by two thirds. That is the better than the all-or-nothing approach.

Mr. SHERMAN. I might disagree with you on the cost savings there. Once you get the internal controls up to snuff, and you get the audit done, the cost the second year should be a lot less. But, I want to move on to another issue. Mr. Hahn, I don't know if you have come here to talk about FASB-2, but if you build a building, you capitalize it. If you spend money on research, which a lot of your companies do, you have to write it off immediately, even if the research is tremendously successful. Are your companies hurt because they are paying to build an asset, and instead they have to show it as an expense?

Mr. HAHN. I would like to make two comments here about the 404 compliance, also. So, thanks to the Jobs Act, we were actually able to perform test-the-waters meetings on our IPO process, and it gave us the ability to reach out to almost 90 investors.

Mr. SHERMAN. Mr. Hahn, if you could just focus on the question I addressed to you, because I am going to try and get one more response from Mr. Quaadman. He knows what I am going to ask him. And if you are not prepared here to talk about that, I will just move on.

Mr. HAHN. I'm sorry, could you repeat the question, please?

Mr. SHERMAN. It was about the immediate write-off of research expenses, even if the research project was successful.

Mr. HAHN. In our business, as an emerging growth in an early stage company, it is all about the cash burn. So the biggest question was, what is your cash runway with this IPO proceeds? Whether we capitalized those costs right now, or expense—

Mr. SHERMAN. So, your focus is on cash burn rather than on earnings per share. Mr. Quaadman, what would it do to the ability to raise capital if we suddenly put $2 trillion of liabilities on the

balance sheet of American corporations as is being proposed by the Financial Accounting Standards Board, in their view that we should depart from hundreds of years of accounting principles, and treat every lease as if you had purchased an interest in the building?

Mr. QUAADMAN. No, Mr. Sherman, thank you for continued focus on this very important issue. That change would have a significant, adverse impact on American businesses, as well as on the commercial real estate industry. We are currently in a position where both the International Accounting Standards Board and the Financial Accounting Standards board here in the United States are at loggerheads and are at an impasse. We have recently met with both boards, as well as the SEC, to try and come up with a rational solution. If, at the end of the day, the solution is to do nothing, and that we keep the status quo in place, we would at least avoid the adverse consequences that the proposals which are out there now would have.

Mr. SHERMAN. And the status quo, everything that could be disclosed is disclosed, either in the financial statements or in the footnotes? So there is no lack of transparency here? It is simply a matter of whether you actually put $2 trillion on the balance sheet of all the American businesses?

Mr. QUAADMAN. Correct. And with those proposals, it is important to note that the investor community has specifically said this would not give them any more information than they currently have today.

Mr. SHERMAN. Thank you.

Chairman GARRETT. Mr. Mulvaney is now recognized for 5 minutes.

Mr. MULVANEY. Thank you. Professor Coffee, before we start—and this is not going to be adversarial—I really want to talk about my bill, but I couldn't help but hear what you said about the SEC and how dedicated they are to the work, and if they just had enough money, they could get all their work done and so forth. On this committee, we are very familiar with that, and we remember intimately how, when faced with Dodd-Frank, it seemed like for some reason conflict minerals took priority over the Volker Rule. I am not sure how that happened at the SEC, but I would suggest to you, sir, that maybe, maybe, just maybe the SEC is susceptible to political pressure, just like other institutions.

Mr. COFFEE. One area on which we can totally agree is conflict minerals, and I am surprised that provision is still in the law today.

Mr. MULVANEY. So, thank you. That is good. Let's move on, because you had some comments on my discussion draft, and, again, this is one of those, I think, very productive meetings, where we can actually ask questions, because we want to know the answers. We are not trying to bait witnesses; we are actually trying to get information about the bills.

You had some criticisms of, I think, one section of the discussion draft that I offered on SEC Rule 144. You said that by lowering the date—as Mr. Huizenga mentioned to you, by lowering the holding period from 6 months to 3 months, it would create this arbitrage opportunity. I think Mrs. Maloney, before she left, said it would

create a bunch of froth in the market and so forth. Let me just ask the question this way: what is magic about 6 months? Why doesn't that same risk, as you perceive it, exist now, just with a 6-month holding period, instead of with a 3-month holding period?

Mr. COFFEE. It is very costly to arbitrage for 6 months. If you are looking at a spread of a dollar, that is going to be used up by the cost of that additional 3 months of hedging.

Mr. MULVANEY. Didn't this rule used to be a year?

Mr. COFFEE. The rule still is a year—

Mr. MULVANEY. Right.

Mr. COFFEE. —for nonreporting companies. It is 6 months for reporting companies.

Mr. MULVANEY. Okay. Was it ever a year for the nonreporting companies?

Mr. COFFEE. It was, yes, it was once a year for nonreporting. Right now, it is a year for nonreporting companies.

Mr. MULVANEY. I guess my question is, if we have made changes in the past, did we see the type of concerns you have come to fruition or not?

Mr. COFFEE. I can't answer that question without investigating. I can tell you that we saw it over in the context of Regulation S. Regulation S invites you to sell securities abroad, and then after a period of time, bring them back. It is the same arbitrage potential, and when it got down to 3 months, we saw a huge arbitrage, and eventually the SEC had to amend the rule to prevent that.

So, I am not telling you this prevents doing what you are saying. I am saying if you do it, you should really think about the arbitrage potential.

Mr. MULVANEY. But let's talk about the good, Mr. Quaadman, because I think your organization had commented on that holding period. Tell me why you think it would be helpful to do this?

Mr. QUAADMAN. We think it would be helpful to do, because you are actually going to provide more opportunities for businesses to raise capital, and you are actually going to provide more liquidity for smaller businesses and that has been something that this subcommittee has looked at very closely.

I understand where Professor Coffee's concerns are. If we are concerned about market manipulation, that is something the SEC has the tools to fight and combat now, and that is something I think, if this bill were to pass, we can ask for increased disclosure, we can ask for the SEC to report back on that, and then determine if further action is needed.

But, clearly, if we provide the information to investors, and provide them with the opportunities to invest in businesses, they are more apt to do that. Part of the reason why we also had longer holding periods was that it was more difficult to deliver that information to investors than what we currently have today. So, I think we are in this position where the SEC is sort of looking at the elephant and deciding, well, the elephant is just too big to eat. Whereas, we should be taking the position of, you have to do it one chew at a time. I think this is a good place to start.

Mr. MULVANEY. And no one has mentioned the other two or three parts of the bill. Professor Coffee, since you seem to be the most interested in, at least, criticizing it in a positive kind of way, not

a negative kind of way, do you have any difficulties, sir? Or does anybody with the proposed changes to the shell company relief that we are talking about?

Mr. COFFEE. I thought that was reasonable. I would want to hear the SEC's views, but as I say in my statement, I did not have an objection to that.

Mr. MULVANEY. What about the changes to the exemptions from State laws? Does anybody see any difficulties with that?

Mr. COFFEE. That is the blue sky preemption; you have already heard me say that I am doubtful about blue sky preemption.

Mr. MULVANEY. That was your point—

Mr. COFFEE. Although I did accept it with regard to, I think, preemption of venture capital fund advisers.

Mr. MULVANEY. Got it. Thank you, gentlemen, very much. I yield back the balance of my time.

Chairman GARRETT. The gentleman yields back. Moving down the row, I guess, Mr. Scott is recognized next.

Mr. SCOTT. Thank you very much, Mr. Chairman. Professor Coffee, each of the pieces of the seven pieces of legislation before us today seeks to ease the ability of smaller companies to raise capital. However, Congress just recently passed the Jumpstart Our Business Startups Act of 2012, and that piece of legislation also sought to encourage capital formation for the same businesses. How have the reforms of that legislation, the Jobs Act of 2012, that we passed, changed the capital-raising landscape for small businesses? And have we effectively evaluated that Jobs Act?

Mr. COFFEE. I can give you some anecdotal answers, but I do think that we do need a thorough evaluation of what the impact has been, and I don't think we have enough data. We can't just look at the number of IPOs, because IPOs are very volatile.

What has changed is the following: almost every issuer is now using the confidential filing provisions so they can work things out with the SEC before they disclose it to the public. That may be good. That may be bad. But that is clearly happening.

With regard to the emerging growth company being able to use only 2-years' financial rather than 3-years' financial, about half of those companies are being advised by their underwriters that they should still give 3 years, because the market wants it. So, it has been partially used, but not entirely used.

The other provisions, certainly any company that can escape 404 is escaping 404, which emerging growth companies permit. Underwriters are actually not using the provisions to free them up from observing the quiet period. The major underwriters have agreed to a procedure under which they will observe a quiet period for basically, I think it is 40 days, after the time of the IPO.

That suggests that the underwriters decided it looked a little dangerous to have underwriters put out their own analysts' reports days after they did the offering. So, some of these rules look like the market thought they made sense. Others, we are definitely seeing some changes. I think it takes a little bit more, and I don't want to shoot from the hip to say what the overall impact of the Jobs Act has been.

Mr. SCOTT. So, with that, does it make sense for us to pass a Jobs Act II? Point zero, which is this collection of bills we are look-

ing at today, before we have had substantive analysis of the impact of the first Jobs Act that we passed last year.

Mr. COFFEE. I agree with you. And I say that even more about crowdfunding, because there is apparently going to be a bill coming in on crowdfunding, and we have not yet had a single crowdfunding offer, and I think it would be wise to see how that works before we expand the crowdfunding exemption.

Mr. SCOTT. And then, finally, Mr. Coffee, how reasonable and appropriate is it to expect the Securities and Exchange Commission to effectuate all of these rule changes, given their inadequate funding today, and the fact that they are still finalizing rules under the Dodd-Frank Act, and the Jobs Act?

Mr. COFFEE. I have to say that they are an overworked, understaffed, resource-constrained agency, which is probably as frustrated as is this committee. I understand that no one is happy with this process. I think there is also some demoralization in some portions of the SEC. So, I think that you can't expect them to do more without giving them more resources.

Mr. SCOTT. Thank you, very much. I yield back the balance of my time, sir.

Chairman GARRETT. Mrs. Wagner is recognized for 5 minutes.

Mrs. WAGNER. Thank you, Mr. Chairman. Mr. Quaadman, my proposed legislation would allow smaller reporting firms who have registered on an S1 to use forward incorporation to automatically update their registration statement. The SEC has recently taken other steps to update rules, given that the widespread accessibility of filings, as you have displayed, has increased investor information, access, and protection. Mr. Quaadman, how would this change help smaller reporting companies which are seeking to raise money in the capital markets?

Mr. QUAADMAN. It would have a significant impact, because the smaller companies that have to use S1, when they use S1, they have to go back and have the SEC approve it. So, that affects their ability to go into the capital markets. It almost puts them on a slow treadmill, rather than putting them on a fast track. So, this actually would be very beneficial to short-circuiting it, and to also make it less costly.

Mrs. WAGNER. Will investors in smaller reporting companies be just as protected as investors in large companies?

Mr. QUAADMAN. Yes, because, again, this is a situation where the SEC has a track record with this company that the information here and the company is known to the investor community as well. So, the investor protections are all in place as is the SEC's continued oversight.

Mrs. WAGNER. Thank you. Mr. Hahn, I received a letter from a small biotech company, Protea Biosciences Group, Inc. It is now a world leader in molecular analysis technology. They basically save lives. He has 48 employees, including 10 Ph.D. scientists, and is helping to bring high-paying jobs to rural parts of America. They have been fully reporting for 2 years, and their SEC filings have always been on time.

The CEO of Protea wrote to me, "If a small company is complying with SEC reporting requirements at the same quality as a large company, then in the spirit of fairness," he believes, "the com-

pany deserves the same options for raising capital. Specifically, the availability of SEC Form S3." Mr. Chairman, I ask unanimous consent to submit this letter for the record?

Chairman GARRETT. Without objection, it is so ordered.

Mrs. WAGNER. Mr. Hahn, have you heard stories like this before? And how do think expanding Form S3 to allow smaller reporting companies under $75 million in market cap will help small biotech companies across America, like Protea?

Mr. HAHN. I fully support increasing access to capital markets for smaller reporting companies. There is actually a company in Maryland right now, a biotech company that is in the same exact situation, where they are having difficulty trying to access capital, and with some of these changes, I think it would make it much easier for those companies to raise capital and advance their programs.

Mrs. WAGNER. Thank you very much, Mr. Hahn.

Mr. Burton, in 1996 Congress preempted State regulation of most offerings on the national securities exchange, and in 2012, Congress further preempted State regulation of public offerings of up to $50 million under SEC Regulation A. Mr. Burton, why is it important that we expand preemptions to smaller reporting companies and emerging growth companies?

Mr. BURTON. The primary reason is that they are already making full reports because they are public companies. So, it is really fundamentally unreasonable to expect them to also have to comply with 51 different State securities laws, the blue sky laws, particularly in the States that are merit review. It makes the offerings extraordinarily expensive, because you are literally increasing by a factor of 50 the number of people with whom you have to deal. And, we see that in other areas as well, with Regulation A; blue sky laws killed Regulation A. That is the reason that nobody uses them. They use Rule 506. So, there are a whole series of areas where it has become clear.

Now, nobody is talking about eliminating the ability of State regulators to police fraud. We are just—

Mrs. WAGNER. Right.

Mr. BURTON. —talking about the registration requirements and the qualification requirements depending on the State. So, it is an extraordinarily important issue in terms of reducing the cost of raising capital in a national marketplace.

Mrs. WAGNER. Thank you very much, Mr. Burton. I couldn't agree more. And, Mr. Quaadman, I would like your input on this also, why it makes more sense to allow Federal regulations to have this patchwork of an additional 50 State laws?

Mr. QUAADMAN. Sure. First off, there are 28 million businesses in the United States, and we fully support the State-based business formation system. However, what we are talking about here is we are talking about taking a small number of those several thousand businesses and helping them access either the national or international capital markets.

So, that clearly is a system where they are trying to get in to bigger capital markets, where you need to have one set of rules. What I think your bill does, is you leave in place the ability of States to regulate those other 28 million businesses, as well as the inter-

mediaries. So I think this is a partial preemption that makes sense and helps facilitate the capital formation abilities of these businesses to grow from small ones into large ones.

Mrs. WAGNER. Thank you, Mr. Quaadman. I believe I have used all of my time. Thank you, Mr. Chairman.

Chairman GARRETT. Your time has expired. And the gentlelady yields back?

Mrs. WAGNER. Yes.

Chairman GARRETT. Yes. Mr. Kildee is recognized for 5 minutes.

Mr. KILDEE. Thank you, Mr. Chairman. In looking at the legislation that is the subject of this hearing, it is obvious that the principal intent here is to increase, provide more access to capital for companies potentially engaged in significant growth. Obviously, that is something with which we are all very concerned. But the notion, or the premise would be that the barrier to that would be accomplished or would be overcome, I should say, by reducing or eliminating requirements for information.

Just sort of thinking about the context of some of the more recent, in the last several years, say a decade, significant financial calamities that this country has faced, it seems to me it that it was not based on an overabundance of information.

I would just like to, perhaps have Dr. Coffee make some comments, but let me just premise the question by saying this: Sort of stepping back from these proposals, from my perspective, I would like to take a look at this from a slightly higher elevation, because when it comes to Congress, one of the things I have learned in the 15 months that I have been here is that there are a couple of overriding themes. One has to do with regulatory reform, which has evolved into a term of art, which really, for the most part, means creating greater exemptions for existing regulations. Reform has its own definition here, I have learned.

And the other continuing theme is, when we deal with the development of regulations, with the lack of a cost-benefit analysis, to look at the effect of a regulation and its cost and implementation versus the public value that it would generate.

Yesterday's hearing in the full Financial Services Committee was focused mostly on the cost-benefit question, and today we are talking more about this notion of reform. But, in thinking about this, in areas that are in need of capital formation, it would seem to me that the committee would focus, and it has somewhat, but focus more attention on areas like the mortgage market is a good place to start, and if we are thinking about capital for small and emerging companies we might think more aggressively about reauthorization of the Export Import Bank, since the notion here is that somehow the government is crowding out the capital that could be available through the private sector.

But, since today we are focused on the SEC, and these various legislative initiatives, and as I stated, some which cause some concern for State regulation, my question would be this to Dr. Coffee, specifically: To what extent are these regulations, these proposed new legislative initiatives necessary? Is there a significant problem with small companies being able to access capital? Or if it is a problem that needs a solution, are these legislative initiatives the solution that you would prescribe? Or would you come up with

some other initiatives that might be more helpful in dealing with that underlying problem if it exists?

Mr. COFFEE. I think there have been two very significant reforms that greatly increased the ability of smaller issuers to access the capital markets. First of all, there is a general solicitation, private placement under Rule 506, which we have only had now for about 3 or 4 months, that the rules have been effective. That is going to be available to small issuers as well as large issuers. Second, we have Regulation A Plus—it is colloquially called Regulation A Plus—which has a $50 million ceiling on it, but $50 million is real money to a smaller issuer, and that allows you to reach even the retail investor who doesn't qualify for a Prop 4A private placement.

So, you can go to accredited investors under 506, with a general solicitation. You can go to retail investors under the Regulation A Plus. Neither of those has had much experience yet—6 months, 2 months, I think those will be developed. It takes a while for industry to adapt to these things, but I think both of those will significantly enhance the ability of issuers to access the capital markets.

I understand there are some costs, there some problems about the continuing costs of compliance, a different issue. But I think, again, we should be searching for scaling these requirements, and there are lots of ways you can do that and not go into this complete exemption mode that some of these bills do. I hope that is helpful.

Mr. KILDEE. It does. And if I could just quickly ask Mr. Quaadman a question, you mentioned that there is a lot of data out there, and, of course, you and I both access most of our information through these devices. In that the presence of data is not the issue, but it is the delivery system of that data, the question I would have for you is if that is the case, who would determine what data is required to be out there? We are fixing delivery systems, but how do we determine what data would have to be provided, under what intervals, and to what extent, if it is not through regulations that are adopted by some entity of the government, the SEC or others?

