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LEGISLATIVE PROPOSALS TO ENHANCE CAPITAL FORMATION AND REDUCE REGULATORY BURDENS

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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LEGISLATIVE PROPOSALS TO ENHANCE CAPITAL FORMATION AND REDUCE REGULATORY BURDENS

Wednesday, April 29, 2015

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 2:28 p.m., in room HVC-210, Capitol Visitor Center, Hon. Scott Garrett [chairman of the subcommittee] presiding.

Members present: Representatives Garrett, Hurt, King, Neugebauer, McHenry, Huizenga, Duffy, Fincher, Hultgren, Ross, Wagner, Messer, Schweikert, Poliquin, Hill; Maloney, Hinojosa, Scott, Himes, Ellison, Foster, Carney, Sewell, and Murphy.

Ex officio present: Representative Waters.

Also present: Representative Moore.

Chairman GARRETT. Good afternoon, and welcome. The Subcommittee on Capital Markets and Government Sponsored Enterprises is hereby called to order.

Today's hearing is entitled, "Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens." I thank the members of the subcommittee for being here, and I thank the witnesses on the panel, as well. Forgive me if my voice is a little bit off today. I am either suffering from a little head cold or some allergies.

Again, thanks to the panel. We will begin as we do normally. I know most of the panel is new to the testifying process. Some of them are not so new, and have been around here before. So, we will begin with opening statements, and I will yield myself 3 minutes.

Since 2011, this subcommittee has held almost a dozen of these hearings, basically to explore ways to do what? To facilitate capital formation, and make the U.S. capital markets more attractive to companies, and to try to increase investment opportunities for all investors. Most notably, this subcommittee led the charge, if you will, to implement one of the most meaningful updates to our securities laws in recent history, in recent memory, and that was the Jobs Act, Jobs 1.0. And we are seeing the positive impacts of the Jobs Act as more and more smaller companies are accessing the capital markets and they are doing so at a lower cost. But I think most agree that more needs to be done.

Therefore, it is incumbent upon this committee and this Congress to provide sensible improvements to our securities laws to help small companies and startups access the capital markets and access capital they need to create jobs and to grow.

The United States has the most fair, most efficient, and deepest capital markets in the world. And the primary function of the capital markets that we have is to do what? It is like I say, it is to help facilitate the appropriate flow of capital from investors to companies which need those funds to create jobs, to grow the companies, to grow the economy, and for prosperity in America.

So today, America's startups and small businesses continue to encounter difficulty, unfortunately, accessing the U.S. capital markets to finance operations. Moreover, the costs of these companies of going and staying public remain unacceptably high. So this afternoon, the subcommittee continues its capital formation agenda by considering a dozen bills. And I want to thank all of the cosponsors of the legislation that will be coming before this subcommittee.

During the 113th Congress, this committee and the House considered many of the bills that are before us today. We approved them, and we approved them overwhelmingly with large, in some cases unanimous, votes, which is a great thing. One of those bills is H.R. 1525, the Disclosure Modernization and Simplification Act, my bill.

This legislation is one that I introduced. I was pleased that this legislation was able to pass by this committee on a 59–0 vote, and by the House with a voice vote last year. And what would that bill do? It would direct the SEC to tailor regulations, S-K disclosure rules, as they apply to emerging growth companies and smaller issuers to eliminate other duplicate, outdated, and unnecessary rules and regulations.

Now, although these bills that we are talking about are modest, they are not insignificant to our fellow citizens back home or to the entrepreneur or small company that our fellow citizen depends upon in order to get his job. So in all of this, it is important to remember that capital formation and investment protection is not an either/or proposition.

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

So, I want to thank again—where I began—all of the witnesses for their appearance at this hearing and also for their very relevant and helpful written testimony that they have all submitted. And I look forward to advancing all of the bills under discussion at the committee markup, and then to the full House at the earliest opportunity so we can move things along. And with that, I yield 2 minutes to the vice chairman of the subcommittee, Mr. Hurt.

Mr. HURT. Thank you, Mr. Chairman. Thank you for holding today's hearing, and I am pleased that this subcommittee is moving forward with ideas to increase access to capital for our small businesses and startups.

At a time when unemployment remains high, and my constituents are struggling to find employment, it is incumbent upon us to do everything we can to reduce the regulatory burden on such enti-

ties that are so vital to job creation in Virginia's 5th District and across this great Nation.

The bipartisan Jobs Act was one successful example of identifying and remedying regulatory burdens that restrict economic growth, and we need to build upon that success. We must do more to remove or refine costly regulations, particularly those that are disproportionately affecting smaller public companies who are considering accessing capital in the public markets.

While a single regulation may seem insignificant, the combined effects of our regulatory regime can be insurmountable. One such requirement is the eXtensible Business Reporting Language, or XBRL, which was mandated by the SEC in 2009. While the SEC's rule is well-intended, this requirement has become another example of a regulation where the costs outweigh the potential benefits.