Mr. QUAADMAN. Sure. The corporate secretary of Ryder Systems was at the Chamber a month ago at an event where we were discussing corporate governance issues, and he was actually talking about the fact that with an over 100-page proxy, that makes it more difficult for them, Ryder, to communicate with their shareholders or potential investors to get capital.

So, the question I think we are all faced with, and this is something that I think we all know, and the SEC has actually been looking at it for several years, and this is actually what the genesis of XBRL was, that different investors want to look at different data that they feel is more important to them, right? And where I think where Mr. Garrett's bill is going is, you can come up with that summary page, and then you could sort that information, and determine what is best for you. But, more importantly, I think we need to do that study in the Garrett bill, because that is what is going to make it, it is what is going to inform all of us, to determine what is the data that is needed? How should it be delivered? And what is the best way to do that? And we don't disagree that it shouldn't be done through regulation, but the problem is we are dealing with regulations that are rooted in 1930s legislation.

Chairman GARRETT. Thanks. Yes, so, it was pointed out to me, two points. One is, we had a study in there, and that is in legislation because, as you probably all know, this is not information that we haven't already sought from them in the past, and we just don't get it. So, now we have do it through legislation.

And, to Mr. Kildee's comment, before I yield over, actually, we came up with a simpler solution so maybe what we need to do is just provide a total government guarantee for the entire securitization process there, and then there will be complete investor confidence regardless of the information that is provided and then we can ensure a robust securitization market. So, let's think about that for a little while. And with that, I will yield to Mr. Hultgren.

Mr. HULTGREN. Thank you, Mr. Chairman. And thank you, again, to all of the witnesses for being here. I want to address my first question to Mr. Quaadman. The U.S. Chamber of Commerce, I know, represents more than 3 million businesses of all shapes and sizes. Do your interactions with member businesses lead you to believe that some companies would consider increasing employee ownership beyond their top executives if we passed this type of legislation, which makes it cheaper and less risky to do so?

Mr. QUAADMAN. Yes, and first of all, thank you for introducing this legislation. I have heard from companies during the Jobs Act, actually before the Jobs Act debate, that they were very worried that 12G was inhibiting their ability to retain employees. And these were small businesses, private businesses that are trying to grow. What happened after the Jobs Act passed is they said they effectively called in and said 12G is fine, but 12G doesn't work unless Rule 701 is lifted, and that the dollar level is raised, and it hasn't been raised since 1976. So, this is a device that, unless we get this Rule 701 changed, that your bill is looking to do, it will be exceedingly difficult for these businesses to retain important employees in order for them to succeed.

Mr. HULTGREN. I would open this up to anyone. I wonder if anyone could elaborate on the danger that confidential information could pose to a privately held companies?

Mr. QUAADMAN. Mr. Hultgren, there is a reason why private companies are private. If they wanted to enter the public markets and disseminate that information in such a way that they felt was beneficial to them, they would. They have made a decision that they feel they would rather not have certain confidential information be displayed, and that is something they have made that value judgment on.

It is something also, when you take a look at the Facebook, when you take a look at the Facebook capital raising issues from several years ago, they specifically tried to evade the American capital markets, because they didn't want to have some information disseminated. And, that is, if that is a value judgment they make, they are doing so in what they feel is in the best interest of that business.

Mr. HULTGREN. Let me offer this out, if anyone has any thoughts, if anyone could elaborate on how increased employee ownership could benefit the market performance of privately held companies. Mr. Burton?

Mr. BURTON. I think it is clear that for some medium-sized companies, the current threshold makes it difficult for them to compete with larger companies that can offer stock options, ISOs, and stock that has sold at a discount into the pensions and so on and so forth. In other words, compensatory benefit plans.

The long and short of it is that by raising the threshold to $20 million, a lot of companies are currently running up against these restrictions, will be able to compete with the Microsofts or the Apples or the Googles or what have you as they are trying to develop new technologies, create jobs, and provide better products to the American people, and we don't want to set up the world so that the only people who can provide these kind of employee benefits are the largest corporations in America. We want there to be parity between the small firms and the large firms, in terms of how the employee benefit programs work, and this is by no means the only case where that goes on.

Mr. HAHN. We are a 30-person—

Mr. BURTON. It needs to be fixed.

Mr. HAHN. We are a 30-person emerging growth biotech company. So, we compete for talent against the large pharmaceutical companies. We can't always compete with the salaries, so it is important for us to be able to give equity stakes, compensation to those employees to help attract the top talent.

Mr. HULTGREN. I have visited in my district—I have a couple of ESOP companies, and it is just a noticeable difference when you walk in there, of a sense of ownership, a sense of pride of every single person there feeling like this is their business, from the top to every single level, it is just amazing.

Do you feel like that is similar as well, of certainly impacting and incentivizing employees to come to a business, but also to work more diligently, and ultimately what have you seen? What would be the benefit for some of your employees to have access to this?

Mr. HAHN. Like you said, ultimately, they have a stake in the company if it does well. If the company grows, their ownership in the company grows. Their stock value goes up. Interestingly, we have had a lot of investor meetings where investors were actually happy that we provide stock options to all of our employees, and some of the investors liked that because, as you said, it gives them more of a stake in the company. It makes the employees actually work harder and feel more ownership to what we are doing.

Mr. HULTGREN. Really quickly, I wondered, has the SEC articulated any reason as to why they have not promulgated a rule since 1998 to update Rule 701? Does anyone know? Okay, thank you, Mr. Chairman. My time has expired. I yield back.

Chairman GARRETT. The gentleman's time has expired. The gentleman from Connecticut is now recognized.

Mr. HIMES. Thank you, Mr. Chairman, and thank you for holding this hearing. I am looking at a number of pieces of this legislation, including some related to the SBICs, which I think are a very effective mechanism for financing smaller companies.

I have two questions, though, for the panel. Thank you for being here. My first question relates to the nature and intensity of the problem that we face. Mr. Burton, and Mr. Quaadman, in particular, you speak in pretty dire terms about the current state of

the IPO market. Mr. Burton, in your testimony you say that it is prohibitively expensive for small and medium-sized companies to access the public markets. That is somewhat belied by the IPO volume that was saw in 2013, which was a record in about the last 15 years or so, so I am trying to get at what is really going on.

Mr. Quaadman, you put this in terms of declining competitive, saying that there is a steady decline of public companies in the United States and new businesses are eschewing public markets for more private forms of financing. So the question is, and by the way this comes from, I was a supporter of the Jobs Act, and I was just—it was hard to get at what was really going on. I was regularly shown charts of the IPO market in 2008 and 2009, as evidence about how tough Sarbanes-Oxley was, this while the financial markets were, of course, in ashes around our feet.

So, my question is this, and Mr. Quaadman, maybe you can just give us a little bit more information. You frame this in terms of competitiveness, saying there is both less public market financing happening and less in the United States. When I got into IPOs 25 years ago, there was Japan, New York, and London, and that was it. Today, it is a very different world. You have all sorts of markets in Asia, and all over Europe.

I have two questions for you, really. What is the optimal distribution internationally that allows you to say that it is too little here in the United States? Number one, can you show us that we have deviated from what you see as internationally appropriately distributed? And number two, your statement that we are doing too much private and nontraditional, as opposed to public. What is the right split between young companies going public, seeking private sources of financing or seeking strategic exits? It is hard to know if there is a problem if we don't know what the optimal steady state is. So, what do you have for us in that regard?

Mr. QUAADMAN. Thank you for the thoughtful question and thank you for your continued leadership on these issues. Last year was the first time we saw a rise—a significant rise with the IPOs, and it was also the first time, as I said in my opening statement, in 15 years that we actually saw a rise in public companies in the United States. I think what we did see in 1999 and 2000, at the same time we were going through Sarbanes-Oxley and the Enron scandal and all of that, we actually had for the first time since World War II, increasingly competitive global financial markets, right? So, our markets now have to compete in a way that they didn't have to compete for 70 years, and from our vantage point, that is not a bad thing, because if we have to go out and compete, let's go and do it because the American business community does that best.

What I think is problematic, and this is where the Chamber has had a concern since before the financial crisis, is that our regulatory structures haven't kept up with the course of time, which is what I think we are seeing with some of the bills here, is that we are actually updating things that haven't been updated in a while. And, at the same time, our regulatory systems are sort of holding back the ability of these businesses to compete.

Mr. HIMES. But, let me stop you. I got that.

Mr. QUAADMAN. Yes.

Mr. HIMES. My question is, can you assert with confidence, based on some view of what is optimal, that we are not doing enough public financing here in the United States relative to Asia and Europe? And can you assert with confidence that we are doing too many private and strategic take outs, rather than IPOs?

Mr. QUAADMAN. I spoke before a group of 100 top entrepreneurs under 35. And I asked them a question, "Who here wants to go public, and who wants to stay private? Who wants to be acquired?" That split up a third, a third and a third. Had I asked that question 10 years ago, 90 percent of the hands would have gone public. So, what we have done, and this is why I think you are right, I think it is difficult to see where the trends are right now, but what we have seen is that the mindset of our younger business people, and our business people is changing, because one thing that is true is that the wealth effects of a company going public and the job creation effects of a company going public, are established, and that we are seeing less of that happening, or have up until last year.

Mr. HIMES. Thank you. I appreciate that answer, and I want to follow up. I am almost out of time, but I really am interested in this question of what is optimal, because, again, it is just not obvious that—

Mr. QUAADMAN. Yes.

Mr. HIMES. —we have a problem, unless we look at numbers. I am almost out of time, but Mr. Burton, you talked about $1.5 million in costs. I want to talk to you afterwards about gross spreads. The average gross spread for an IPO has been 7.5 percent for about, well, for forever. The average IPO is $200 million in size, a little bit of math tells you that is $15 million in capital that goes away for public companies, and for some reason I hear a lot about the $1.5 million, but I don't hear anybody talking about that $15 million in the gross spread. I am out of time, but I would really—I am going to approach you afterwards to kind of get a sense of why that is happening, and what you think about it. And with that, I will yield back the balance of my time.

Chairman GARRETT. The gentleman yields back.

The gentleman from Texas.

Mr. NEUGEBAUER. Thank you, Mr. Chairman, and thank you for holding this hearing. Mr. Hahn, I think there is a lot of perception out there, that, basically, the securities laws in this country kind of assume that everybody is a big corporation and are flush with money, and that the large, sophisticated multinational companies, and that kind of discriminates against smaller companies, because of the way those laws are imposed. Would you agree with that?

Mr. HAHN. I agree completely with that. As I was stating earlier, with the 30-person company, and with the Jobs Act, we reached out to 90 investors during our road show, and test-the-waters meetings, and when we talk about 404(b) and the internal controls, I can tell you that in not one of those meetings did anybody ask about our internal controls, our financials. They wanted to dig into the science, and understand where were coming from. The only financial question we ever received was, how long is this cash going to last?

Mr. NEUGEBAUER. Yes, I think one of the things, particularly, and maybe it discriminates against biotech companies and research

companies a little bit more, but the life bread for those companies is to pour as much money back, I guess, into research and development as you possibly can because that, ultimately, is going to create value for your company. Is that a fair assessment?

Mr. HAHN. That is very fair. As we were saying earlier, the cost of our IPO was $2.5 million. And then, $1.5 million a year just to be a public company. And, with a base salary expense, annual salary expense of $4 million, that additional $1.5 million could be put toward research and development, hiring more scientists.

Mr. NEUGEBAUER. Creating more jobs, right?

Mr. HAHN. Creating more jobs.

Mr. NEUGEBAUER. And creating more value for shareholders, and creating more jobs. I think, Mr. Burton, we heard Professor Coffee say that the SEC is overworked and underpaid, or underfunded. Do you agree with that?

Mr. BURTON. I think that is maybe true with respect to enforcement, but it definitely is not true on the regulatory side. The SEC budget, and I have these numbers in a paper I put together about 3 months ago, has grown approximately—this is from memory—10 percent a year for nearly 30 years, which is a pretty high rate of growth. And if you look at the regulations, even the relatively simple regulations have, perhaps, a dozen lawyers involved in it. So, the bottom line is I don't think they are under resourced in the regulation area. In fact, I think to some degree, they may have too many people involved in each project, and that impedes your ability to get done what we would all like to see them get done.

Mr. NEUGEBAUER. Yes, in fact, the numbers are this: the operating budget for 2013, I believe, is $1.26 billion. That is 20, 22 percent higher than the highest level of funding approved by the Democratic-controlled Congress from the period of 2007 to 2010.

Mr. BURTON. I think they have a management problem, not a financing problem. And that requires a different kind of solution.

Mr. NEUGEBAUER. Mr. Quaadman, I think you picked up on something that I wanted to talk about a little bit, and this is about when these small to medium-sized companies can access the capital markets, can go public, it provides a lot more capital for them to accelerate the growth of a lot of those companies, and creates quite a few jobs. Is that a fair assessment?

Mr. QUAADMAN. Yes, there are numerous academic studies which show that the job impacts and the wealth creation that goes along with that, and that is where I was getting to, something that I think we have lost, and I also think we are seeing the mindset changing.

But also, to go back to your earlier question, as well, we came out with two separate studies that have 51 recommendations for how the SEC can better manage itself, and I think you see that with some of, even the prioritization of rulemakings, that the SEC has done, where they have put conflict minerals ahead of other rulemakings that are of more consequence to investors and businesses.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. I yield back.

Chairman GARRETT. The gentleman yields back. I guess last, but certainly not least, Mr. Luetkemeyer is recognized for 5 minutes for the last word.

Mr. LUETKEMEYER. Thank you, Mr. Chairman, I will be brief. Thank you very much, I appreciate your allowing me to participate this morning in your subcommittee, as I don't normally sit on your subcommittee, but I think it is an honor to be here, and I appreciate your indulgence.

Also, this morning, I would like to ask for unanimous consent to add to the record two op-eds: one that appeared this morning in The Wall Street Journal regarding to my bill; and one that appeared in Law360 regarding my bill.

Chairman GARRETT. Without objection, it is so ordered.

Mr. LUETKEMEYER. They are such glowing and supportive tomes that I could not resist putting them in the record, so I certainly appreciate your willingness to do that. Thank you, sir.

With regards to H.R. 4200, I assume that most of the Members here this morning are familiar with the bill, and what it does, I can just briefly say that it allows advisers that have jointly advised only SBICs and venture funds to exempt from SEC registration.

Combining the two separate extensions that currently exist, one for advisers that solely advise SBICs and one for advisers that solely advise venture capital funds as well as exclude SBIC S. That is from SEC registration, threshold calculation, and exempt from State regulation advisers of SBIC funds with less than 90-man assets under management, leading those to be regulated by the SBA as they are they are today, which I think is an important point. So I would just like to get some acknowledgement of what a wonderful bill this is, Mr. Quaadman, from the Chamber. How do you appreciate that effort by myself and other colleagues of mine, with tremendous bipartisan support on this bill?

Mr. QUAADMAN. Yes, sir, we support your bill, and we appreciate the bipartisan manner in which it is moving forward, and I look forward to working with you for its passage.

Mr. LUETKEMEYER. Do you have any advice or do you like everything in it? Do you think it is going to address a need, a concern?

Mr. QUAADMAN. We think it actually addresses a very significant problem in that we have seen where we don't have the exemptions normally lining up as they should, so I think you are correcting a problem here. I think it makes the markets more efficient and will help business who use both SBICs and venture capital, and we appreciate your work on this.

Mr. LUETKEMEYER. Mr. Burton, do you have any comments about the bills?

Mr. BURTON. As outlined in my written statement, I think the bill is very constructive and addresses a significant problem, and the bottom line is that SBICs should not be treated less favorably than other venture capital firms. And they are a form of venture capital firms.

Mr. LUETKEMEYER. I appreciate your remarks, and I also want to give kudos to Ranking Member Maloney for her welcome support, and again it is a bipartisan effort, and her efforts to support the bill are greatly appreciated.

Mr. Chairman, there is an old saying that you want to quit while you are ahead, and understanding that, I certainly appreciate the support and all the fine words from our panel this morning, and I yield back.

Chairman GARRETT. So, now we understand why you wanted to come to the panel here at the meeting today. Great. While taking that under advisement for the next time that you come into our subcommittee hearing, great. So, again, I appreciate the testimony, information, and responses from each and every member of the panel. It is always helpful, and as somebody here said—I think it was Mick Mulvaney—that this type of hearing is a good hearing because we are, honestly, each one is trying from both sides of the aisle just to try to get to the root issues, on the problems, and to try to elicit what we can do in the best case on these very complicated topics. So, I do thank you for that.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing is now adjourned. Thank you again.

[Whereupon, at 12:04 p.m., the hearing was adjourned.]

A P P E N D I X

April 9, 2014

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CONGRESSIONAL TESTIMONY

Proposals to Enhance Capital Formation for Small and Emerging Growth Companies

Testimony
before the
Capital Markets and Government Sponsored Enterprises Subcommittee
of the
Committee on Financial Services
United States House of Representatives

April 9, 2014

David R. Burton
Senior Fellow in Economic Policy
The Heritage Foundation

My name is David R. Burton. I am Senior Fellow in Economic Policy at The Heritage Foundation. I would like to express my thanks to Chairman Garrett, Ranking Member Maloney, and Members of the Subcommittee for the opportunity to be here this morning. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

The 2012 JOBS Act[1] was a bipartisan achievement of consequence. Republican and Democratic members of this committee and your counterparts in the Senate put aside partisan differences, overcame substantial difficulties and legislated in the public interest by enacting substantial, positive reforms to the securities laws. These reforms will help small business entrepreneurial capital formation, innovation, and job creation. I had the good fortune to attend the Rose Garden signing ceremony when President Obama signed the JOBS Act into law. It was a reminder that important, constructive change can still be accomplished when policymakers resolve to craft genuine solutions to the problems that face the American people.