I put forth a proposal that would offer small companies relief from the burdens of XBRL: H.R. 1965, the Small Company Disclosure Simplification Act, provides a voluntary exemption for all emerging growth companies (EGCs) and other small public companies from the SEC's requirements to file their financial statements via XBRL.

I believe this proposal is a measured step forward, and during the 113th Congress identical legislation was passed by this committee by a bipartisan vote of 51–5. I look forward to the testimony of our distinguished witnesses and thank them for their appearance before the subcommittee today.

I thank you, Mr. Chairman, and I yield back the balance of my time.

Chairman GARRETT. The gentleman yields back. I don't believe there are any other opening statements, so at this point we will turn to our panel.

And just as a refresher for our new panelists, your entire written statement will be made a part of the record, and you will be recognized now for 5 minutes for a summary of your testimony.

We will begin with Mr. Deas, vice president and treasurer of FMC Corporation. Welcome to the panel, and thank you.

You are recognized for 5 minutes.

STATEMENT OF THOMAS C. DEAS, JR., VICE PRESIDENT AND TREASURER, FMC CORPORATION, ON BEHALF OF THE COALITION FOR DERIVATIVES END-USERS

Mr. DEAS. Thank you, Mr. Chairman, and thanks to the members of this subcommittee. I am Tom Deas, vice president and treasurer of FMC Corporation, and immediate past chairman of the National Association of Corporate Treasurers (NACT). FMC and NACT are members of the Coalition for Derivatives End-Users, representing hundreds of companies across the country that employ derivatives to manage day-to-day business risk.

First, let me sincerely thank you, Mr. Chairman, and the ranking member, and also the members of the subcommittee for doing so much to protect derivatives end-users from the burdens of unnecessary regulation. When it comes to the needs of Main Street companies, the members of this committee have worked together to get things done. You drove the end-user margin bill to enactment

and have led the charge on the centralized Treasury unit bill sponsored by Representatives Moore and Stivers.

As you oversee the implementation of the Dodd-Frank Act, I want to assure you that in my experience, end-users comprising less than 10 percent of the derivatives market do not engage in the kind of risky, speculative derivatives trading activity that became evident during the financial crisis.

We use derivatives to hedge risks in our day-to-day business activities. We are offsetting risks, not creating new ones. FMC Corporation has been a proud American innovator since our founding some 130 years ago. This is our 84th year of listing on the New York Stock Exchange (NYSE).

When we first listed in 1931, the NYSE was the largest pool of capital available to us to grow our business. Today, the over-the-counter derivatives market represents an additional and even larger pool of funds available to us, and is a flexible and cheap way to hedge everyday business risk such as changes in foreign exchange rates, interest rates, and also global energy and commodity prices.

We support the transparency in the derivatives market that the Dodd-Frank Act attempts to achieve. We also believe it is sound policy and consistent with the law to exempt end-users from provisions intended to reduce the inherent riskiness of swap dealers activities.

However, at this point—4½ years after passage of the Act—there are several areas where regulatory uncertainty compels end-users to appeal for legislative relief.

First, centralized Treasury units. The Coalition recognizes the efforts of the Commodity Futures Trading Commission (CFTC) to provide relief on centralized Treasury units, but their actions have not addressed the fundamental concern that companies must operate at all times in strict compliance with the law.

End user treasurers have long used widely accepted risk reduction techniques to net exposures within our corporate group so that we can reduce derivatives outstanding with banks. However, the internal centralized Treasury units we use have been viewed as financial entities subject to mandatory clearing and margining even though they are acting on behalf of non-financial end-user companies otherwise eligible for relief from these burdens.

The Coalition strongly supports H.R. 1317, which would clarify that certain swaps with CTUs of non-financial end-users are eligible for the end-user exception for mandatory clearing and the requirement to post margin for their derivatives positions.

With your help, however, we could successfully navigate the complex regulatory issues I have described today, only to find that the uncleared over-the-counter derivatives we use have become too costly because of much higher capital requirements imposed on our banks.

U.S. bank regulators are implementing significantly increased capital requirements on all derivatives. However, European regulators have concluded that end-users hedging activities are risk-reducing and should attract less capital than swap dealers trades. They have exempted non-financial end-users from these additional capital requirements. This could put FMC and other American

companies at an economic disadvantage relative to our European counterparts.

Although I have focused here on two main issues, end-users are concerned about the web of, at times, conflicting rules from U.S. as well as foreign regulators that will determine whether we can continue to manage business risk through derivatives.

Our fear is that cross-border regulatory uncertainty could conflict, and put FMC and other American companies at an economic disadvantage. End user exemptions for margining and clearing we thought would apply are still uncertain as they affect our risk-reducing centralized Treasury units, confronting us with potentially competitive burdens that could limit growth and, ultimately, hamper our ability to grow and create jobs.

Thank you for your attention, Mr. Chairman.

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

Chairman GARRETT. I thank you for your testimony.

Professor Gabaldon from George Washington University Law School, welcome to the panel. You are recognized for 5 minutes.