There remains, however, much to be done. Securities and Exchange Commission (SEC) implementation of the JOBS Act is much too slow, in some cases nearly a year and a half behind the pace required by Congress. And the rules being proposed by the Commission are often so voluminous and complex that they will undermine the laudable purposes of the JOBS Act. I would encourage Members of this Committee to actively monitor the rule-making process in your oversight capacity and communicate your concerns to the Commission. There are also significant statutory reforms which are still required if we are to give genuine rebirth to the spirit of enterprise, innovation, and dynamism necessary for a lasting and widespread prosperity that provides opportunity and better incomes for all Americans.

I have been asked to provide my perspective on a number of legislative proposals to enhance capital formation for small and emerging growth companies. In addition, I will comment on the Commission's implementation of the JOBS Act and suggest about a dozen specific policy changes that would promote small business capital formation and entrepreneurship.

Regulation S-K

Regulation S-K[2] is the key regulation governing non-financial statement disclosures of registered (i.e., public) companies. Regulation S-X[3] generally governs public company financial statements in registration statements or periodic reports. These two rules, including the various rules and accounting policies that they incorporate by reference, impose the vast majority of the costs incurred by public companies.

[1]The Jumpstart Our Business Startups Act, Public Law 112–106, April 5, 2012.
[2]17 CFR Part 229.
[3]17 CFR Part 210.

The Commission has estimated that "the average cost of achieving initial regulatory compliance for an initial public offering is $2.5 million, followed by an ongoing compliance cost, once public, of $1.5 million per year."[4]

For small and medium-sized firms seeking to raise capital, these costs make access to the public capital markets prohibitively expensive. Obviously, $2.5 million imposes a hefty 10 percent deadweight cost even on a $25 million offering. If the hurdle rate for investors is X percent, then a 10 percent regulatory toll charge is going to increase the required rate of return by 11.1 percent for a company to make the hurdle rate.[5] If the costs were 20 percent of the amount raised, then the required rate of return on the net amount raised will increase by 25 percent.[6]

But the continuing costs — $1.5 million annually on average according to the SEC — are actually more problematic. A company with shareholders' equity of $10 million with a healthy return on equity of 20 percent is going to earn $2 million. Net of public company regulatory costs, however, that company will earn only $500,000 and have a return on equity that is an anemic 5 percent. In effect, there is a $1.5 million toll charge for being a public company. This makes going public out of the question until companies reach a substantial size. Reducing this toll charge would make the public market available for more companies and enable them to grow more rapidly.

The table below illustrates this point. It shows the impact that $1.5 million in annual compliance costs would have on a company if it were public instead of private. It shows companies with shareholders' equity of $10 million, $20 million, and $30 million, and returns on equity as a private company of 15 percent, 20 percent, and 25 percent. By way of comparison, the return on equity for the Standard and Poor's 500 is generally in the 13 percent to 17 percent range.[7]

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[4]Proposed Rules, "Crowdfunding," *Federal Register*, Vol. 78, No. 214, November 5, 2013, p. 66509 (col. 2).

[5]If the hurdle rate (the minimum rate of return required by investors) is X, where X is the expected profit (P) divided by the investment (I) then, with costs of 10 percent, the effective amount raised will be 0.9I (i.e., 90 percent of the amount invested by investors) and the profit on the amount invested will have to 11.1 percent higher to achieve the hurdle rate. For example, if the hurdle rate were 10 percent, then the profit required on an investment of $1,000 would be $100. If the amount raised net of costs were only $900, then a profit of $100 on that $900 would be necessary to achieve the investors hurdle rate on an investment of $1,000. $100/$900 is 11.1 percent which in turn is 11 percent higher than the 10 percent hurdle rate. If the required hurdle rate were 30 percent (not atypical in highly risky investments), then the investors will require a profit (P) of $300 annually on the $1,000 investment. Thus, the net of cost $900 would have to earn a return of $300 or 33.3 percent, 11.1 percent higher than the hurdle rate of 30 percent. In short, the return will have to increase by the inverse of net of costs amount raised divided by the amount invested.

[6]Because 1/0.8 is 1.25. Following the 30 percent example above. Three hundred dollars divided by the net of cost $800 raised is 37.5 percent and 37.5 percent is 25 percent higher than 30 percent.

[7]See, e.g., Management Effectiveness Information & Trends, CSIMarket.com, http://csimarket.com/Industry/industry_ManagementEffectiveness.php (accessed April 7, 2014).

Impact of Public Company Regulatory Costs on Return on Equity

Shareholders' Equity	Private Company Return on Equity	Private Company Profit	Net of Regulatory Cost Public Company Profit	Public Company Return on Equity	Percentage Decrease in Return on Equity By Going Public
$10 million	25 %	$2.5 million	$1 million	10 %	-60 %
$10 million	20 %	$2 million	$0.5 million	5 %	-75 %
$10 million	15 %	$1.5 million	$0	0 %	-100%
$20 million	25 %	$5 million	$3.5 million	17.5 %	-30 %
$20 million	20 %	$4 million	$1.5 million	7.5 %	-62.5 %
$20 million	15 %	$3 million	$1.5 million	7.5 %	-50 %
$30 million	25 %	$7.5 million	$6 million	20 %	-20 %
$30 million	20 %	$6 million	$4.5 million	15 %	-25 %
$30 million	15 %	$4.5 million	$3 million	10 %	-33 %

As shown in the table, the negative impact of continuing compliance costs on the return on equity for small companies, even those of substantial size, is negative and substantial. It reduces the return on equity even for fairly substantial companies by 20 to 100 percent. It is a particularly steep barrier for development stage companies that have limited current cash flow.

Another way of looking at this is to capitalize the $1.5 million annual cost. Using a discount rate of 10 percent, this additional $1.5 million cost is the equivalent of erasing $15 million from shareholders' equity.[8] This kind of shareholders' equity erasure cannot be justified by the higher price-earnings ratio a public company commands until expected risk-adjusted earnings are quite high.

Economic research has increasingly demonstrated that most of the job creation in the economy comes from young, dynamic companies. These companies need equity investment to launch and to grow. Some call these companies gazelles. A recent survey of the economics literature on the subject reached the conclusion that gazelles "create all or a large share of net new jobs."[9] These are the type of companies that seek outside investors either via Regulation D or in the public market. But the burdens imposed by

[8]The present discounted value of $1.5 million annually with a 10 percent discount rate is $15 million.
[9]Magnus Henrekson and Dan Johansson, "Gazelles as Job Creators: A Survey and Interpretation of the Evidence," *Small Business Economics*, Vol. 35 (2010), pp. 227–244.

existing regulations (primarily Regulation S-K and Regulation S-X) effectively deny these companies access to the public market and make investors less willing to invest.

Chairman Garrett has drafted legislation designed to address this very important problem. The proposed legislation has two major components. First, it would require the SEC to issue a revised Regulation S-K to provide for better scaling of its disclosure requirements to reduce the burden on emerging growth companies and other small reporting companies and to simplify and modernize provisions of Regulation S-K that are duplicative, overlapping, outdated, or unnecessary. The SEC would be required to issue a final rule within six months. Second, the bill would require that the Commission conduct a study and provide a report to Congress about how to modernize regulation S-K and to propose a rule doing so within a year of the report being provided to Congress. The bill provides some detail about what the study should examine but provides the Commission great latitude.

There is reason to believe that the Commission itself is serious about addressing this problem. Section 108 of the JOBS Act required the SEC to study the issue. This report was released last December.[10] In it, the staff recommends "the development of a plan to systematically review (on either a comprehensive or a targeted basis, as discussed below) the disclosure requirements in the Commission's rules and forms, including Regulation S-K and Regulation S-X, and the related rules concerning the presentation and delivery of information to investors and the marketplace."[11]

In summary, this legislation is very constructive and the Commission is likely to be receptive to it. It might well launch a process that would substantially reduce unneeded impediments to smaller firms being able to access the public capital markets. I have three suggested improvements.

In its report, the Commission staff acknowledges the importance of considering cost and other economic considerations and sets forth a series of factors that should be considered. The problem is that regulation of the private capital market is done in a virtually data free environment and there is very little information regarding the *regulation* of smaller reporting companies. In other fields in which I work or have worked — tax, health care, labor and employment, immigration — there is robust data for policymakers to consider. Not so for securities regulators and you, the Members of this Committee. The SEC does a very bad job of collecting and making available to the public information about these markets. Thus, it will be difficult for the SEC Division of Economic and Risk Analysis to do this work well.

Two relatively small steps could be required of the SEC to help address this data gap. The legislation could require a survey of smaller reporting companies. This survey should seek information both from firms that recently undertook an IPO and those who have

[10]U.S. Securities and Exchange Commission, "Report on Review of Disclosure Requirements in Regulation S-K," December 20, 2013, http://www.sec.gov/news/studies/2013/reg-sk-disclosure-requirements-review.pdf (accessed April 7, 2014).
[11]Ibid., p. 95.

been registered companies for some time. It should seek to determine which aspects of Regulation S-K and Regulation S-X are the major cost drivers and seek input about what should be changed. In addition, the Commission should begin to collect and publish data regarding its enforcement actions relating to both the private securities markets and the public market. The Commissioners, Congress, and the public need actual information — not anecdotes — about what types of disclosures, misrepresentations, or omissions are the source of enforcement actions, what types of issuers and exemptions give rise to enforcement actions, what are the frequency and severity of different types of violations, and whether it is the primary or the secondary market that is the source of most problems.

Second, the legislation should seek a study of these issues by the Government Accountability Office (GAO). The GAO has a well-deserved reputation for dispassionate and useful analysis and information collection. I think it would be very useful to this committee and the public to have an independent source of information regarding Regulation S-K and an independent analysis.

Third, I would recommend that both the SEC and the GAO be asked to consider the recommendations of the SEC Advisory Committee on Small and Emerging Companies[12] and the recommendations of the SEC Government-Business Forum on Small Business Capital Formation.[13]

SBIC Advisers Relief Act of 2014 (H.R. 4200)

The SBIC Advisers Relief Act of 2014 (H.R. 4200) amends the Investment Advisers Act of 1940 to include advisers of Small Business Investment Companies (SBICs) in the class of venture capital funds and private funds that are exempt from SEC registration. Although I am familiar with SBICs, I should hasten to add that I am by no means an expert on SBICs.

Government loans and loan guarantees to private businesses are inappropriate, particularly when the federal fiscal situation is so grave. Thus, I do not support that aspect of the SBIC program. SBICs do, however, raise billions of private dollars that they then invest in small business and, in this sense, they are an important part of small firm capital formation. They are a form of venture capital firm and it is appropriate to treat them as such for purposes of the Investment Advisers Act of 1940. Exemption from SEC registration is further justified by the fact that SBICs are regulated by the Small Business Administration.

Increased Threshold Amounts for Compensatory Benefit Plans

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[12]Stephen M. Graham and M. Christine Jacobs, Committee Co-Chairs, letter to SEC Chairman Elisse B. Walter, "Recommendations Regarding Disclosure and Other Requirements for Smaller Public Companies," March 21, 2013, http://www.sec.gov/info/smallbus/acsec/acsec-recommendation-032113-smaller-public-co-ltr.pdf (accessed April 7, 2014).

[13]U.S. Securities and Exchange Commission, Final Reports of the SEC Government-Business Forum on Small Business Capital Formation, http://www.sec.gov/info/smallbus/sbforumreps.htm (accessed April 7, 2014).

The committee is considering draft of legislation to amend SEC Rule 701.[14] Rule 701 only applies to private companies maintaining a written compensatory benefit plan for the participation of their employees, directors, general partners, trustees (where the issuer is a business trust), officers, or consultants and advisors, and their family members who acquire such securities from such persons through gifts or domestic relations orders. Under the rule, a compensatory benefit plan is any purchase, savings, option, bonus, stock appreciation, profit sharing, thrift, incentive, deferred compensation, pension, or similar plan. Under present law, if an issuer sells more than $5 million of securities in any consecutive 12-month period, then the issuer is required to provide additional disclosures to investors. The discussion draft would require the SEC to increase that threshold to $20 million.

For medium-sized firms the $5 million limit is a significant constraint on their ability to compensate employees and attract talent. Increasing the limit is warranted to help these firms grow and create jobs, to compete with larger public companies, and to provide new and innovative products to consumers. Employees, officers, directors, and others who will benefit from this proposal are better situated than ordinary investors to know the future prospects of the company and are less in need of voluminous disclosures than outside investors. It is important to remember that Rule 701 transactions are not exempt from the antifraud, civil liability, or other provisions of the federal securities laws. The SEC's Government-Business Forum on Small Business Capital Formation has expressed support for this idea on a regular basis.

Well-Known Seasoned Issuer Definition

The committee is considering draft legislation to require the SEC to revise the definition of a Well-Known Seasoned Issuer (WKSI) to reduce this threshold from $700 million to $250 million, thus enabling more issuers to take advantage of the benefits of WKSI designation. At this time, I do not have enough information about the implications of this proposal to provide useful input to the committee.

Conflict Minerals and Extractive Resources Disclosures

The committee is considering draft legislation to amend the Securities Exchange Act of 1934 to exempt emerging growth companies and non-accelerated filers from disclosures relating to conflict minerals and extractive resources.

In my judgment, the securities laws are sufficiently complex. The purpose of securities law is to protect investors from fraud and misrepresentation and to promote capital formation by ensuring orderly, honest markets and by requiring the disclosure of information material to investment decisions. Policymakers need to resist the temptation to introduce requirements that are extraneous to the core purposes of the securities laws. Disclosures relating to conflict minerals and extractive resources do not promote the purposes underlying securities regulation. This constructive proposal removes a burden on small issuers that has nothing to do with the purposes of securities regulation.

[14] 17 CFR 230.701.

Rule 144

The committee is considering draft legislation requiring the SEC to amend Rule 144 to reduce from 6 months to 3 months the mandatory holding period before which restricted securities issued by an SEC reporting company may be resold to the public. The discussion draft would also amend Rule 144 to allow the public resale of restricted securities originally issued by a shell company starting two years after the date on which the company files a Form 8-K with the SEC disclosing that it is no longer a shell company. Finally, the discussion draft would amend Section 18(b) of the Securities Act of 1933 to include in the definition of "covered securities" exempt from state regulation any security offered or sold in compliance with Rule 144A.

At this time, I do not have enough information about the implications of this proposal to provide useful input to the committee.

Small Company Freedom to Grow Act

The committee is considering draft legislation entitled the "Small Company Freedom to Grow Act." The discussion draft would amend the SEC's Form S-1 registration statement to allow a smaller reporting company to incorporate by reference any documents the company files with the SEC after the effective date of the Form S-1. The discussion draft would also amend the SEC's Form S-3 to allow a smaller reporting company to register a primary securities offering exceeding one-third of the aggregate market value of voting and non-voting common equity held by non-affiliates of the registrant, and to eliminate the restriction that the smaller reporting company have a class of common equity securities listed and registered on a national securities exchange. Finally, the discussion draft would amend Section 18(b) of the Securities Act of 1933 to include in the definition of "covered securities" exempt from state regulation securities issued by smaller reporting companies and emerging growth companies that are not listed or authorized for listing on a national securities exchange.

Allowing incorporation by reference of documents filed with the SEC after the effective date of the Form S-1 will reduce the administrative burden on issuers without having any appreciable negative impact on the information available to investors. Allowing smaller reporting companies to register securities offerings exceeding the one-third aggregate market value test eliminates an artificial barrier to capital formation.

The aim of section 4 of the draft legislation is laudatory. It aims to preempt state Blue Sky laws with respect to unregistered securities offered by registered companies that are smaller reporting companies or emerging growth companies. It seeks a report from the SEC within 45 days about how to do it. The burden of Blue Sky laws, especially in merit review states, is enormous. Blue Sky regulation has effectively killed Rule 504, Rule 505, and Regulation A. Since the companies in question are registered companies subject to rigorous federal disclosure requirements, there is no good reason to also subject them to 51 different sets of Blue Sky laws and 51 different regulators.

It seems that simply defining "covered security" to include securities offered by smaller reporting companies or emerging growth companies in the bill and seeking SEC input before actually reporting the bill out of committee would be a more direct approach.

Fostering Innovation Act of 2013 (H.R. 2629)

The Fostering Innovation Act of 2013 would amend Rule 12b-2 so that companies with a public float of either (1) less than $250 million with no annual revenue restriction or (2) between $250 million and $700 million and less than $100 million in annual revenue are deemed "non-accelerated filers." The definition of accelerated filer currently is a firm with a public float of $75 million or more.[15]

Section 989G of the Dodd–Frank Wall Street Reform and Consumer Protection Act[16] exempts non-accelerated filers from section 404(b) of the Sarbanes–Oxley Act of 2002. Section 404(b) imposes very high costs and is of very limited utility with respect to small companies. In these companies, a small executive team of a very few persons controls the company. If they want to abscond with company funds, a loose-leaf binder on the shelf is not going to stop them. Yet these internal control assessment loose-leaf binders can cost a quarter of million dollars or more to produce. Section 404(b) is best thought of as the accountants' and management consultants' full-employment provision. As a practical matter, it does little to protect investors in small firms but imposes extremely high costs on law-abiding firms.

The legislation would amend the definition of accelerated filer in Rule 12b-2 to more reasonable levels and eliminate one of the worst sources of compliance costs for small public companies. A similar measure was included in the bipartisan American Growth, Recovery, Empowerment and Entrepreneurship (AGREE) Act during the last Congress.[17]

JOBS Act Implementation

SEC implementation of the JOBS Act is much too slow, in some cases already nearly a year and a half behind the pace required by Congress. And the rules being proposed by the Commission are often so voluminous and complex that they will undermine the laudable purposes of the JOBS Act. Below, I discuss the SEC proposed rules relating to Regulation A, Regulation D, and crowdfunding.

Regulation A Plus

The Commission is to be commended for recognizing the debilitating problems with the existing Regulation A, taking congressional concerns about the small issue exemption seriously and making a concrete proposal to rectify the problem. However, unless the proposed rule is modified in substantial ways, it will be of only limited value to issuers

[15] 17 CFR §240.12b-2.
[16] 15 U.S. Code §7262.
[17] S. 1866, H.R. 3476, 112th Congress.

seeking to raise capital. My comments regarding the proposed rule may be summarized as follows.

- The Commission's regulation of small business capital formation and entrepreneurship is of macroeconomic significance.
- Overregulation by state regulators and the Commission has destroyed the usefulness of Regulation A (as well as Regulation D Rules 504 and 505).
- The proposed rule is a modest step in the right direction, of potential value to firms making Tier II offerings between $5 million and $50 million, but for various reasons will be of much less value than the Commission appears to believe unless the proposed rule is revised.
- The Commission should broaden the scope of its qualified purchaser definition, otherwise Tier I will be an illusion and remain just as unhelpful to small business capital formation as Regulation A is currently.
- The Commission needs to resist calls by state regulators to narrow the scope of its qualified purchaser definition and to otherwise over-regulate small business capital formation and entrepreneurship.
- The Commission needs to reduce the regulatory burden on Tier II issuers. Given the fact that the proposed Tier II compliance burdens are similar, although less, to the burdens imposed on small public companies, it is likely to be the case that many issuers will find the proposed rule to be of little value and continue either to use Rule 506 or become a registered company.
- The Commission should reject the proposed investor limitations as inconsistent with the disclosure and fraud prevention principles of federal securities law, as having no statutory basis, and as inconsistent with congressional intent. The Commission should not get into the business of providing investment advice, it should not mandate that people maintain a particular portfolio, and it should not mandate the level of risk that they may choose to undertake.
- The Securities Exchange Act section 12(g)(1) thresholds must be relaxed for Regulation A offerings; if they are not, then Tier II will be of very limited utility except for small offerings substantially below the $50 million cap because per investor sales amounts will have to be extremely high if the current section 12(g) limits are maintained. The interaction of the section 12(g)(1) thresholds and the investor limitations are likely to make offerings anywhere near the $50 million cap simply infeasible. The presumption of Commission staff that broker-dealers will typically hold Regulation A securities in street name, thus reducing the number of holder of record substantially, is entirely unwarranted. The Commission has authority to take action rectifying this problem under section 36 of the Securities Exchange Act.
- It currently takes 8 months, on average, to qualify a Regulation A offering. For a start-up business, this is an eternity. If the Commission wants Regulation A to work, then it must, as a management matter, dramatically reduce both the complexity of and length of time it takes to navigate the qualification process.

A more detailed analysis is available in my comments to the Commission regarding the proposed rule.[18] Issues discussed include the economic importance of small business capital formation, the qualified purchaser definition, Tier I offerings and Blue Sky laws, the investment limitation, the section 12(g) triggers, the content of the offering, circular and continuing disclosure requirements, qualification, the North American Securities Administrators Association Coordinated Review System, fraud and small issuers, venture exchanges, insignificant or immaterial violations, the testing the waters provisions and confidentiality, and valuation.

Regulation D

Regulation D, although imperfect, works well. In important respects, it has become the most important means of raising capital in the U.S., particularly for the young, dynamic companies that contribute the most to economic growth and job creation. In the JOBS Act, Congress made the policy judgment that the restrictions in Regulation D should be relaxed to some degree. Yet the proposed rules will sharply reduce the positive economic effects of the constructive changes made by Congress. If combined with substantial increases in the accredited investor thresholds that the SEC is contemplating and regarding which the SEC has sought comments in this proposed rule, then the SEC will almost certainly negate most of the positive impact of the JOBS Act.[19]

The proposed amendments to Regulation D are not going to affect only affluent accredited investors. The proposed rule and its potential progeny can be expected to have a macroeconomically significant negative impact on the U.S. economy and to adversely affect millions of people.

The simple fact that these unwarranted rules contain within them over 100 issues regarding which the Commission is seeking comments from the public is illustrative of the fact that they are overly complex and will materially increase the burden on small and start-up business. No matter how the Commission resolves these issues, they are issues that counsel for small firms must become familiar with and address in their Regulation D filings and, of course, for which they will bill their clients. If the proposed rules are adopted, using Regulation D (particularly with general solicitation) will become notably more expensive and fewer issuers will be able to raise the capital needed to innovate and create jobs.

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[18]Comments of David R. Burton on Proposed Rule Regarding Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act, March 21, 2014, http://www.sec.gov/comments/s7-11-13/s71113-52.pdf (accessed April 7, 2014).

[19]See also David R. Burton, "Don't Crush the Ability of Entrepreneurs and Small Businesses to Raise Capital," Heritage Foundation *Backgrounder* No. 2874, February 5, 2014, http://www.heritage.org/research/reports/2014/02/dont-crush-the-ability-of-entrepreneurs-and-small-businesses-to-raise-capital (accessed April 7, 2014).

A more detailed analysis is available in my comments to the Commission regarding the proposed rule.[20] Issues discussed include the size and importance of the Regulation D capital market, securities regulation administration, the purpose of securities regulation, the accredited investor net worth and income tests, general solicitation in Rule 506(c) offerings[21] and the proposed temporary rule for mandatory submission of written general solicitation materials, the proposed additional Form D filings, the proposed mandatory legends, the ability to cure and sanctions, improved data collection, the SEC economic analysis, and the Small Business Regulatory Enforcement Fairness Act.

Crowdfunding

Crowdfunding has the potential to substantially improve very small firms' access to capital provided that the regulatory framework adopted by the Commission does not impose prohibitive costs on either issuers or funding portals. It also will enable ordinary investors access to investments in start-up companies that ordinarily only accredited investors have access to. The primary advantages of crowdfunding are that it will enable small firms to access small investments from the broader public (i.e., from non-accredited investors) and that resale of the stock will not be restricted after one year. If, however, the regulatory costs associated with crowdfunding are too high, then issuers will either use other means to raise capital or be unable to raise capital and ordinary investors will be denied the opportunity to make these investments.

Firms using crowdfunding will almost invariably be the smallest of small businesses. More established firms or those seeking more than $1 million will use Regulation D or, perhaps, Regulation A+. If the Commission over-regulates crowdfunding, it will frustrate the bipartisan intention of Congress and the President and impede both the ability of small firms to raise the capital they need to create jobs, innovate, and contribute to the prosperity of the country and the ability of small investors to invest in the firms with the most potential growth. This is no idle possibility. The history of the small issues exemption and Regulation A demonstrates that over-regulation can destroy the usefulness of an exemption. Regulation A as currently constituted is seldom used.[22] It is simply too costly.

The Commission is underestimating the costs imposed by the proposed rule. The sum total of the costs that will be imposed by the proposed rule are likely to be near, or exceed, the point where issuers will find crowdfunding to be uneconomic. As one commentator put it, there is the need to be "light" and if problems appear in the future,

[20]Comments of David R. Burton on Proposed Rule Regarding Amendments to Regulation D, Form D and Rule 156 under the Securities Act, November 4, 2013, http://www.sec.gov/comments/s7-06-13/s70613-462.pdf (accessed April 7, 2014).
[21]See also Comments of David R. Burton on Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, October 5, 2012, http://www.sec.gov/comments/s7-07-12/s70712-118.pdf (accessed April 7, 2014).
[22]U.S. Government Accountability Office, "Factors That May Affect Trends in Regulation A Offerings," GAO–12–839, July 2012.

then tailored changes to the crowdfunding rules can be crafted.[23] There is every reason to believe that the proposed rule, while not as "heavy" as it might be, is not sufficiently "light" to make crowdfunding the success that Congress and the President intended it to be.

A more detailed analysis is available in my comments to the Commission regarding the proposed rule.[24] Issues discussed include the economic analysis of the proposed rule, the $1 million aggregate offering limitation, joint income or net worth rules, issuer reliance on intermediaries' efforts to determine the applicable investor limits, accredited investors, mandatory legends, prior exempt offerings, the application of Generally Accepted Accounting Principles, voluntary higher standard financial statements, the role of the American Institute of Certified Public Accountants and the Public Company Accounting Oversight Board, adverse and qualified accounting opinions, material events, continuing disclosure reporting obligations for micro-offerings, the terms of offering definition, valuation methodology, intermediary interests in issuers, background checks and due diligence, educational materials, fidelity bonds, broker-dealer registration exemptions, funding portals,[25] anti-money laundering rules, insignificant deviations from regulatory requirements, and the application of the section 12(g) triggers.

Future Reforms

We currently have a patchwork quilt of exemptions and requirements with various and sometimes conflicting requirements. There is a need to rethink the regulation of small company capital formation so that there is a coherent, rational system of exemptions and reasonable scaled disclosure that considers the cost of compliance, the investor protection benefits of the added disclosure, the cost to investors of being denied investment opportunities by investment restrictions and the cost to the public of lost economic growth, capital formation, innovation, and job creation caused by over-regulation.

The Heritage Foundation has established a Securities Regulation Working Group composed of small business people, attorneys, broker-dealers, policy analysts, and others from around the country who are concerned about entrepreneurship and small business capital formation to craft recommendations about how to accomplish this goal.

There are intermediate steps that can be taken to improve the situation.[26]

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[23]Andrew A. Schwartz, "Keep It Light, Chairman White: SEC Rulemaking Under the Crowdfund Act," 66 Vanderbilt Law Review En Banc 431 (2013).

[24]Comments of David R. Burton on Proposed Rule Regarding Crowdfunding, February 3, 2014, http://www.sec.gov/comments/s7-09-13/s70913-192.pdf (accessed April 7, 2014).

[25]See also Comments of David R. Burton to FINRA on proposed funding portal rules, February 3, 2014, http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticecomments/p443447.pdf (accessed April 7, 2014).

[26]For a reasonably detailed analysis of intermediate steps that can be taken, see David R. Burton, "Ideas for Improving Small Businesses' Access to Capital," National Small Business Association, September 10, 2013 http://www.nsba.biz/wp-content/uploads/2013/09/NSBA-White-Paper-on-Improving-Small-Business-Access-to-Capital.pdf (accessed April 7, 2014). A few of the ideas discussed need to be amended in light of events over the past six months and some of them are the subject matter of legislation being considered in this hearing or previously reported out of this Committee.

1) Create a statutory exemption for business brokers to the broker-dealer registration requirements.[27] The January 31, 2014, SEC no action letter is a very positive step in this direction.[28]
2) Create a statutory exemption to the broker-dealer registration requirements for finders who are not "engaged in the business of effecting transactions in securities for the account of others" or of "buying and selling securities" and, as a integral component of that exemption, provide a bright-line safe harbor such that small finders are not deemed to be engaged in the business of being a securities broker or a dealer.
3) Create a statutory definition of accredited investor that prevents the current thresholds for natural persons from being increased. In other words, make the current accredited investor income and net worth standards statutory.
4) Either define NSMIA covered securities to include securities sold in transactions exempt under Rule 504, Rule 505, and Regulation A (in addition to Rule 506) or define qualified purchasers to include all purchasers of securities in transactions exempt under Rule 504, Rule 505, and Regulation A (in addition to Rule 506), or both.
5) Allow persons to definitively qualify as a sophisticated investor for purposes of Rule 506 by passing an exam or meeting other bright line tests. There is strong reason to believe that the SEC is considering constructive change in this regard.[29]
6) Amend the Securities Act to create a safe harbor so that any offering (within a 12-month period) is exempt if it

    - is made to people with whom the issuer (or its officers and directors) has a substantial pre-existing relationship;
    - involves 35 or fewer other persons; or
    - is less than $500,000.

7) Permit Peer-to-Peer (P2P) Lending portals to provide loans to small businesses without filing a registration statement. The key substantive point here is that a loan is a loan not a security. And whether that loan is from a

[27]See Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2013 (H.R. 2274), and David R. Burton, "Don't Overregulate Business Brokers," Heritage Foundation *Backgrounder* No. 2883, February 19, 2014, http://www.heritage.org/research/reports/2014/02/dont-overregulate-business-brokers.

[28]See SEC no action latter, January 31, 2014, http://www.sec.gov/divisions/marketreg/mr-noaction/2014/ma-brokers-013114.pdf (accessed April 7, 2014).

[29]The SEC is considering modifying the definition of accredited investor to include persons in "possession of professional certifications or degrees, such as a CFA, CPA, or a securities license, which some believe may provide an individual with the knowledge and sophistication needed to be an accredited investor, presumably irrespective of the person's financial wherewithal." Keith F. Higgins, Director, Division of Corporation Finance, keynote address at the 2014 Angel Capital Association Summit, March 28, 2014, http://www.sec.gov/News/Speech/Detail/Speech/1370541320533#.U0G8mVeh1Mg (accessed April 7, 2014).

bank, a credit union, a non-bank lender or an individual via a P2P lending portal should not matter. The SEC has adopted the absurd position that lending $10,000 to a small business via a P2P lending portal requires the filing of a separate registration statement.

8) Amend the Bank Secrecy Act to make it clear that federal "Know Your Customer" and anti-money laundering laws do not apply to finders, business brokers, or crowdfunding Web portals that do not hold customer funds. These rules are tremendously burdensome and requiring funding portals, for example, to comply with them even though they are prohibited by law from holding customer funds is likely to mean that only broker-dealers will become funding portals, a result at variance with the clear intent of Congress when it adopted the JOBS Act.
9) Improve SEC collection of data on private placements and Regulation A offerings (relating to offering amounts, enforcement, and compliance costs) and ensure the data is published regularly without materially increasing the administrative burden on issuers.
10) Improve SEC collection of data on the regulation of and regulatory costs incurred by small public companies.
11) Conduct the following studies by the GAO:

- Examine whether bank regulators inappropriately treat small business loans as disproportionately risky, thereby discouraging bank lending to small firms. Generally, bank regulators deny this but small business owners frequently report this as a reason given by bankers for not lending and some community bankers have raised the issue.
- Determine the typical compliance costs incurred by issuers in various Regulation D filings and Regulation A filings.
- Determine the typical compliance costs incurred by private placement issuers because of Blue Sky laws.
- Determine the typical compliance costs incurred by small capitalization public companies.
- Determine and quantify the primary sources of fraud or other violations in private placements and the percentage of offerings that involve fraud.
- Determine and quantify the primary sources of fraud or other violations for smaller reporting companies and the percentage of offerings that involve fraud.

Thank you for the opportunity to appear today and discuss these important issues.

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Statement of Professor John C. Coffee, Jr.
Adolf A. Berle Professor of Law
Columbia University Law School

at

Hearings Before the Subcommittee on Capital Markets and
Government Sponsored Entities

of the

Committee on Financial Services

of the

United States House of Representatives

**"Legislative Proposals to Enhance Capital
Formation for Small and Emerging Growth Companies"**

April 9, 2014
Room 2128 of the Rayburn House Office Building
Washington, D.C.

Chairman Garrett, Ranking Member Waters, and Fellow Members of the Committee:

Introduction

I thank you for inviting me. I have been asked to comment on seven proposed bills, some of which appear to be a still early stage of drafting. Reasonable people can disagree about several of these provisions, but others are beyond the pale. Still, my overarching comment is that each of these bills represents a piecemeal attempt to "tweak" something in our existing system, but collectively they are uncoordinated and lack any consistent vision. If there is any common theme to these bills, it is that better integration and coordination is desirable between our twin disclosure regimes under the Securities Act of 1933 and the Securities Exchange Act of 1934. That could well be true. If so, the appropriate starting point might be to mandate a study by the SEC (within, say, a realistic two-year period) of how to better coordinate both (1) these two disclosure systems, and (2) public and private offerings. Absent such an attempt at coordination, we will obtain only piecemeal (and fumbling) reforms that resemble the seven blind men groping at the elephant. In particular, as these proposals suggest, private placements may soon overtake public offerings—without adequate attention being given to the appropriate role of each.

More generally, we seem to be moving from JOBS Act I to a JOBS Act II without any serious evaluation of the impact of the first round of changes. On balance, the JOBS Act may have had only modest impact, and the proposals that are being considered today will likely have less. Because my time is limited, I will analyze these proposals in terms of the intensity of my reaction, moving from those that I feel are likely to cause real harm to those that are understandable (but that probably do not require legislation). I will

begin with a provision (the definition of "well-known seasoned issuer") whose impact has not been adequately or candidly explained.

1. The Definition of "Well-Known Seasoned Issuer." This may be the most radically deregulatory of the seven proposals now before this Subcommittee, but it has not been adequately explained just how far reaching this proposal would be. The proposal derives from the 2011 Report of the SEC Government-Business Forum on Small Business Capital Formation, where it was the 19th out of 25 recommendations made by that body. Frankly, it received only lukewarm support.[1] The recommendation there made was to:

> "Expand the availability of the special public offering provisions currently applicable only to "well-known seasoned issuers" (WKSIs) to all public companies, including smaller reporting companies and foreign private issuers. This would permit such companies to, among other things:
>
> a. File a universal shelf registration statement;
> b. Test the waters;
> c. Pay as you go; and
> d. Use forward incorporation by reference for Form S-1 registration statements."
>
> (Emphasis added)

Each of these "benefits" can be debated. For example, a WKSI is exempt from the "gun jumping" and "quiet period" restrictions of Section 5(c) of the Securities Act of 1933, and there can be reasonable debate about the wisdom of freeing smaller companies from these rules. Still, the key implication of expanding the definition of "well-known seasoned issuer" has not been explained: it would permit the majority of public

[1] See Final Report of the SEC Government-Business Forum on Small Business Capital Formation (November 17, 2011) at p. 31. This recommendation received an average ranking of 2.92 (whereas some recommendations received a perfect score of 4.00 and the lowest score for any recommendation was 2.34)

companies to qualify for "automatic shelf registration." This may not have been the intent, but it is the consequence.