STATEMENT OF THERESA A. GABALDON, LYLE T. ALVERSON PROFESSOR OF LAW, THE GEORGE WASHINGTON UNIVERSITY LAW SCHOOL

Ms. GABALDON. I do thank Chairman Garrett, Ranking Member Maloney, and the other members of the subcommittee for inviting me. I am Theresa Gabaldon from George Washington University. I have comments on eight of the proposed bills. I have a few general remarks before addressing specific bills, as time allows.

First, although the bills can be broadly characterized as deregulatory, deregulation that is not well-thought-out does not assist capital formation. I believe the bills generally were prepared without appropriate regard to the opportunities for abuse, and without regard to the way the proposals would interact with other recent deregulations.

The proposed rules, in the wrong hands, essentially could render registration under one or both of the 1933 and 1934 Acts optional. I also am concerned that some of the proposals don't work coherently together, pushing for modernization on one hand and fighting it on another. Overall, the proposed changes would adversely affect the quality and availability of the information investors need.

I will move on to the specifics of the bills, in view of the time, starting with the ones I believe are most flawed and create the most opportunity for mischief.

First, with respect to the M&A Brokers bill, I will align myself with Oliver Wendell Holmes and say that to know what a law is you must look at it as a bad man—updating to include a bad woman. As this bill is drafted, it literally would permit someone banned from the securities industry to publicly offer the securities of shell companies to what could be hundreds of people who will, in 1 year, be permitted to resell the securities without any limit whatsoever. I don't suppose that is what is intended, but that is how it could and, in my opinion, would operate if allowed to pass in exactly its current form. Some of the defects can be remedied

with bad-actor provisions, exclusion of the involvement of most shell companies, and limiting public offering activity.

The SEC's M&A no-action letter of early 2014 outlines necessary conditions that would be improvements. And that letter also makes this legislation unnecessary. Even if improved, what you are left with is a bill to allow unlicensed and federally unregulated brokers to compete with those who are willing to submit to inspection and other controls.

The argument for deregulation supposes that this will bring down M&A costs for smaller companies. I have a few responses to that. One, the cutoffs for eligible privately held companies who supposedly need cut rate service are extremely high. This relates to a concern that the provision, even if improved, has the potential for exploitation by large private equity firms who already are pressing the envelope as far as avoiding registration is concerned. I don't doubt their ingenuity in structuring transactions that could capitalize on this exemption.

Two, the resales to accredited investors, or Section 4[a](1½) bill. I started my evaluation of this bill with a proposition that the common law Section 4[a](1½) exemption is not broken and does not need to be fixed. This is particularly true in light of the relaxation over Rule 144.

As written, the new exemption would be a perilously easy way for affiliates to flip securities either on their own or on the issuer's behalf, providing only that separate compensation for that service is not received. In addition, first tier and subsequent purchasers would assume no real holding risk and could be expected to evaluate their purchases less carefully.

There are other problems with the bill, particularly its failure to propose the types of protection associated with private placements under Rule 506 and/or the existing resale rule of Rule 144A.

The latter is especially startling since Rule 144A allows resales only to qualified institutional buyers, generally institutions with portfolios of $100 million or more with issuer-sponsored disclosure.

Moving to the compensatory benefit, or Rule 701 bill, for reasons amplified in my written testimony, doubling the limit before disclosure to prospective employee investors is triggered can't be justified simply by talking about inflation. Things have changed since 1999 in addition to the value of a dollar. We now have an amendment to Section 12G of the 1934 Act that says purchasers under 701 don't count for triggering registration requirements. The proposal then would allow large issuers, year after year, to place $10 million worth of securities with employees who would never receive the benefit of disclosure under either Act.

Finally, I will close with a comment on the XBRL bill, stating my conviction that it may well have the effect of reducing access to capital and provide very little savings in regulatory burden, all while lagging behind a number of other countries.

Thank you once again for permitting me to speak today.

[The prepared statement of Professor Gabaldon can be found on page 47 of the appendix.]

Chairman GARRETT. Thank you, Professor.

Ms. Hughes, you are recognized for 5 minutes.

STATEMENT OF GAYLE G. HUGHES, PARTNER & FOUNDER, MERION INVESTMENT PARTNERS, ON BEHALF OF THE SMALL BUSINESS INVESTOR ALLIANCE (SBIA)

Ms. HUGHES. Good afternoon, Chairman Garrett, Ranking Member Maloney, and members of the subcommittee. My name is Gayle Hughes, and I am a founder and partner of Merion Investment Partners, a family of private equity funds licensed by the Small Business Administration as small business investment companies (SBICs). Merion was founded in 2003, is based just outside Philadelphia, and is involved in providing subordinated debt and equity to small businesses that have significant growth potential. Merion advises two SBIC funds.

I am here today representing the Small Business Investor Alliance (SBIA), which is a trade association of lower middle market private equity funds. SBIA members provide vital capital to small businesses across the country.

Over my 30-year career in the financial industry, I have worked with companies from small entrepreneurial firms to members of the Fortune 500, and found working with small businesses most rewarding. For the last 20 years my partners and I have focused on investing in and managing small businesses. We work closely with management teams to help them achieve their growth objectives.