Under Rule 405, a "Well-Known Seasoned Issuer" generally qualifies for "automatic shelf registration." Since 2005, the instant that a "well-known seasoned issuer" files a registration statement, the registration statement becomes "effective" and the securities can be sold under it—without any prior SEC review.[2] As a practical matter, allowing a company to qualify for automatic shelf registration both (1) denies the SEC's staff any opportunity to review and correct the registration statement before sales are made, and (2) makes it much more difficult for the issuer, its investment bankers, and its other agents to conduct a pre-offering "due diligence" review of the registration statement's contents (because there no longer is a pre-offering period between the filing of the registration statement and its effectiveness). Further, the SEC has a substantial staff in its Division of Corporation Finance that conducts a pre-effectiveness review of the registration statement and engages in a dialogue with the issuer.[3] This provision short-circuits that review and largely renders them irrelevant for such issuers.

At present, a "well-known seasoned issuer" (or "WKSI" in the parlance) basically must either (i) have a "public float" of at least $700 million (that is, the worldwide market value of its common equity, voting and nonvoting, held by non-affiliates must equal or exceed $700 million), or (ii) have issued over the last three years $1 billion in non-convertible debt securities. These are high standards. By some estimates, only about a third of the issuers on the NYSE meet this standard.

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[2] See General Instruction ID(5) to Form S-3.

[3] Of course, the SEC could lay off this excess staff, in which case this bill should be called the "Anti-Jobs Act."

Under the proposed legislation, the $700 million standard would be reduced to $250 million. At that point, probably a majority of the issuers on both the NYSE and Nasdaq could become WKSIs—and in most cases could use "automatic shelf registration." Many of these issuers might be followed by only a single securities analyst, and do not necessarily trade in an efficient market. The SEC's staff that reviews registration statements would be unable to focus on these offerings and would be left to concentrate on IPOs and very smaller issuers. This seems a poor allocation of the SEC's resources.

Since 1933, prior review by the SEC's staff of the registration statement has been one of the bedrock protections of our federal securities laws. Thus, I suggest to you that it is a fairly radical step to deny the SEC's staff any opportunity for a pre-offering review of the securities to be issued by most issuers. Yet, that is what this proposed expansion of the definition of WKSI does. This result may or may have been intended, but it both invites misbehavior (if an issuer knows it will not be subject to prior review) and encourages costly litigation (if errors are later discovered).

Even if this proposal were cut back so that it only permitted smaller issuers to use "universal shelf registration," I would still have some concerns. When shelf registration was first introduced in 1983, the issuer had to allocate the gross dollar value of its offering to specific types of securities (i.e., debt, equity, warrants, etc.). Then, in 1992, the SEC permitted unallocated shelf registration. In such a "universal" shelf registration, the issuer may pre-register debt, equity and other classes of securities in a single shelf registration statement without any allocation of offering amounts among these classes. In

1992, the SEC lowered the threshold for Form S-3 and universal shelf registration to $75 million (well below the $250 level here proposed).

Thus, smaller issues can already make use of universal shelf registration. What then is achieved by expanding the definition of WKSIs (other than entitling the issuer to use "automatic shelf registration")? A partial answer is that WKSIs can uniquely register securities for sale for the account of selling shareholders without separately identifying "the selling security holders or the securities to be sold by such persons" until the time of the actual sale by such persons. See General Instruction ID(d) to Form S-3. In short, by expanding the definition of WKSI, we facilitate not primary offerings by the issuer, but secondary sales by large shareholders. This does not raise capital for the issuer or create jobs, but essentially encourages a bailout by insiders. Such secondary sales, which do not have to be disclosed in the original registration statement, seem particularly problematic in the case of smaller companies.

To sum up, this provision is not what it seems. It does not simplify the issuer's access to capital, but it does both (i) strip the SEC of its pre-offering review authority, and (ii) facilitate secondary bailouts by insiders.

2. HR 2659 ("Accelerated Filer"). This provision would modify the definition of "accelerated filer" in SEC Rule 12b-2 (17 C.F.R. § 240.12b-2), which today makes an issuer an "accelerated filer" if it has a "public float" of between $75 million and $700 million (that is, the value of its equity shares not held by affiliates). Under the proposed revision, the new test would be moved up to $250 million (instead of $75 million), and in addition the issuer would need to have "annual revenues of greater than $100,000,000 during the most recently completed fiscal year for which audited financial

statements are available" (see Section 2 of H.R. 2629). Thus, many issuers today deemed accelerated filers would escape that label under this revised test, including some with very large market capitalizations.

What is the consequence of this change? First, it will allow many companies to escape Section 404(b) of the Sarbanes-Oxley Act and its requirement of an annual audit of internal controls. The JOBS Act already did this with respect to "emerging growth companies" (at least for a five-year "on ramp"), but this provision would exempt older companies that did not qualify for that exemption. Also, the exemption could continue forever and not just for five years. Second, under the instructions to Form 10-Q, an "accelerated filer" must file its Form 10-Q within 40 days after the end of the fiscal quarter, whereas all other issuers must file within 45 days after the end of the quarter. This is a further small step away from transparency.

If the goal is to cut back further on the scope of Section 404(b), this might best be done directly without causing any other collateral consequences. Still, some estimate should be made of just how many companies will escape Section 404(b) by this back door. Finally, the JOBS Act had a stronger rationale for its Section 404(b) exemption, (namely, that it permitted a temporary accommodation for young and emerging companies), whereas this bill's exemption covers old companies and potentially forever.

3. Raising the Disclosure Exemption Under Rule 701(e) from $5 million to $20 million. Currently, Rule 701 exempts from registration sales by non-reporting issuers of their securities to employees, consultants and advisors (and their family members) pursuant to a written compensatory benefit plan or compensatory contract. Effectively, this rule shelters non-reporting companies from the potentially expensive

obligation to register stock options and similar equity compensation under the Securities Act of 1933. But under Rule 701(e), some minimal disclosure is required, including financial statements and "information about the risks associated with investment in the securities." This limited obligation to provide such information is not applicable if the issuer sells less than $5 million of its securities under this exemption during any consecutive 12-month period. The proposed bill before this Committee would raise this $5 million level to $20 million.

Because the disclosure obligation under Rule 701 is minimal and does not require the preparation of any formal disclosure document, this proposal to raise the exemption by 400% to $20 million seems hard to justify. First, there is no rationale advanced for the $20 million threshold. Second, there is little hardship or burden in giving your financial statements to your own employees. This proposal did not even seem to win substantial support within the small business community (as it has not been regularly cited at the SEC's Government-Business Forum on Small Business Capital Formation).

Further, once the volume of sales under Rule 701 exceeds $5 million and begins to approach $20 million, the cost of providing minimal disclosure falls as a percentage of the total transaction. It may seem a nuisance to an issuer to provide disclosure when its Rule 701 sales are minimal, but if the sales fall into the $5 to $20 million range, this is a major (and probably recurring) activity for the issuer.

4. Expanding the Availability of Form S-3. Today, eligibility for use of Form S-3 (and thus the ability to use shelf-registration) generally requires that an issuer have a "public float" of at least $75 million. See General Instruction IB(l) to Form S-3. In addition, other registrants can use Form S-3 if (i) the aggregate market value of

securities sold by the registrant during the period of 12 calendar months immediately preceding and including the sale does not exceed one-third of its public float (i.e., the aggregate market value of its common equity held by non-affiliates—see General Instruction IB(6)(a) to Form S-3), (ii) the issuer is not a "shell company," and (iii) the registrant has at least one class of common equity registered on a national securities exchange (General Instruction IB(6)(c) to Form S-3). In effect, this alternative test allows listed companies with less than a $75 million public float to use Form S-3, but places a ceiling on the size of the offerings that they may do using Form S-3 that is equal to one-third of their public float. Letting a small company with a modest $50 million public float use shelf registration to attempt to sell $150 million in securities invites potential disaster and investor confusion.

Nonetheless, a bill before this Committee, known as the "Small Company Freedom to Grow Act of 2014" would permit this by eliminating most of these limitations. Effectively, it would allow any company, which is not a "shell company" (as defined in Rule 405) and that has not been a "shell company for at least 12 calendar months, to use Form S-3. Under this provision, even microcap companies could thus use shelf registration and offer securities from time to time in any amount, at least if they were reporting companies and were current in their 1934 filings (to thereby satisfy General Instruction IA).

This would represent a significant change in long-standing SEC policy, and I suggest that Committee consult the SEC to hear its view. Traditionally, shelf registration was limited to seasoned issuers with a sizable market capitalization and an established market following. Under this provision, even companies traded only on the Pink Sheets

or the OTC Bulletin Board might use shelf registration and make a sizable offering with no prior notice. As a practical matter, I doubt that the market will accept such offerings or that reputable underwriters will feel comfortable with them, but the door is at least opened (and in a frothy market, anything can happen and has).

5. Blue Sky Preemption. The above-noted "Small Company Freedom to Grow Act of 2014" would also preempt state "Blue Sky" laws in the case of "smaller reporting companies" and "emerging growth companies." Currently, Section 18 of the Securities Act preempts only "nationally traded securities" that are either (i) listed on certain national securities exchanges (under SEC rules that look to their listing standards), or (ii) are issued in certain exempt transactions involving qualified purchasers. This proposal would extend the scope of Section 18's preemption of state blue sky law by an order of magnitude. Potentially, companies traded on the Pink Sheets (or not even traded at all) would be exempted if the issuer was a reporting company.

This makes little sense at a time when the SEC is resource-constrained and cannot challenge every transaction. The cases most likely to sneak under the SEC's radar screen are precisely those involving local or regional companies that are traded over-the-counter, on the OTC Bulletin Board, or on the Pink Sheets. Unfortunately, these are exactly the low visibility companies that this statute would exempt from the scrutiny of state regulators.

Perhaps, the sponsors of this bill see state "Blue Sky" regulators as difficult, overly suspicious, bureaucratic, or prone to delay. I believe such a characterization is unfair. State regulators are hard-working, have more than enough to do, and typically focus their attention on precisely those smaller companies that the SEC is most likely to

overlook. Preempting state law simply because an issuer files reports with the SEC places excessive reliance on the SEC and invites fraud and misconduct.

6. Form S-1 and Forward Integration. For some time, the SEC's Government-Business Forum on Small Business Capital Formation has called for changes to permit smaller reporting companies that have filed a Form S-1 to incorporate by reference documents filed with the SEC. Effectively, this would make the Form S-1 "evergreen" in the sense that it would not become stale. Of the various proposals before this Committee, I believe this one does have real efficiency justifications and could help smaller issuers.

Again, I believe the Committee should seek the views of the SEC on this matter, and I do not suggest that Form S-1 should be expanded to become a vehicle for shelf registration (which should instead require that the issuers qualify for the use of Form S-3). But I do see merit in this proposal.

7. Regulation S-K and Form 10-K. The "Disclosure Modernization and Simplification Act of 2014" proposes that the SEC issue regulations to permit issuers to submit a summary page on Form 10-K that would cross-reference (by electronic link or otherwise) the material contained in the Form 10-K. I see no conceptual objection to such a cross-reference sheet, and believe it is already possible. Legislation is thus unnecessary.

I do not believe it is realistic to expect Form 10-Ks to become short and concise. Indeed, securities analysts want them that way because they see them as a treasure trove of valuable data. Form 10-Ks are not aimed at the retail investor, but at the professional: the securities analyst and other intermediaries. Thus, while some simplification may be

possible, it is a mistake to believe that the Form 10-K can be made as simple and direct as the summary pages of a prospectus.

Although I certainly do not object to the SEC conducting a study or re-examining its regulations, the 180-day period specified in Section 3 of this proposed bill and the 360-day period specified in Section 4 for such SEC studies and rulemaking are both unrealistic. The SEC is still only about half done with implementing the Dodd-Frank Act (which was passed in 2010) and clearly cannot expedite everything at the same time.

8. Rule 144. The proposal among these bills that seems likely to attract the greatest attention is the one that would shorten the holding period before "restricted securities" may be resold from six month to three months (in the case of an issuer that is a "reporting company"). Presumably, although it is not said explicitly, this shortened period would only apply so long as the issuer was current in all its 1934 Act filings.

A three month holding period in my view is a mere hiccup, and its adoption would greatly decrease the likelihood that a public company would use a public offering after its IPO. Instead, we would see many more PIPE transactions ("Private Investment in Public Equity") in which public companies sell their stock in private placements at prices below the public trading price. For the most part, stockholders resent such transactions (and they generally lead to a stock price decline), but this legislation would encourage PIPE transactions. Indeed, if a three-month holding period were used, I expect that many investors would hedge the stock so acquired over that three-month period and then dump the stock into the public market to realize the locked-in discount in the PIPE transaction. This was the experience under Regulation S when it originally required only

a three-month waiting period before resale (and as a result Regulation S was amended to bar the investor from hedging over this period).

This bill also proposes to extend Section 18 of the Securities Act to cover securities sold under Rule 144A. Although I generally dislike the preemption of state "Blue Sky" Law, I can understand the case for this provision, as Rule 144A is a very different type of offering, limited to very large "Qualified Institutional Buyers" (or "QIBS"). Nonetheless, I doubt this provision is really needed, because Rule 144A transactions follow after an earlier Section 4(a)(2) private placement, which is already largely covered by Section 18(b)(4).

9. HR 4200—Registration of Fund Advisors for Venture Capital Funds and SBICs. This bill, denominated the "SBIC Advisers Relief Act of 2014," would amend the Investment Advisers Act of 1990 to expand the exemption under §203(l), which already exempts venture capital fund advisers, to cover persons who are advisers to both venture capital funds and SBICs. It is hard to quarrel with this exemption, but even harder to believe that it will have any serious impact on capital market competitiveness or that it will create jobs.

H.R. 4200 also extends the preemption of state "Blue Sky" authority over investment advisers. In general, I find such preemption undesirable, but, because of the sophisticated nature of venture capital funds, this is less objectionable than the proposed preemptions earlier discussed. That is, however, hardly an endorsement.

10. Crowdfunding. I understand that legislation is to be proposed with respect to the "crowdfunding" exemption of the Securities Act of 1933 (i.e., Sections 4(a)(6) and 4A). I cannot comment because I have not been provided this draft. Still, I would

observe that we have not yet seen a single transaction under the crowdfunding exemption (because the rules are not yet final). Thus, it may be premature to amend it in the absence of any experience. In general, discretion is the better part of valor.

Summary

Some of these provisions essentially would revise SEC Forms S-1 and S-3 or amend specific rules. In my judgment, this is micromanagement. Nor are these bills united by any central vision. Thus, I would again suggest the need for an SEC study and the adoption of more general policies.

Finally, if the public is today dissatisfied with the securities market, the more likely cause is not excessive regulation, but loss of investor confidence. Although Michael Lewis overstates, the public see securities markets today as dominated by high frequency traders who have privileged access to both information and trade execution. I submit that this perception, not excessive regulation, should be this Committee's primary concern.

Brian Hahn

Chief Financial Officer, GlycoMimetics, Inc.

On behalf of the Biotechnology Industry Organization

Before the United States House of Representatives Committee on Financial Services, Subcommittee on Capital Markets and Government Sponsored Enterprises

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Legislative Proposals to Enhance Capital Formation for Small and Emerging Growth Companies

April 9, 2014

Executive Summary

- GlycoMimetics is a clinical-stage biotechnology company based in Gaithersburg, Maryland. BIO represents GlycoMimetics and more than 1,100 innovative biotech companies, academic institutions, state biotechnology centers, and related organizations in all 50 states.

- GlycoMimetics undertook a successful IPO in January 2014 using key provisions in the JOBS Act. Nearly 80 biotech companies have taken advantage of the JOBS Act to go public, and many more are on file with the SEC.

- GlycoMimetics and many biotech EGCs have benefited from the testing-the-waters, confidential filing, and regulatory relief provisions in the JOBS Act. This important law allows enhanced access to investors, increasing the capital potential of an offering, and then institutes a relaxed regulatory burden, decreasing the amount of capital diverted from R&D.

- A healthy public market is vital to the success of the biotech industry. BIO supports targeted market reforms that will decrease the cost of capital and increase the capital formation potential for emerging biotech companies trading on the public market.

- BIO supports the Fostering Innovation Act (H.R. 2629), which would amend the filing status classifications in SEC Rule 12b-2 to classify companies with a public float below $250 million or revenues below $100 million as non-accelerated filers.

- BIO supports targeted reforms that enhance capital formation for small companies, including:
  - Reforms to SEC Rule 144A to enhance secondary market liquidity for private offerings, including those conducted under SEC Regulation D and Regulation A,
  - SEC review of Regulation S-K to reduce duplication and small company costs,
  - Amendments to SEC Rule 701 to allow growing innovators to attract and compensate employees competitively,
  - An expansion of the WKSI definition to increase access to effective shelf offerings,
  - An EGC and non-accelerated filer exemption from conflict minerals reporting,
  - Forward incorporation by reference on Form S-1, and
  - Expanded eligibility for Form S-3 to encompass a greater pool of small companies.

BIO Contact: Charles H. Fritts
cfritts@bio.org
(202) 962-6690

Testimony of Brian Hahn

Good morning Chairman Garrett, Ranking Member Maloney, and Members of the Subcommittee. My name is Brian Hahn, and I am the Chief Financial Officer at GlycoMimetics, a small, publicly traded biotechnology company in Gaithersburg, Maryland. GlycoMimetics has 30 employees, all of whom are dedicated to our search for next generation medicines. Our lead product is designed to treat patients undergoing acute crises caused by sickle cell disease. These critical events are extremely painful and hard to treat beyond simple palliative care, but we are hopeful that our research will lead to a better path forward for patients and their families. In order to fund the next stage of our research, GlycoMimetics raised $64.4 million through an IPO in January – the first public offering of 2014.

I am also a member of the Finance and Tax Committee at the Biotechnology Industry Organization (BIO). BIO represents more than 1,100 biotechnology companies, academic institutions, state biotechnology centers, and related organizations in all 50 states. Because of the unique capital needs of biotech research – it can take more than a decade and upwards of $1 billion to bring a single product to patients – a strong public market that supports capital formation is vital to the success of our industry.