The core of our strategy is to invest in small firms and provide them with the financial wherewithal and management expertise to realize their growth objectives. Merion's first SBIC license was approved in August 2003. We sought a second license, which was approved in January 2010. And we plan to seek a third license later this year.

Since receiving our first SBIC license, we have invested nearly $190 million in 35 small businesses, and have been examined 14 times by Federal examiners. A large percentage of our investments are made directly with business owners, with Merion as the only institutional capital.

Despite our small size, I am pleased to tell you that of the 23 different States represented by members of the committee, Merion has made investments that are either headquartered in or have significant operations in 78 percent of those States. For example, we provided financing to fund a growth opportunity for an IT services company in northern New Jersey that tripled its revenues, expanded its footprint, and nearly doubled its employees.

In a second example, Merion provided the capital for a central Virginia firm that grew revenues at a 23 percent compounded annual growth rate and its employment base grew by 67 percent. We helped other businesses grow from small business to global business with hundreds of employees.

As an SBIC, we are highly regulated and regularly examined by a regime designed for private equity and small businesses. The cost and time associated with duplicative regulatory burdens would materially reduce our ability to focus on finding and growing small businesses. Dodd-Frank recognized this issue and attempted to address it in the statute, but we know now that a few technical corrections are needed to provide relief.

The SBIC Advisors Relief Act is a common-sense, bipartisan, and effective clarification of the investment advisor regulation that will

enhance the ability of small business investors to concentrate on making investments rather than filling out forms. It concentrates on three targeted changes to current law.

First, the legislation prevents venture funds from losing their exemption from SEC registration when entering the SBIC program. Having two exemptions should not be worse than having one.

Second, the legislation helps advisors to both private equity funds and SBICs by removing the SBIC capital, which is already regulated by the SBA from the calculation for SEC registration. This would help my fund and many other funds that regularly face this problem of having more than one type of small business fund.

Third, the legislation prevents the duplicative registration of SBICs by Federal and State securities regulators and returns SBICs to their original, sole Federal regulator. Smaller funds have a lower threshold for regulatory pain, and one regulator is enough. Our SBIC funds exceed the registration trigger, and our fund in wind-down will eventually cease to be an SBIC, triggering SEC registration and all the associated costs and burdens.

This does not make sense and does not add investor protections. It would create very significant and ongoing costs for all of our small business funds. My written testimony explains in more detail the elements of this legislation and why the solutions and clarifications it makes to the Dodd-Frank Act are necessary to ensure that smaller funds will be able to continue focusing on small business investing rather than filling out regulatory paperwork.

I would like to thank the subcommittee for examining this bill today, and I especially want to thank the sponsors of the legislation. In addition to H.R. 432, the SBIA generally supports other legislation that is the subject of today's hearing. These include H.R. 686, H.R. 1525 and H.R. 1659. These bills will contribute to improving access to capital and reducing associated regulatory burdens in the capital raising and deal-sourcing process.

Thank you very much for allowing me to present this testimony.

[The prepared statement of Ms. Hughes can be found on page 62 of the appendix.]

Chairman GARRETT. Thank you for your testimony.

Next, Mr. Kovacs, welcome to Washington, and welcome to the panel.

Mr. KOVACS. Thank you.

Chairman GARRETT. You are recognized for 5 minutes.

STATEMENT OF SHANE KOVACS, EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER, PTC THERAPEUTICS, INC., ON BEHALF OF THE BIOTECHNOLOGY INDUSTRY ORGANIZATION (BIO)

Mr. KOVACS. Good afternoon, Chairman Garrett, Ranking Member Maloney, and members of the subcommittee. My name is Shane Kovacs, and I am the CFO of PTC Therapeutics, a biotech company based in South Plainfield, New Jersey. We are a growing company with 250 employees to date, up from about 125 at the time of our initial public offering less than 2 years ago. And we plan to grow to 400 employees by the end of this year.

PTC is developing a portfolio of treatments for ultra-rare genetic disorders that mostly impact children, and capital formation is a key to that lifesaving research and development.

PTC has spent approximately $800 million in R&D over the past 17 years, and we are just now on the precipice of our first FDA-approved product. Our story is common in the biotech industry. BIO represents over 1,100 companies, and the vast majority of them are pre-revenue small businesses.

Because biotech R&D is typically supported only by investment capital, not product revenue, our investors emphasize the importance of resource efficiency. Every dollar spent on regulatory burdens is a dollar that we are not spending in the lab or in the clinic. Yet, a one-size-fits-all regulatory regime often prevails, bringing with it damaging diversion of capital from science to compliance.

In my experience, there are three financial metrics that biotech investors focus on and understand. It is pretty simple: one, how much cash does the company have on its balance sheet; two, what is the company's cash burn rate; and three, how much time is there until that company needs to go to the markets to raise more capital. These high-level metrics are not the focus of the existing regulatory regime, which includes high-cost regulatory standards like XBRL and SOX 404(b), yet we must spend time and dollars preparing the mandated reports instead of talking to our investors about a cash position and key non-financial metrics like our science and our regulatory pathway.

The Jobs Act has supported over 140 biotech IPOs because it strikes a nice balance between capital formation incentives and appropriately tailored regulations.

And I am encouraged by the fact that the subcommittee is considering legislation today that will build on the Jobs Act's successes. The Jobs Act was a boon to PTC's IPO, and we have created 125 new jobs since our offering, with more on the way. Clearly, smart policymaking can support job growth and innovative R&D.

And particularly, I strongly support Congressman Hurt's Small Company Disclosure Simplification Act. We spend nearly $50,000 annually complying with XBRL, all to pay for reporting that doesn't include key information on our company which is important for investors to evaluate an opportunity in PTC. For PTC and other small biotechs, an informed investor is a good one. The Jobs Act, including testing-the-waters meetings, was critical to our successful IPO because we could share more information with investors prior to our offering.

But XBRL relies on standardized financial metrics better suited to comparing financials on much larger companies. So, it does not paint a true picture of the opportunity of investing in small biotech companies.

I worked as an investment banker with Credit Suisse for 12 years on Wall Street before joining PTC, and I can say with confidence that investors need to understand the scientific foundation of biotech, the clinical progress, and the regulatory pathway before really trying to evaluate metrics enabled by XBRL.

Congressman Hurt's bill gives the SEC a chance to improve the compliance mechanism to enhance transparency and decrease costs, and removes the cost burden from small companies while the

SEC does its work. I want to thank him for introducing this important legislation, and I urge the subcommittee to support it.

I also encourage the subcommittee to take a discerning look at any and all regulations governing public company disclosures, with the goal of achieving a common-sense, right-sized regulatory environment, a spirit embodied by Chairman Garrett's Reg S-K bill.

This spirit also applies to Congresswoman Wagner's proposed reforms to Form S-1, which I believe represent an important change for SRCs, and I believe can go further by extending forwarding corporation by reference to EGCs. Emerging biotechs like PTC highly value capital formation and capital efficiency, and I strongly support your efforts to enhance the capital formation ecosystem by reducing regulatory burdens. Enhancing the secondary market for Reg-A offerings, reforming Rule 701, and enhancing the IPO on-ramp are all important steps toward a common-sense disclosure regime.

Thank you for considering legislation to support the search of next-generation medical advances, and I look forward to answering any questions you may have.

[The prepared statement of Mr. Kovacs can be found on page 83 of the appendix.]

Chairman GARRETT. And, again, I thank you.

And finally, last but not least, Mr. Quaadman, once again, welcome back, and you are recognized for 5 minutes.

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

Mr. QUAADMAN. Thank you, Chairman Garrett, Ranking Member Maloney, and members of the subcommittee. Thank you again for the opportunity to testify as well and, more importantly, for this committee's bipartisan leadership on issues of importance to capital formation and business creation.

Businesses need the ability and the tools to expand from small to large, and they must be able to engage in the reasonable risk-taking needed to stimulate economic growth and job creation. The Jobs Act was an important piece of legislation to help further those goals.

Since the turn of the century, we have had 14 years of consecutive declines in public companies in the United States. But since we have had the partial implementation of the Jobs Act, we have actually seen a dramatic uptick in IPO activity, and last year, we actually saw the number of public companies in the United States rise for the first time.

However, when Michael Dell says that he will never operate a public company again, we are still in perilous territory. Indeed, the long-term trends are not good. We are still seeing a large outflow of public companies as well as a series of reports that have been released recently, including the Census Bureau, that business formation in the United States is at its lowest point since numbers were kept, since 1977, and that we have had a steady decline in the number of overall businesses in the United States since 2008.

So the package of legislation that we are discussing here is important to build on that foundation of the Jobs Act as well as to

overcome the reluctance of the SEC to modernize its rules. One doesn't have to look any further than the Reg A example from the Jobs Act to understand how tortuous that can be.

So with the Swap Data Repository and Clearinghouse Indemnification Correction Act, this is an important clarification needed to bridge international differences in law to facilitate better cross-border coordination amongst regulators.

The Holding Company Registration Threshold Equalization Act and the SBIC Advisers Relief Act both codified congressional intent of the Jobs Act as well as the Dodd-Frank Act.

The Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act is an important bill because we have an atmosphere where businesses are increasingly looking to be acquired. Younger business owners are no longer willing to go down the path of the public company, and for older business owners, where the business is their largest asset, that is what they need to sell in order to retire.

So we need to have certainty to allow that activity to flourish. And unfortunately, while the SEC no-action letter does provide relief, we have recently seen, in an unrelated area, where the SEC revoked a no-action letter that overturned a decades-long process on a Friday night without any SEC Commissioners being consulted.

With the improving access to capital for emerging growth companies, this is a needed change to help emerging growth companies get financing-simplified disclosures that are material to investors. The Disclosure Modernization and Simplification Act, the Small Company Disclosure Simplification Act, and the Small Company Simple Registration Act, taken together, these bills are an important step forward to change the 1930s paper-based disclosure model and create one for 21st Century markets using tools that investors use to acquire information.