A late-stage clinical trial can cost upwards of $200 million, a sum that is difficult to raise with just private investors. The public market has a broader capital reach, and growing biotechs often turn to an IPO to fund the expensive Phase III trials required for FDA approval. As such, the Jumpstart Our Business Startups (JOBS) Act, designed to increase capital availability for emerging growth companies (EGCs) entering the market, was tremendously important for the growth of small biotechs like GlycoMimetics. The JOBS Act was signed into law two years ago by President Obama, and in that time it has stimulated nearly 80 biotech IPOs. For comparison, the two years prior to the JOBS Act saw just over 30 IPOs in our industry. This important law allows enhanced access to investors, increasing the capital potential of an offering, and then institutes a relaxed regulatory burden, decreasing the amount of capital diverted from research. This one-two punch is critical for biotech innovators and has increased the viability of the public market for a growing company looking to fund its capital-intensive development program.

I have spent most of the past 15 years in biotech start-ups, and I am extremely optimistic about the potential that companies like GlycoMimetics have to develop medicines that change and save lives and, while doing so, create jobs and stimulate the American economy. The recent market for biotech offerings in the wake of the JOBS Act has sped this progress by providing innovation capital for breakthrough R&D being conducted at small businesses across the country. During my time in the biotech industry, I have seen growing companies struggle to access public capital because the policy environment did not support capital formation on the public market, so I am thankful that Congress passed the JOBS Act two years ago and is considering legislation to further improve its efficacy.

The JOBS Act and the Biotech Industry

In 2003, I was part of the management team that took Advancis Pharmaceutical public. Advancis was a small biotech company developing treatments for infectious disease, and our IPO raised $60 million to fund a Phase II clinical trial and to expand our pre-clinical pipeline. We had only 40 employees and no product revenue, and all of our energy was focused on staffing up and enrolling patients to complete our Phase II trial. But 2003 was well before the JOBS Act instituted the IPO On-Ramp for emerging growth companies. From Day 1 on the market, Advancis was hit with a full-blown public reporting burden. We faced

the same compliance requirements as the rest of our IPO brethren from 2003, including Colonial Bank, Tempur-Pedic, and Orbitz – you may have heard of them.

Shortly after our IPO, we tripled our finance and accounting staff, going from a small shop with just two employees to a seven-person team. For a company with just 40 total employees, this was a significant jump. More importantly, five new hires in the finance department meant that Advancis missed out on hiring five scientists who would have furthered our research. Even with our staff expansion, we were nearly overwhelmed by public company reporting. Compliance with Sarbanes-Oxley (SOX), which had passed Congress the summer before our IPO, became my full-time job.

For growing biotech companies, overly burdensome regulatory standards present a unique challenge. Because these R&D-focused innovators do not fund the billion-dollar biotech research process through product revenue, they depend almost entirely on external investors for innovation capital. These investors stress the importance of resource efficiency, because spending capital on compliance diverts funds from the lab and could delay drug development. Investors looking for a return, companies advancing their science, and patients waiting for treatment – all parties involved are united in the need for capital efficiency in the name of scientific progress. As such, costly regulations that divert capital from science to compliance can stifle capital formation, slow company growth, and ultimately harm patients and their families.

Unfortunately, in 2003 Advancis was still subject to a one-size-fits-all regulatory regime. When GlycoMimetics went public a decade later, the regulatory environment had changed dramatically. The JOBS Act has led to a sea change in how growing biotechs approach the public market. Title I of the law creates the IPO On-Ramp, instituting a commonsense compliance burden for emerging growth companies.

During the IPO process, the ability to conduct testing-the-waters meetings and increase our dialogue with potential investors was a game-changer. More than half of our testing-the-waters meetings eventually resulted in the investor participating in the IPO, and across the board we saw substantially increased investor awareness of our company and interest in the offering. Biotech companies like GlycoMimetics have complicated technology, an opaque regulatory pathway, and a complex commercial story – and the additional time with investors gave us time to clarify questions about these aspects of our business in a more robust way that would not have been possible in a traditional half-hour roadshow meeting. For GlycoMimetics specifically, we were able to get to know several investors that we had not previously met, and they ended up being among the largest of the new investors in our IPO.

The confidential filing provision in Title I of the JOBS Act played a similarly influential role in our offering. We tested the waters while on file confidentially, conducting investor meetings out of the glare of the media spotlight and avoiding heightened scrutiny that could have placed an undue expectations burden on the company or our potential investors. The confidential filing period led to a more productive dialogue with the SEC and allowed us to wait for the right market conditions before going forward with our IPO.

Now that GlycoMimetics is a publicly traded company, we benefit from the five-year transition period onto the market that comes with being an EGC. The most notable allowance during these five years is the exemption from compliance with Section 404(b) of SOX. Section 404(b) requires an expensive external attestation of a public company's internal controls, to be disclosed to investors on an annual basis. However, the true value of a biotech company is found in scientific milestones and clinical trial advancement toward

FDA approvals rather than financial disclosures of losses incurred during protracted development terms. The business model of biotechnology is simple – we take in millions, if not billions, of dollars to fund our research and often do not earn a single penny in product revenue for more than a decade. Our science is the key to our business, and it is the most important thing for investors to understand. In the biotech industry, an informed investor is a good one. However, the information that these investors want and need does not always align with what is required by SOX.

At GlycoMimetics, we strive to keep our investors informed of our progress, but wasting their valuable capital on government red tape instead of spending it on innovation and advancement does not serve their needs nor those of the patients who are waiting for our therapies. As such, the five-year EGC on-ramp and corresponding SOX exemption will have an important impact on growing biotechs like ours. We will remain pre-revenue through the entirety of the EGC time horizon, so the cost savings from this allowance will be vital to our progress. SOX compliance would require us to take dollars from investors and divert them to reporting that investors do not want or need, so without that burden we will be able to focus exclusively on advancing our research and moving our clinical trials forward in order to find cures and treatments for devastating diseases.

H.R. 2629, the Fostering Innovation Act

The transition period onto the market is extraordinarily impactful for emerging growth companies in the biotech industry, and GlycoMimetics and the rest of the nearly 80 biotech EGCs are already benefiting from that JOBS Act allowance. But it remains the case that the biotech development timeline is a decades-long affair. It is extremely likely that GlycoMimetics will still be in the lab and the clinic in five years – which is to say that we will still not be generating product revenue. Biotech companies that went IPO shortly after the JOBS Act was signed are approaching the halfway point of their EGC exemptions, and most of them are similarly far from having a product on the market.

When the EGC clock runs out, they will still be reliant on investor capital to fund their research, and they will be in the same predicament in which I found myself in 2003 – facing a full-blown compliance burden identical to that faced by commercial leaders and multinational corporations. As I have mentioned, biotechs retain a simple corporate structure through most of their development timeline. They may grow from 15 scientists in a lab to 50 scientists in lab, but the core essence of the business model is a capital-intensive, laser-focused drive toward medical advancement. Yet the dawn of Year 6 on the market will bring with it a new diversion of capital from science to compliance for these pre-revenue innovators.

Rep. Michael Fitzpatrick has introduced legislation that would better reflect the reality that emerging, pre-revenue companies face on the public market. His bill, the Fostering Innovation Act (H.R. 2629), would provide the SEC with more accurate company classifications in order to institute a commonsense regulatory burden for small businesses and innovative job creators outside of the EGC on-ramp.

Rep. Fitzpatrick's bill would amend the accelerated filer definition under SEC Rule 12b-2. Currently, the term "accelerated filer" encompasses any and all companies with a public float between $75 million and $700 million. This wide swath of businesses is far too broad as it currently exists, and ensnares growing businesses by lumping them in with mature, profit-generating companies. Accelerated filers are subject to an enhanced regulatory burden compared to non-accelerated filers (companies with a public float below $75

million), including, but not limited to, compliance with Section 404(b) of SOX, from which non-accelerated filers are exempt.

This problem is particularly acute in the biotech industry because of the high costs of biotech research. After GlycoMimetics's $46 million IPO, our stock has done well on the market and our public float is currently about $300 million. But we still have only 30 employees, one facility, and no product revenue – hardly the picture of a complex corporation. The Fostering Innovation Act recognizes this reality for many highly valued, low-revenue companies by taking the important step of adding a revenue test to the accelerated filer definition. Under the bill, any company with annual revenues below $100 million would not be considered an accelerated filer, and would thus be classified as non-accelerated unless their public float topped $700 million, pushing them into large accelerated filer status.

Such a change would further open the public market to biotech capital formation, allowing companies to grow and attract investors without fear of subjecting themselves to a costly compliance burden. Instead of dreading the expiration of the EGC on-ramp, small companies can continue to focus their attention and capital on growth, research, and development. As I have mentioned, the most damaging facet of SOX for the biotech industry has been the diversion of investment funds from science to compliance in the absence of product revenue. By taking revenue into account when determining a company's compliance burden, the Fostering Innovation Act would more accurately classify companies and provide important regulatory relief for small businesses.

H.R. 2629 would also amend the public float ceiling for non-accelerated filers. Despite their simple corporate structure and lack of product revenue, many biotechs have a relatively high public float. Thus, they find themselves grouped with the accelerated filers and obliged to comply with the numerous regulatory burdens attendant to that definition, including SOX. By defining companies with a public float below $250 million as non-accelerated filers (a change from the existing $75 million standard), the Fostering Innovation Act would update Rule 12b-2 and provide a more accurate picture of the market for companies and regulators alike.

The Fostering Innovation Act would narrow the universe of accelerated filers to those with a public float between $250 million and $700 million with revenues above $100 million. The companies below these thresholds would benefit from being treated by the SEC as the small companies that they truly are. Complying with non-accelerated filer standards rather than those required of accelerated filers would provide tremendous relief for these growing businesses. The exemption from SOX Section 404(b) alone would save innovative start-ups millions of dollars. Additionally, non-accelerated filers have a relaxed timeline for their quarterly disclosures because their small size and lack of a large compliance department make the filings more onerous – attributes shared by biotech companies currently in the accelerated filer bucket. Non-accelerated filers also enjoy certain allowances within those filings, including exemptions from Compensation Discussion and Analysis (CD&A) reporting, the elimination of certain disclosures about market risk and other risk factors, and exclusions for some financial data. These changes would allow small biotech companies to focus on their mission of delivering cures and treatments to patients who need them rather than time-consuming and costly reporting.

Capital Markets Enhancement

As I have mentioned, a viable public market is vital for the health of the biotech industry – and, of course, the health of the patients waiting on the treatments being developed – both

because it allows companies to raise enough capital to fund expensive research and expand their pipeline and because it can give small businesses leverage in M&A negotiations with larger pharmaceutical partners. I am pleased that Congress has taken steps to follow the success of the JOBS Act and further improve market conditions for emerging businesses.

Recently, the Financial Services Committee approved two pieces of legislation that I believe will stimulate capital formation for innovative research. The Small Company Disclosure Simplification Act (H.R. 4164), introduced by Reps. Robert Hurt and Terri Sewell, would provide an exemption for growing companies from the costly requirement to file financial statements using eXtensible Business Reporting Language (XBRL). The Small Cap Liquidity Reform Act (H.R. 3448), introduced by Reps. Sean Duffy and John Carney, would also stimulate capital formation by providing small businesses with tick size flexibility through a pilot program designed to relieve them from the one-size-fits-all trading standard imposed by decimalization. I applaud the Committee for taking these important steps toward a public market that better supports funding for vital research.

I am also encouraged that the Subcommittee is considering today a package of legislation to further enhance the capital formation potential of the markets. Congressional support of the market is key to financing the search for breakthrough cures and treatments.

Rep. Ann Wagner has circulated a bill that would increase the pool of companies eligible to use Form S-3 to register for an offering. Form S-3 is the most simplified SEC registration form, and utilizing it to conduct an offering contributes to the cost-savings goals of emerging companies. Additionally, the Form allows forward incorporation by reference so that certain data automatically updates when new quarterly or annual reports are filed (Forms 10-Q and 10-K), giving companies flexibility when conducting an offering on a delayed or continuous basis. Rep. Wagner's legislation would expand Form S-3 eligibility by allowing public companies not currently listed on a national exchange to file the Form. It would also remove the capital limit for offerings conducted using Form S-3, eliminating the existing cap that limits offerings to a third of an issuer's public float. These expansions to Form S-3 eligibility would increase small companies' access to public funds in an efficient and cost-effective manner that will stimulate capital formation.

Rep. Wagner's legislation is complemented by a bill offered by Rep. Kevin McCarthy that would expand the Well-Known Seasoned Issuer (WKSI) definition. The primary benefit of being a WKSI is that any Form S-3 filed by a WKSI is automatically effective and not subject to SEC review. This streamlined process grants flexibility to WKSIs, eliminates delays, and allows them to conduct offerings "off the shelf" with greater efficacy. Because WKSIs are only required to pay the SEC a filing fee when the shelf offering actually commences (rather than at the time of filing the S-3, as is the case for non-WKSIs), they save capital and only incur a cost burden when they decide to go forward with an offering. Currently, WKSI eligibility is limited to companies with a public float above $700 million. Rep. McCarthy's bill would lower that threshold, allowing companies to qualify as WKSIs if they have a public float above $250 million. For a growing biotech company, this would give important flexibility in the timing of a secondary offering, allowing the company to prepare and register the offering in advance, and make the offering at the moment market conditions are best. Allowing more issuers to qualify as WKSIs and therefore conduct effective shelf offerings will expand the capital formation potential of Form S-3 and provide a valuable avenue to innovation funding on the public market.

There are a number of other important reforms being considered today. Rep. Wagner's bill would, in addition to allowing more companies to use Form S-3, extend eligibility for forward incorporation by reference (currently limited to issuers filing Form S-3) to issuers

filing Form S-1. Also, I understand Rep. Gary Miller is working on a bill that would exempt EGCs and non-accelerated filers from conflict minerals reporting, which could relieve growing companies from a costly and confusing burden.

Chairman Garrett's Disclosure Modernization and Simplification Act would direct the SEC to review the compliance regime under Regulation S-K in order to reduce and eliminate duplicative or outdated reporting requirements. Regulation S-K governs all of a company's annual filings, so its reach has a significant capital impact on pre-revenue issuers. This welcome initiative would instruct the SEC to study and institute commonsense rules for smaller issuers and EGCs, allowing for scalability and a move away from one-size-fits-all burdens.

Rep. Randy Hultgren's legislation to amend SEC Rule 701 would reduce the disclosure burden for companies that offer stock options to their employees, a valuable compensation practice that allows small businesses to hire the most highly skilled workers. BIO was supportive of the private shareholder limit reforms in Title V of the JOBS Act; specifically, the exemption from the shareholder count for employees compensated with stock options gives small companies room to grow. Rep. Hultgren's legislation is a welcome follow-on to this provision, preserving the ability for innovative biotechs to attract talented workers and compensate them competitively without incurring additional compliance burdens.

For private offerings, Rep. Mick Mulvaney would improve on the expansion of SEC Regulation D in the JOBS Act by shortening the holding period for restricted securities from 6 months to 3 months, improving the secondary market liquidity of these shares. BIO strongly supported Title II of the JOBS Act, which lifted the ban on general solicitation for Regulation D offerings, and I believe that improving the tradability of shares purchased under the Regulation D exemption will ensure that these offerings have the trading environment they need in order to be viable capital-raising tools.

I am encouraged that the Financial Services Committee remains committed to continuing its work to improve the capital formation ecosystem for small and emerging companies, and I am proud to support its efforts.

Conclusion

Emerging, pre-revenue biotech companies depend on investment capital to support the search for next-generation medicines, and many turn to the public markets to find investors and fund research. We have seen the clear appetite for capital formation on the public market in the wake of the JOBS Act – and GlycoMimetics was a clear beneficiary of that law. The rise in biotech IPOs in the last two years has unambiguously shown that public fundraising is fundamental in the search for groundbreaking medical advancements.

If Congress wants to build on the success of the JOBS Act and further increase capital availability for breakthrough research, it should take steps to ensure that the public market remains accessible for emerging businesses. If these smaller issuers have increased access to investors and are not forced to siphon off innovation capital to spend on costly compliance burdens, they will be able to fund R&D and create jobs across the country. A public market that supports capital formation for growing companies will stimulate the American economy and, in the biotech industry, support research that will change the lives of patients and their families.

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

DATE: April 9, 2014

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.

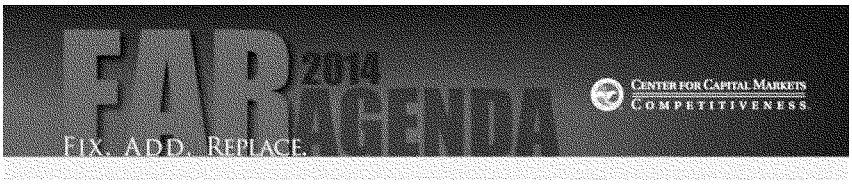
FAR

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.

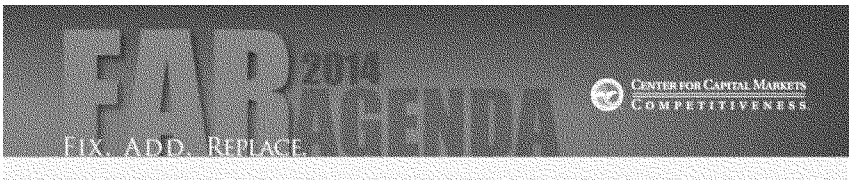
More than three and a half years into Dodd-Frank implementation, the law's complexity and overlapping, even conflicting, requirements are still challenging both regulators and regulated entities. Last year, the U.S. Chamber's Center for Capital Markets Competitiveness (CCMC) prepared the *Fix. Add. Replace. (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?

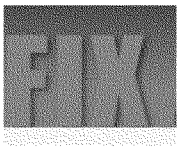
While there will be honest disagreements about particular provisions, almost everyone can agree that today's financial regulatory structure and oversight is still **FAR** from what is needed.