I also want to thank Chair White and Corporation Finance Director Keith Higgins for their leadership in trying to modernize disclosures. But these bills are important to help save those efforts from inertia.

The Encouraging Employee Ownership Act is an important change to make the Jobs Act effective. This will change the threshold, based on inflation, which hasn't been changed since 1988. And these tools are used for employee retention and reward and not for capital-raising.

The RAISE Act is an important piece of legislation as well because courts have allowed for the sales of certain securities. The RAISE Act will help set parameters around an emerging market, ensure liquidity and, most importantly, provide for investor protection.

The treatment of affiliates of non-financial firms that use a central Treasury unit is a narrowly tailored bill. It codifies congressional intent of the Dodd-Frank Act, and allows a non-financial company to use derivatives without clearing, to mitigate commercial risk, and lock in prices.

The bill to amend the Securities and Exchange Act of 1934 to require the SEC to refund or credit excessive Section 31 fees is in keeping with the bipartisan spirit of the Investors Capital Market

Fee Relief Act. This actually creates a mechanism to pass back to investors overcharges.

So, again, Mr. Chairman, these bills are important to build upon the foundation of the Jobs Act, and I am happy to answer any questions you may have.

[The prepared statement of Mr. Quaadman can be found on page 92 of the appendix.]

Chairman GARRETT. Thanks. I appreciate your testimony, and the testimony of the entire panel. So let us look at maybe the most fundamental and most important piece of legislation that is up here. Oh, it happens to be right in front of me—H.R. 1525, the Garrett bill. If you look at the—I will just throw this out to the professor and then move on to some other bills.

If you look at what has happened in the history, here, Professor, it was back at the end of 2013 when the SEC did their review and said that maybe more review wasn't necessary. But I think Chair White and Commissioner Gallagher said, hey, maybe so, but there are certain areas that—they didn't use the term, "low-hanging fruit" or what you say that can be done for simplification in this area. Can you spend just 10 seconds, so to speak, on where those areas are that we could have appropriate scaling that this would provide for in the legislation?

Ms. GABALDON. I am familiar with the concept of low-hanging fruit. And to my mind, I would like someone else to identify it for me. Because it isn't obvious to me, looking at Regulation S-K, exactly what it is that the SEC could be expected to act on quickly. I do know that—and we all know that—they have an ongoing initiative. This is the fifth, I believe, either task force or initiative that has been under way in the last 2 decades.

Chairman GARRETT. So there is nothing that should be done now, even after all that time?

Ms. GABALDON. I certainly would not say that there is nothing to be done.

Chairman GARRETT. Okay.

Ms. GABALDON. And I do think that, as a matter of fact, the scaling that we see coming out of the Regulation A-Plus process may very well lead the way. I am skeptical of the idea that it is of any kind of benefit to put the SEC on a tight timeframe. We saw how that worked out as far as Dodd-Frank legislation was concerned.

Chairman GARRETT. Yes, right.

Ms. GABALDON. And I don't see any particular need to replicate that experiment, given that they do seem to be working on it and do seem to be making progress with a template of the Reg A-Plus.

Chairman GARRETT. Let us ask the other people who are in the field. I will jump down to Mr. Quaadman. Can we, on this and on a number of other issues that are here before us, simply wait on the SEC, on where they say there is additional study that needs to be done?

And also, on the second area that you raise, which is the area of saying there are guidance letters that they do, which they can repeal back? Is there a need for us to intercede in these areas, or should we just allow the SEC to go its course, however long that course may be?

Mr. QUAADMAN. I think it is important that Congress acts in order to push the SEC forward. All of the issues that were encompassed in the Jobs Act, the SEC could have done on its own and didn't do it. And even where the Congress mandated that the SEC do it, it took them a long time.

I do want to take issue with something the professor said. We issued a report last summer where we identified 15 regulations that are low-hanging fruit. So the issue here is that the SEC is now talking about the potential of a concept release, but if you take a look at, as an example, the SEC issued a concept release to update proxy voting systems in 2010 and hasn't done anything.

Chairman GARRETT. Let me just stop you there, sorry to interrupt, but that just brings me to another point. The SEC has various small business advisories on these areas, right? And I guess they meet, and year after year they come up with these recommendations, right? What is the track record on them actually coming up with ideas, and then following suit with them and implementing them?

Mr. QUAADMAN. That group does come up with a series of recommendations. Again, those recommendations became the core of the Jobs Act. And the SEC does not follow through—

Chairman GARRETT. We did the Jobs Act.

Mr. QUAADMAN. Correct.

Chairman GARRETT. Right, so in other words—

Mr. QUAADMAN. That is correct.

Chairman GARRETT. —the SEC didn't take the initiative.

Mr. QUAADMAN. No, Congress acted on the recommendations of that group, and not the SEC.

Chairman GARRETT. Right. Thanks.

Mr. Kovacs, you mentioned a couple of bills, mine and also Mrs. Wagner's. She is here, and she will probably bring it up as well. But it is a great bill, so let us give credit where credit is due. What is the significance and the importance of that? And you also talked about the EGCs, as far as the reform in those areas. Let me just give you some time to flesh that out a little bit.