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



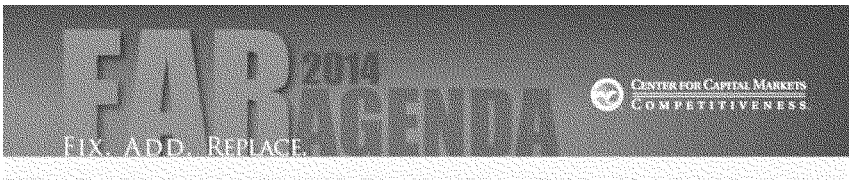
As with any broad legislation, Dodd-Frank has left gaps between regulations and created unintended consequences. In addition, as regulators have scrambled to meet statutory deadlines, they have been constrained by the rigidity of the statute in some areas or misinterpreted Congressional intent in others. 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

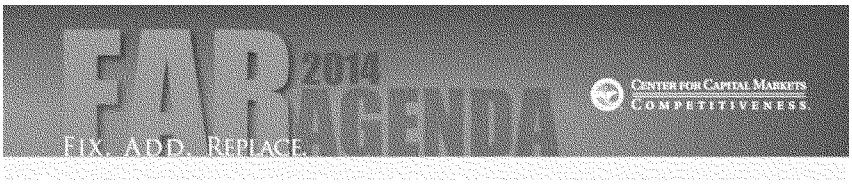
- Implement appropriate Congressional oversight by bringing the Office of Financial Research's (OFR) budget within the formal appropriations process.
- Improve the quality and process of the OFR's analyses and reports to better inform the FSOC. For example, require the OFR to undergo a notice-and-comment 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

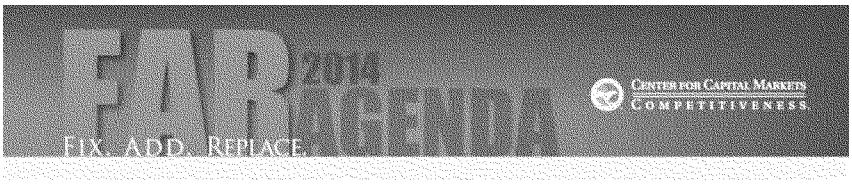
- Ensure further regulatory changes to Money Market Mutual Funds (MMMFs) seek to strengthen these funds while preserving their utility to investors and issuers.
- Target reforms so they effectively address clearly defined problems and conduct a thorough analysis of potential reforms to MMMFs to understand 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.



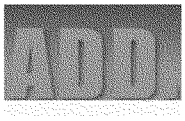
Fiduciary Standard: Preserve Choice and Affordability for Retail Investment and Retirement Savings

- 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.

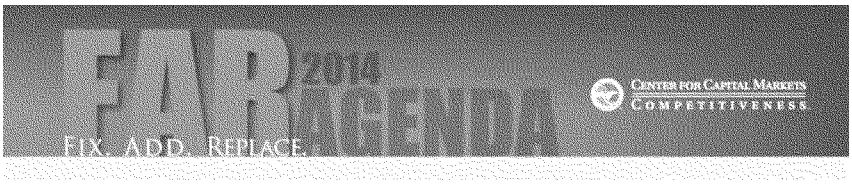
The Unresolved



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

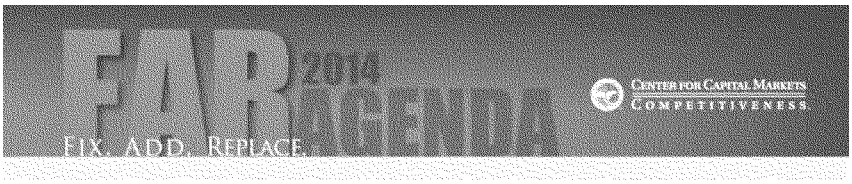
- Promote retail investor participation in proxy voting through examining possible interpretive guidance to give retail shareholders access to Client Directed Voting and encourage greater use of web-based communications and technology, such as enhanced broker internet platforms
- Educate retail investors 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

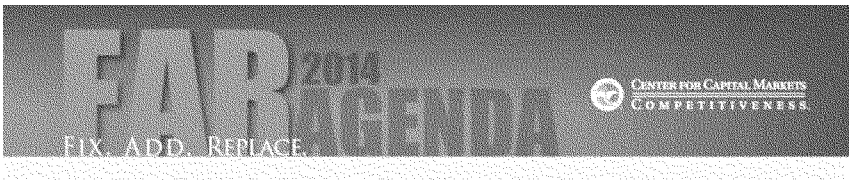
- Enact reform that will enable a robust and responsible return of the private sector to the broader housing finance market.

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

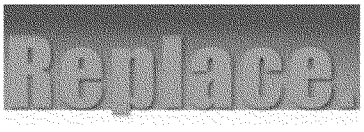
- Address issues that continue to impede the development of liquid, efficient, and well-regulated securitization markets that are critical to efficient debt financing for businesses.



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



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.

April 23, 2014

The Honorable Michael Fitzpatrick
2400 Rayburn House Office Building
United States House of Representatives
Washington, DC 20515

Re: Legislative Proposals to Enhance Capital Formation for Small and Emerging Growth Companies

Dear Representative Fitzpatrick,

I was honored to testify at the April 9, 2014, hearing of the Subcommittee on Capital Markets and Government Sponsored Enterprises. I am pleased that the Subcommittee is considering your important legislation, the Fostering Innovation Act (H.R. 2629), and I want to thank you for your hard work on this vital issue. Below please find my responses to your important inquiries about the impact that unnecessary regulations can have on the capital formation potential of emerging businesses.

1. *In his opening statement, Mr. Burton of the Heritage Foundation gave the example of securing loose leaf binders as some of the more ridiculous requirements of these small companies when complying with 404(b). I have actually heard similar stories from companies back in my district like Synergy in Doylestown, PA.*
    a. *Has GlycoMimetics or other BIO-member companies had similar experiences?*

In his statement, Mr. Burton correctly identified the ineffectiveness of certain SOX controls for small companies. At GlycoMimetics, we produce several binders each month to document every step that goes into the various activities and operations that make up the day-to-day functions of the accounting department. We also produce indexed tabs for the binder to ensure we are reviewing and auditing these procedures. The same processes existed at my previous public company, Advancis Pharmaceutical. At the end of the day, however, the presence of a binder on a shelf does nothing to protect or inform investors, despite the million-dollar price tag on said binder.

At GlycoMimetics, we only cut 110 checks per month – and each one is signed by either myself or the CEO. This centralized authority serves as its own control, as there is no risk of irresponsible (or corrupt) employees defrauding investors because the two of us are the only ones with access to the checkbook. The monthly bank reconciliations are performed by a different employee in the accounting group, closing the loop on any potential risk. I appreciate the importance of the internal controls mandated by Section 404(a), but the audit of those controls (and its attendant complications, like Mr. Burton's binders) does not provide relevant information to investors. As such, the costs of Section 404(b) compliance for a growth-stage company far outweigh any potential benefits.

2. *The JOBS Act provided some relief from 404(b) for emerging growth companies; however, it is only for 5 years. You mentioned in your opening statement that it is common that biotech firms may not "earn a penny for a decade." I guess it is fair to say that while 5 years is helpful it still means there are a lot of small firms that are*

going to get socked with this regulation before they are fully mature. You touch on this in your opening statement but I was hoping you could expand on why relief beyond 5 years is so important.

The biotech development process is a decades-long, billion-dollar endeavor. I greatly appreciate the five-year exemption from Section 404(b) included in the JOBS Act – which will save GlycoMimetics millions of dollars – but most biotech companies will still be in the lab or clinic after the exemption expires. GlycoMimetics will likely remain pre-revenue through the entirety of the EGC time horizon, so the dawn of Year 6 on the market will bring with it a new diversion of capital from science to compliance in the form of Section 404(b).

GlycoMimetics will spend an additional $1.5 million per year in increased expenses just to be a public company, and adding Section 404(b) compliance in Year 6 will increase those costs by an additional $750,000 to $1 million per year. With a current base payroll of about $4 million per year, the increased cost burden of SOX will negatively impact job creation. We could increase our scientific staff by a quarter for what we will instead spend on compliance costs.

I strongly support the Fostering Innovation Act because it recognizes the long-term, pre-revenue nature of innovative research and emerging companies. Recalibrating the existing one-size-fits-all compliance burden for small companies beyond the five-year JOBS Act horizon will provide important regulatory relief to these growing innovators. Instead of dreading the expiration of the EGC on-ramp, small companies will be able to focus their attention and capital on growth, research, and development.

3. *Could you please explain why you think revenue is an important component in SOX 404(b) regulatory relief?*

For growing biotech companies, overly burdensome regulatory standards like Section 404(b) of SOX present a unique challenge. Because these R&D-focused innovators do not fund the billion-dollar biotech research process through product revenue, they depend almost entirely on external investors for innovation capital. These investors stress the importance of resource efficiency, because spending capital on compliance diverts funds from the lab and could delay drug development. At GlycoMimetics, we strive to keep our investors informed of our progress, but wasting their valuable capital on government red tape instead of spending it on innovation and advancement does not serve their needs nor those of the patients who are waiting for our therapies.

As I discussed in my testimony, the increased cost of these regulations pulls funds directly from research. The annual cost of compliance could be used for additional clinical trials in various indications, reducing the time it will take to bring life-changing medicines to the market.

The Fostering Innovation Act recognizes that this is the reality for many innovative pre-revenue companies by taking the important step of adding a revenue test to the accelerated filer definition. The most damaging facet of Section 404(b) for the biotech industry has been the diversion of investment funds from science to compliance in the absence of product revenue. By taking revenue into account when determining a company's compliance burden, the Fostering Innovation Act would more accurately classify companies and provide important regulatory relief for small businesses.

4. *The high cost associated with SOX 404(b) compliance has been cited repeatedly by small, emerging companies as one of the deterrents from listing in the U.S. public*

markets. Would you agree that total costs include not only the direct cost of compliance but also the opportunity cost of foregone investment and research? For example, on average, how many research and development jobs are not created due to the dollar cost of 404(b) compliance for a small company with a market cap of, say, $150 million?

One of the most significant challenges for small companies in the biotech industry is the steep capital burden of next generation research, virtually all of which is funded by external investment. The common message that we hear from our investors is the utmost importance of using their funds efficiently. Companies and investors alike understand this key aspect of the biotech business model: because investment dollars go directly from the investor to the lab, any diverted funds are, by definition, lost to innovation.

When I was at Advancis Pharmaceutical (before the JOBS Act instituted the IPO On-Ramp), we added five employees to our finance and accounting team just to comply with SOX and the other reporting burdens attendant to being a public company. Before our IPO we had a two-person shop, so adding five hires to the department was a huge increase. More importantly, five new people in the finance department meant that Advancis missed out on hiring five scientists who would have furthered our research.

We expect that it will cost GlycoMimetics around $750,000 annually to comply with Section 404(b) once the EGC on-ramp expires. The average biotech salary is about $80,000, so the math is pretty simple. Spending $750,000 on SOX means that our company will not be able to hire 9 people who could actually support our R&D and move us toward product approval.

The cost is real. The opportunity cost is even greater when one considers that these resources (and jobs) are being lost to a requirement that I believe adds little-to-no real value to the investor, and certainly no value to the company.

5. *The purpose of Sarbanes-Oxley is an admirable one: to protect investors. However, I am of the opinion that the cost of Section 404(b) of SOX far outweighs any perceived benefit for most small public companies. You suggest in your testimony that investors in biotech companies do not list 404(b) compliance as a top priority of their own due diligence. Could you describe what types of information are used by investors in small biotech companies to make their investment decisions?*

The story of biotech drug development is one of advancement. As a given molecule moves through the development process, the science involved gets ever more complex, and the clinical stakes get higher as companies move closer to a cure. However, while the science is increasingly intricate, our corporate structure remains essentially the same. As scientists, we are innovators expanding the world's understanding of human life. As a corporation, we strive to stay as simple as possible so that the maximum amount of investment dollars can flow directly to our R&D.

During GlycoMimetics's testing-the-waters meetings and subsequent roadshow, I attended 90 investor meetings. Not once did a potential investor ask a financial question other than "How long will this cash last?" This is because the true value of a biotech company is found in scientific milestones and clinical trial advancement toward FDA approvals rather than financial disclosures of losses incurred during protracted development terms.

The business model of biotechnology is simple – we take in millions, if not billions, of dollars to fund our research and often do not earn a single penny in product revenue for more than a decade. Our science is the key to our business, and it is the most important thing for

investors to understand. The testing-the-waters meetings allowed by the JOBS Act have been universally praised by my biotech colleagues, largely because the additional time with investors allows for increased dialogue and greater information flow. Biotech companies like GlycoMimetics have complicated technology, an opaque regulatory pathway, and a complex commercial story – investors want to know about these important facets of our business, not the reports required by SOX. As such, the cost burden of Section 404(b) is damaging to our scientific progress without providing insight or protection to investors.

6. *When the SEC originally estimated public companies' cost of complying with 404(b) of Sarbanes-Oxley, it stated that it would cost each company $91,000. In reality, five years later, the SEC determined that the real cost had skyrocketed to $2.87 million. What effect would such a tremendous cost have on a smaller company that is determining whether it should go public?*

Growing biotech companies are acutely aware that costly regulations can stifle their progress by siphoning off research dollars. The influx of biotech IPOs in the wake of the JOBS Act – 80 biotech EGCs have gone public in the last two years – has shown that a commonsense regulatory burden can foster capital formation. The five-year EGC transition period gives small businesses time to spend capital on company growth rather than compliance burdens, which is vitally important for pre-revenue biotechs that are better served spending investment capital on groundbreaking R&D.

The costs of being a public company are high, but companies like GlycoMimetics accept and even embrace this burden in order to access public financing. There is a trade-off, and we support that. In order for GlycoMimetics to be a publicly traded company – even with the advantages of the JOBS Act – we increased our annual accounting expenses from $35,000 per year to over $500,000 per year. We have also seen an increase in our legal fees (from $300,000 to $900,000 annually) and a new cost burden for filing and printing our quarterly and annual reports (about $150,000 per year).

While we would love for these costs to be lower, we willingly entered the public markets understanding the cost. Once our phase-in period expires, we expect our costs to increase *another* $750,000 just to comply with one subsection of Sarbanes-Oxley that we view as duplicative and unnecessary. Again, while we accept the burdens of being a public company and understand the importance of protecting investors, we do not support wasting precious resources on a requirement that does nothing to inform investors and can actually delay our company's progress.

A burdensome, one-size-fits-all regulatory regime can deter small businesses from going public. When growing innovators are forced to turn away from the public market, it can slow company growth, delay R&D, and suppress job creation. Because of the unique capital needs of biotech research, a strong public market that supports capital formation is vital to the success of our industry. I am hopeful that Congress will continue to build on the success of the JOBS Act and further increase capital availability for breakthrough research by taking steps to ensure that the public market remains accessible for emerging businesses.

Sincerely,

Brian Hahn
Chief Financial Officer
GlycoMimetics, Inc.

Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

SBIC Relief Act Will Be Good For Advisers — And Business

Law360, New York (April 07, 2014, 5:23 PM ET) -- U.S. Rep. Blaine Luetkemeyer, a Missouri Republican, recently introduced new legislation, the SBIC Advisers Relief Act of 2014 (H.R. 4200), with the goal of resolving some of the unclear aspects of the Dodd-Frank Act for investment advisers to Small Business Investment Company funds. This new legislation will fix several regulatory uncertainties many advisers to SBIC, venture capital and private funds currently experience, as well as dramatically reduce legal and compliance costs for these advisers, without negatively impacting investor protections.

The SBIC program was created in 1958 as a public-private partnership between the U.S. Small Business Administration and successful fund managers in the private sector. The idea was to utilize private capital and management expertise, accompanied by SBA-guaranteed debentures, to drive economic growth and job creation in domestic small businesses.

Throughout its existence, SBIC funds have financed more than 11,000 domestic companies, including such household names as Intel, Apple, Whole Foods Market, Federal Express and Costco. Luetkemeyer, a member of both the House Small Business Committee and House Financial Services Committee, understands the long history of the SBIC program and drafted this bill with the aim of restoring the SBA as the sole regulator of SBIC funds and their advisers.

The SBIC program continues to grow, with over $20 billion invested in small businesses across the country. The program has also been a strong focus of the Obama administration, which supports increasing the amount in SBA debentures that is made available to successful SBIC managers. The administration has also supported new SBIC programs, including an early-stage program that encourages venture capital investment managers to enter the SBIC program.

Despite the strong bipartisan support for the program, when the Dodd-Frank Act came into law in 2010, it left SBICs in unclear regulatory territory, providing overlapping and duplicative regulatory oversight by multiple agencies, disincentivizing venture capital fund managers to enter the program, and creating increased costs and uncertain compliance obligations for fund managers.

One of the most important implications of Dodd-Frank was the registration of investment advisers for smaller private funds, and the investment adviser switch, where advisers below a certain asset under management threshold would now be regulated by state securities regulators.

While advisers to solely SBIC funds were purposely exempted from U.S. Securities and Exchange Commission registration requirements, recognizing the rigorous oversight conducted by the SBA, an oversight in the law left these advisers open to duplicate regulation at the state level.

SBIC fund managers, often five- to seven-person shops, were suddenly faced with new regulatory bodies, unfamiliar with SBIC funds and duplicative and costly regulatory burdens. The patchwork of blue sky laws in over 50 jurisdictions resulted in unclear compliance obligations, as some states have exemptions from registration for SBIC advisers, others did not, and others had potential reporting requirements.

In many instances, funds were faced with state regulators who were unclear themselves whether these entities would have to register with them, qualified for their adviser exemption, or would have to report to them. H.R. 4200 would address these concerns and leave solely SBIC advisers in the hands of the SBA, as was originally intended.

The SBA operates a vigorous oversight regime on SBIC funds, conducting an in-depth examination of the management of the fund, enforcing stringent investment rules, operational requirements, record-keeping, reporting and examination requirements, conflict-of-interest rules and, conducting compliance audits on a two-year cycle (required by law) or less.

Another implication of Dodd-Frank was the creation of a new "exempt reporting adviser" regime for advisers to venture capital funds. This new regime required "reporting" to the SEC, but eliminated the higher cost and regulatory burden of SEC registration for these advisers.

Unfortunately for those venture capital advisers seeking to start SBICs, the SEC has indicated that these former "exempt reporting advisers" will be required to register if they utilize the program. This requirement may have had a chilling effect on venture fund advisers' interest in starting an SBIC fund, and may also have contributed to the underutilization of the new "early-stage" SBIC program specifically geared toward venture fund advisers.

H.R. 4200 would allow these venture funds to continue under an "exempt reporting adviser" regime, while still providing sufficient investor protections through the SBA oversight of the SBIC funds, and encouraging use of the SBIC program by these advisers. Incentivizing the use of the program by venture fund managers will result in increased job creation and funding for startup companies, all certain to be invested here in the United States.

As a result of the new "asset under management" threshold test in Dodd-Frank, those advisers who jointly advise both private funds and SBIC funds must now register with the SEC, with accompanying costs and regulatory burden. Unfortunately for these advisers, the assets included in the SBIC fund, which are overseen by the SBA, are included in the calculation for the threshold test, resulting in many advisers having to register with the commission while having in reality very small private funds.

H.R. 4200 would resolve this concern and not include the assets of an SBIC in this calculation. These assets should not be included because they are in fact already heavily regulated by the SBA, and the registration requirement does not incentivize private fund advisers to start SBIC funds.

H.R. 4200 would therefore allow these advisers to be regulated at the state level if appropriate, or be part of the "exempt reporting adviser" regime at the SEC, allowing them to apply their funds' assets toward small business investment, rather than legal and compliance costs.

In sum, the SBIC Advisers Relief Act of 2014 provides significant support toward growing the SBIC program, a program with broad bipartisan support. The legislation has bipartisan support, with Rep. Carolyn Maloney, D-N.Y., a senior democrat on the House Financial Services Committee, recognizing the common sense changes present in the bill and joining as a co-sponsor.

In addition to Maloney, Rep. Erik Paulsen, R-Minn., has also co-sponsored the bill, which is expected to be the subject of a hearing in the Subcommittee on Capital Markets on April 9, 2014. The bill is expected to advance quickly in the House, with bipartisan support as more co-sponsors are anticipated.

—By Christopher Hayes, Small Business Investor Alliance

Christopher Hayes is legislative and regulatory counsel at the Small Business Investor Alliance, a trade group representing SBIC funds.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

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April 9, 2014

Chairman Scott Garrett
Subcommittee on Capital Markets and GSEs
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

Ranking Member Carolyn Maloney
Subcommittee on Capital Markets and GSEs
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Garrett and Ranking Member Maloney,

On behalf of the Small Business Investor Alliance (SBIA), we appreciate the Subcommittee on Capital Markets and Government Sponsored Entities (Subcommittee) holding a hearing on "Legislative Proposals to Enhance Capital Formation for Small and Emerging Growth Companies." Regulatory burdens on small business investors inhibit access to capital for small businesses and stunt economic growth. We would like to thank Representative Blaine Luetkemeyer (R-MO) for introducing H.R. 4200 on March 11, 2014, and joining him as bipartisan cosponsors, Representative Carolyn Maloney (D-NY), Representative Patrick McHenry (R-NC), and Representative Erik Paulsen (R-MN).

SBIA strongly supports the passage of H.R. 4200, the SBIC Advisers Relief Act of 2014, and encourages members of the House Financial Services Committee to act to provide relief to advisers to Small Business Investment Companies (SBIC) and other small business investment funds. SBIA is the premier organization of lower middle market private equity funds, SBICs, their limited partner (LP) investors in these funds, and Business Development Companies (BDCs). SBIA represents and advocates on behalf of over 400 funds in the lower middle market space, supporting efforts to ensure a healthy market for small business investing.

The SBIC Advisers Relief Act will reduce unnecessary compliance costs many advisers to SBIC, venture capital, and private funds currently experience. These changes, while largely technical, remove duplicative regulation and move closer to what was originally intended for the treatment of funds investing in small business. Correcting these provisions will allow fund managers to focus more on growing small businesses and less on fitting into a regulatory regime that is not designed for small business investing.

The SBIC Program

The SBIC program was created in 1958 to increase the amount of capital flowing to domestic small businesses. The SBIC program has been regulating venture capital and private equity funds for more than half a century. Although SBIC regulations are cumbersome and sometime onerous in their own right, at least most of the regulations are specifically designed for small business investing, not for investing in large publicly traded corporations. Additional layers of regulation do not add protections, but do hinder small business investment funds – funds commonly made up of a handful of investing professionals

outside the major financial centers. A two or three person small business fund in places like Cincinnati, Little Rock, or Baltimore does not have the same capacities or complexities as multinational, multibillion dollar, multistrategy funds with offices in Shanghai, London, and New York.

SBICs are already heavily regulated and closely supervised. This review and oversight starts before an applicant is permitted to file a formal license application with SBA and continues until such time that the license is surrendered or revoked. SBICs and their management undergo an extensive background check prior to licensing. The regulatory regime is similar to, but also much more intense than that applicable to other private funds that are regulated by the Securities and Exchange Commission (SEC). Generally, fewer than 25% of fund managers who start the licensing process are able to earn an SBIC license. This is not a "check the box" review. This is a vetting. The SBIC regulatory regime consists of an in-depth examination of the fund's management, stringent investment rules, specific operational requirements, recordkeeping, reporting, examinations, conflict of interest rules, and many other obligations. Federal examinations are required by at least every two years, although in practice they are performed annually. High standards and oversight designed for private equity and venture capital has led to a successful small business investment industry that provides a significant benefit to the U.S. economy.

The Impact of Dodd-Frank on SBIC Advisers

The Dodd Frank Act made a number of changes to the regulatory landscape for investment advisers to SBIC, venture and private funds. These small business investors were never the impetus for the act and had no part in causing the financial meltdown. Nonetheless, these funds were caught up in new and costly regulatory regimes of the SEC and state regulators. These regulatory burdens did not exist previously. This new regulatory power came without adequate clarity when it came to joint advisers to SBIC and private or venture funds.

First, in writing Dodd-Frank, the Committee debated and decided that double regulation of SBICs was unnecessary and therefore created an SBIC exemption. Dodd-Frank specifically prevented the SEC from registering advisers that advise SBIC funds, recognizing the need for only one regulator. Unfortunately, the Dodd-Frank language included the word "solely" in an attempt to make clear that the language was not inadvertently creating a loophole through which publicly traded BDCs with an SBIC subsidiary would suddenly be exempt from SEC rules. Because of the word "solely," the SEC then felt obligated to interpret this to mean that if an SBIC advisor also advised anything outside of the SBIC then double regulation was triggered – even if the non-SBIC funds would otherwise be exempt. We do not believe this was the Congressional intent. Further, this section of Dodd-Frank inadvertently opened up SBIC funds to double regulation because it did not explicitly preempt state regulation of federally licensed SBIC funds. Federally licensed SBICs can be regulated by the states too. Most states choose not to double regulate, but some do and all can.

Second, the new "exempt reporting adviser" (ERA advisers) regime for venture funds in Dodd-Frank failed to provide sufficient guidance to the SEC on how to treat dual advisers who advise both venture and SBIC funds. As a result, while advisers to venture funds may remain ERA advisers if they only advise a venture fund, if they also enter the SBIC program, they are now required to fully register – a much more expensive proposition. As a result, venture funds are effectively penalized with additional costs if they choose to add an investment vehicle for domestic small businesses via an SBIC.

Lastly, advisers that advise both SBIC funds and other private funds are required to include the Assets Under Management (AUM) of the exempt SBIC fund in addition to the private fund they manage in calculating the AUM threshold for SEC registration. Basically for the purposes of SEC Advisor Registration, regulated and exempt SBIC capital is being combined with otherwise exempt capital which effectively nullifies both exemptions. For example, if a fund manager has a $150 million SBIC fund and another $10 million dollars in any other fund then the adviser would have to register both funds. This exemption nullification applies even if the non-SBIC private fund is very small or is winding down. These outcomes do not help increase small business investing. This bill will correct these issues.

The SBIC Advisers Relief Act of 2014 Will Provide Significant Relief

The SBIC Advisers Relief Act of 2014 would correct these errors and provide significant relief. Clarity will benefit these small business investors as well as regulators who will not need to expend resources double regulating advisors. The resulting benefits will allow SBIC advisers to focus on creating jobs and investing in domestic small businesses. H.R. 4200 would address the concerns set forth above by: (1) returning SBIC advisers solely advising SBIC funds below $100 million in AUM to federal oversight by their federal licensing agency; (2) allowing venture fund advisers to remain Exempt Reporting Advisers if they choose to also advise an SBIC fund; and, (3) not including exempt SBIC capital in the triggering calculation for SEC registration for those advisers jointly advising both SBIC and other small private funds. The Committee should support this bill as a common-sense solution to encourage small business investment.

We appreciate the Committee's continued focus on improving conditions for access to capital for our job creators.

Sincerely,

Brett Palmer
President
Small Business Investor Alliance

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If you have a $500,000 portfolio, you should download the latest report by *Forbes* columnist Ken Fisher's firm. It tells you where we think the stock market is headed and why. This must-read report includes our latest stock market forecast, plus research and analysis you can use in your portfolio right now. Don't miss it! Click Here to Download Your Report!

THE WALL STREET JOURNAL.
WSJ.com

April 9, 2014, 6:30 AM ET

Dodd-Frank Interfering With Small Business Investment

By Brett Palmer

Brett Palmer

The opinions expressed in this item are those of the author. Private Equity Beat welcomes responses and rebuttals, by e-mail or in the comments section.

The U.S. House Financial Services Committee is continuing its push to help small businesses access capital. Today the committee continues its pro-investment agenda by considering seven different pieces of legislation, which includes legislation removing unnecessary regulations on private equity funds investing in domestic small businesses.

The Dodd-Frank Act created new regulatory requirements for private equity funds, and in the process set up unnecessary new reporting compliance burdens. This regime was designed for investments in publicly traded entities, not privately held businesses. These burdens are a particular problem for small business investors who lack internal legal compliance departments and the information technology infrastructure of large financial institutions. If left unfixed, these investors will continue to divert attention and resources to compliance and away from investing in small businesses.

The current private equity regulatory regime is effectively a "one-size-fits all" approach to regulating private funds. Currently, advisers that advise both Small Business Investment Companies (SBICs) and any other funds, such as venture capital funds, are caught in the Securities and Exchange Commission's registration regime. Basically, if a fund manager has more than one type of small business fund then double regulation is triggered. As a result, these investors are experiencing a level of regulation that is costly, unnecessary,

and a benefit to no one.

The SBIC Advisers Relief Act (H.R. 4200), bipartisan legislation brought to the committee docket today by Rep. Blaine Luetkemeyer (R, Mo.) and three other cosponsors including Carolyn Maloney (D, N.Y.), amends Dodd-Frank to help small business investors.

Thanks to the bipartisan work laid out in the SBIC Advisers Relief Act, the law will be corrected to promote capital to growing small businesses.

Brett Palmer is president of the Small Business Investor Alliance.

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protea®

Protea Biosciences Group, Inc.
955 Hartman Run Road
Morgantown, WV 26507
P: 304.292.2226
F: 304.292.7101
www.proteabio.com

April 7 2014

To The House of Representatives
Financial Services Committee
Washington D.C.

Re: Proposed Legislation Re: SEC Forms S-3 and S-1 and State Securities Regs.

Ladies and Gentlemen:

I write this letter as a company founder and job creator, in support of proposed legislation in consideration by the House Financial Services Committee to expand the availability of SEC Form S-3 to all SEC reporting companies regardless of public float, and to declare all securities issued by emerging growth companies to be covered securities under the National Market Systems improvements Act of 1996.

I founded my company in 2001, in Morgantown, West Virginia, in affiliation with West Virginia University. It is the first successful Biotechnology company in the State's history. We are now the world commercial leader in the development of technology that enables the molecular analysis of living cells, providing results in seconds to minutes. The technology has the potential to revolutionize clinical medicine, pharmaceutical research, and many other fields.

Today we have 48 full time employees, including 10 PhD. scientists, all located in Morgantown West Virginia, bringing high paying jobs to Appalachia. We have over 400 customers throughout the world. We have been a fully reporting company for over two years, and are in the process of completing the listing of our securities (OTCQB: PRGB) to commence trading. Our SEC filings have always been on time.

Over the past ten years, I have spent a great deal of my time raising capital for our company. Capital raising is always going to be challenging for a new business, as it probably should be. However, if a small company is complying with SEC reporting requirements at the same quality level as a large company, then, in the spirit of fairness, I believe that company deserves having the same options for raising capital, specifically in our case the availability of SEC Form S-3 to consummate financings as a public company.

protea®

Protea Biosciences Group, Inc.
955 Hartman Run Road
Morgantown, WV 26507
P: 304.292.2226
F: 304.292.7101
www.proteabio.com

I am grateful to hear that your Committee has taken this question under consideration, and respectfully urge the Committee to take this action to address an inequity in SEC regulation that unfairly restricts the access to capital for vibrant growth companies such as ours, who are in compliance with the full SEC reporting requirements. There is no reduction of investor protection involved here, just the basic issue of fairness.

Yours sincerely,

Stephen Turner, CEO

April 4, 2014

House of Representatives

Financial Services Committee

Washington, DC

Re: Proposed Legislation Regarding SEC Forms S-3 and S-1 and State Securities Regulation

Ladies and Gentlemen:

We write this letter strongly supporting the proposed legislation being considered by the House Financial Services Committee to (i) expand the availability of SEC Form S-3 to all SEC reporting companies regardless of public float, (ii) permit forward incorporation by reference after the effectiveness of an SEC Form S-1 registration statement and (iii) declaring all securities issued by smaller reporting companies and emerging growth companies to be "covered securities" under the National Market Systems Improvements Act of 1996.

The main policy driving these changes is the ability to significantly enhance the ease of capital formation for the smallest public companies while maintaining investor protections since there is now easy access to tremendous amounts of information about public companies with the click of a computer mouse.

In the East and West Coast offices of our law firm, we represent many publicly held companies, a number of which are smaller. Even in one of the strongest stock markets in years, these smaller companies struggle to raise money for growth and job creation. There are a variety of reasons for this, but a major impediment has been the burdens and restrictions placed solely on the smallest companies who disproportionately bear the responsibility of compliance based on their size and revenues. The proposed changes offer a chance to meaningfully improve their access to capital while still ensuring that investors receive all the information they need to make decisions.

Form S-3. As to the proposed expansion of Form S-3, the SEC itself actually proposed doing so in 2007 based on the recommendation of its Advisory Committee. This recommendation has been repeated annually since then at the SEC's government-business forum on small business. If a company has been a full reporting company for a year and has completed all its periodic filings on a timely basis, an investor in a public offering will have access to all material information necessary to make an informed investment decision without re-filing and re-approving this same information in a full S-1 registration. The Sarbanes-Oxley Act mandates SEC review of all reporting companies' periodic filings every three years, so this information will be regularly reviewed by the Staff.

In addition, various recent amendments to the Current Report on Form 8-K require much more information be disclosed on a continuous basis as it occurs, further enhancing the information flow to investors. Given the easy access to complete and current information, it is quite appropriate to allow these companies to utilize a short form to register securities.

This matters for smaller companies, below $75 million in public float, because most investors in today's market demand liquidity and shares that can be immediately traded. Without short form registration, companies

The Chrysler Building - 405 Lexington Avenue, 49th Floor New York, NY 10174
T 646 755 7315 • F 917 591 3479

must raise money in a private offering which is extremely difficult to complete based on current market conditions since the private investment in public equity (PIPE) market has been effectively shut down since 2008. To offer freely tradeable shares, the alternative is a full Form S-1 registration which is expensive, time-consuming and risky. The smallest companies have the greatest burden in bearing the cost of this full registration, which appears unnecessary since all company information is already easily available to the public.

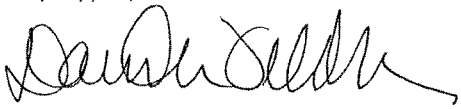
Form S-1. There will still be circumstances, if the Form S-3 changes are adopted, where a Form S-1 is still required. An IPO, for example, or a public offering during the first year of being public, or an offering at a time when the company may not have timely filed its periodic reports in the last year. A major challenge, especially when Form S-1 is used to register already issued shares to be publicly resold, is keeping the Form S-1 current to reflect changes in the company. Form S-3 is automatically deemed amended by incorporating by reference all future SEC filings made after effectiveness. Adding this forward incorporation to Form S-1 is logical for the same reason that Form S-3 expansion makes sense – the subsequent filings are easily available online for any investor. Even a poor investor without a computer can obtain a local library card and use a computer at the library to obtain investor information. Thus today literally anyone can easily access all key information about a public company.

Blue Sky Preemption. It makes sense in our view to continue to move to relying on federal regulation of the securities markets in the 21st Century. Unlike social issues where local attitudes and conventions become more relevant, there is no reason to "localize" the regulation of the offering of securities if the federal oversight is robust and balanced. There remains a strong local interest in enforcement and in regulation of intermediaries in transactions.

In 1996 Congress preempted state regulation of most offerings on the national securities exchanges. In 2012 Congress further preempted state regulation of public offerings of up to $50 million under SEC Regulation A, with reduced disclosure and reporting during and after the public offering. It therefore makes sense to expand this to all SEC reporting companies, since they will provide even more public information than a company completing a Regulation A offering. For all these reasons there is simply no demonstrated additional benefit to an added layer of regulation at the state level. And in fact, the significant costs and delays in often burdensome state merit reviews of offerings literally can cause a proposed transaction to be canceled.

For all these reasons, we believe that the proposed bill could provide a real game-changing opportunity for exciting small companies. As we know, the US economy is driven in vast majority by small business. By effecting the changes suggested in the bill, younger companies, whether in life sciences, energy, technology or other sectors, can raise capital, grow, bring amazing changes to our world and, most importantly, create jobs for Americans.

Very truly yours,



David N. Feldman, Partner

Richardson & Patel LLP