Mr. KOVACS. I think anything that will reduce the burden, keep adequate disclosure but reduce the burden on companies, can be helpful.

Chairman GARRETT. Okay, I appreciate that.

Mr. Deas, can you walk me through, in the brief time that we have here, as far as the netting arrangement that you were referring to, I guess about two-thirds of the way through your testimony, with regard to the net derivative units as it actually happens for a company?

Mr. DEAS. Yes, Mr. Chairman. The concept of a centralized Treasury unit is to net exposures within a corporate group and then trade one smaller amount of derivative transaction with a bank. And unfortunately, the original language in Title VII provided for the central Treasury unit to work only if it were an agent—acting on behalf of the other companies, and it didn't include, really, the more common way in which it operates, which is netting. And so—

Chairman GARRETT. Was there a risk there if you don't treat it that way?

Mr. DEAS. There is actually a risk-reducing activity. And, in fact, the risk is higher when it acts as an agent. Because the volume of derivatives that the group is doing with banks is great. And, of course, it is everyone's aim to accomplish netting.

Chairman GARRETT. Right.

Mr. DEAS. That was a major goal of Dodd-Frank. So it was a drafting glitch, really, that everyone agreed—in fact, there were colloquies entered in July of 2010 saying that, in general, there would be these kinds of technical corrections fixed promptly. And this is one which has taken 4½ years.

Chairman GARRETT. Yes. So, I will close on that. My time is up. But I guess that is the overall message that I think these bills got when they received near unanimity in the past is that this is not what we are talking—we are not talking about deregulation here, we are just simply talking about re-regulation or smart regulation to—fixing some of those problems that were created in a 2,000-page bill that moved very quickly.

So with that, I now recognize the ranking member of the full Financial Services Committee, Ms. Waters, for 5 minutes.

Ms. WATERS. Thank you very much. I would like to start with, I think it is Mr. Quaadman. When an entrepreneur wants to finance an idea, and she is not independently wealthy, she must approach an outside investor, possibly a friend, an angel investor, a venture capitalist, or another institution, right?

Now, how does this entrepreneur convince more sophisticated investors that her project, her idea, is worth financing? Later, as her business takes off, it seems she will need to attract a deeper pool of investors, many of whom may not have the benefit of having known about the project from the beginning.

How does she convince these investors to commit their funds? She uses various information about her company, including financial information, right? It seems that it is in the best interest of this budding entrepreneur to provide her investors with as much information as possible. If they do not receive this information, would you expect them to impose a premium to cover the uncertainty about the project? This is an additional cost to the company, correct? Have you studied this cost? So could you just tell me yes or no?

Mr. QUAADMAN. Let me answer it in two parts, Ranking Member Waters. Number one is, if you are talking about a private company, we were part of a blue ribbon panel that looked at financial reporting for private companies. And when investors to private companies said financial reports for private companies was not as important as what the idea was that the company was trying to sell, that is what angel investors were worried about. And GAAP accounting doesn't fit with private company accounting. Cash flow or cash burn is more important. So public company disclosures don't fit there.

In terms of public company disclosures, I think a study that sort of crystallizes it best is a study by Professor Larcker out of Stanford University. He just released a study of large institutional investors who have trillions of dollars in the market. According to the study, 55 percent of them said the current disclosure regime is too cluttered, and 48 percent said they don't have the time to go

through those disclosures. So this is a matter of, let us figure out how to make it easier to have investors access the information, and then also let them sort through the information that they find most material. Because materiality, for both private companies where disclosure is needed, and public companies where we have decided that large amounts of disclosure is important, that is the key threshold for how information should be disclosed.

Ms. WATERS. Professor Gabaldon, do you have any thoughts about the importance of information to an investor's funding decision? In your opinion, what happens when investors have less information, less confidence in the information they have, or find it harder to compare the information to other companies? Who bears the cost of invester uncertainty? How do some of the bills being considered today affect investor confidence in American issuers, especially small businesses?

Ms. GABALDON. It seems clear to me that to the extent several of the bills head in the direction of reducing disclosure to investors, that does come at a cost to the entities that are trying to raise capital.

Reduced disclosure increases investor risk. Without a doubt, the investor will be interested in seeking a higher return. And therefore, to the extent disclosure is reduced or there is less time made available for contemplation of what is disclosed, or to the extent that what is disclosed is not comparable to what is being disclosed by other entities, it may reduce regulatory burden. But in my view, it does nothing to assist capital formation.

Ms. WATERS. Thank you very much.

I yield back the balance of my time.

Chairman GARRETT. The gentlelady yields back.

I now recognize the vice chairman of the subcommittee, Mr. Hurt.

Mr. HURT. Thank you, Mr. Chairman. I want to thank each of the panelists for appearing today. And I want to start with Professor Gabaldon. First of all, just to set the stage for the piece of legislation that we have introduced now for the second Congress in a row, would you admit that what we are talking about here is not whether or not the information is disclosed through financial statements? Wouldn't you agree that the issue here with XBRL is the format in which it is reported? Would you agree with that?

Ms. GABALDON. Yes.

Mr. HURT. Would you also agree that the format in which it is presented has been criticized for perhaps distorting the information and really affecting the quality of the information, as I think Mr. Kovacs testified or made clear in his testimony. Would you agree with that?

Ms. GABALDON. I agree that—I heard what Mr. Kovacs said, but I would also point out that regulators in the United Kingdom, in Japan, in China, and in Israel have all come to the conclusion that XBRL reporting is appropriate and not distortive.

Mr. HURT. And that is right, and that is from the regulators' standpoint, right? That is what you just said.

Ms. GABALDON. Correct.

Mr. HURT. That is why I was curious. In looking at your testimony, you say that you believe that this bill, if passed, would put

investors and analysts at a disadvantage. I guess my question is, who is in the best position to know whether this information is useful and puts them at an advantage? The regulators or the investors themselves?

Ms. GABALDON. I believe that the regulators are experienced. I believe that the regulators also need to rely on, or are helped in their analysis, by the existence of XBRL. And that helps them make better judgments about the regulations that they devise, which is ultimately—

Mr. HURT. But wouldn't you agree that certain—certainly, the regulators have experience, and many of them have been in the investing world and have been analysts. But I guess my question is, at the end of the day, who is in the best position to know? And I guess the reason I am asking that question—and you didn't really answer it—is because if you look at a 2012 study that Columbia published, it says that only 10 percent of investors use this format, or found it in any way, shape or form useful. Doesn't that tell you something?

Ms. GABALDON. It tells me that there is a learning curve, and that the more XBRL is utilized, the more useful it will probably become.

Mr. HURT. What about the cost-benefit part of this? Don't you think it is appropriate for the regulators to be looking at the cost of things? And that would be—I think Mr. Kovacs testified that it costs his company $50,000 to pay an XBRL contractor to do this work. And he also testified that investors aren't interested in it, analysts aren't interested in it. Doesn't that mean something to you?

Ms. GABALDON. What it means to me is that I suspect that his company may be an unfortunate outlier, from what I have read.

Mr. HURT. Well, 90 percent of investors and analysts didn't think it was useful in the 2012 study. I wouldn't call that an outlier. But anyway, thank you for your answers.

Mr. Kovacs, I just wonder if you could talk a little bit more about the idea that investors and analysts somehow would be put at a disadvantage. And what I thought was most remarkable about what Professor Gabaldon said was that emerging growth companies would be put at a disadvantage by this bill. And that this would actually restrict capital in a pretty sophisticated marketplace. I was wondering if you could comment on that?

Mr. KOVACS. It is interesting—in preparation for today's meeting, I actually reached out to a number of the Wall Street analysts who cover our company and cover the industry, and a couple of the large institutional investors, and asked them, "Do you know what XBRL is? And if so, do you think it is important to your assessment in investing, at least, in biotech?" And the response I got was that they didn't even know what XBRL was, and, from at least investing in small biotech companies, the critical information in evaluating an investment in us or one of our peers is really to understand our data, our science, and what is going on in terms of our future as opposed to looking at the historical financial detail.

By the way, XBRL is really just a way of quickly getting the financial information to compare costs to other companies. Our 10Ks and 10Qs kind of lay out financials that are pretty straightforward

to be able to go on EDGAR and pull that information and get it pretty quickly.

Mr. HURT. Right.

Mr. KOVACS. I don't think people are using XBRL.

Mr. HURT. Thank you.

I yield back.

Chairman GARRETT. Thank you. Very good.

The gentlelady from New York is recognized.

Mrs. MALONEY. The analysts and investors that I have talked to say the more information they get in an easy, understandable form, the better. All of us can find information if we go on the Internet and spend hours looking for it and researching it. But if it is in a format that is usable, then it is much, much better to use. Now, I believe in testimony, Professor Gabaldon—by the way, thank you all for being here, and I thank the chairman and my colleagues for bringing these bills forward—you testified that over time the cost will continue to go down. And there was one study from the CPAs, the American Institute of CPAs, that estimated the median cost of doing XBRL for a company would be roughly $8,000. I don't see that as onerous. And I am concerned. I am all for small companies, but the more information you have easily attainable, the more investors will be likely to invest in it.

And I would like to ask Professor Gabaldon, do you think people are more likely to invest in a company that has data they understand or in a dark pool where they don't understand it and it is not out there?

Ms. GABALDON. I most definitely think they are more willing to invest in companies about which there is easily accessible information.

Mrs. MALONEY. I agree. And this debate reminds me somewhat of our debate on Sarbanes-Oxley, where everyone was opposed to it, industry was opposed to it. It had gotten to the point—when major companies crashed overnight, losing their pensions, going bankrupt, dragging this country down—that there wasn't faith in the system. So we brought all the dark money back onto the balance sheets. The cost of complying keeps going down every year, and now no one is complaining about it.

And hopefully, we won't have an example of a company that crashes with a grade A rating overnight, losing jobs and disrupting the economy.

Now I would like to ask Professor Gabaldon—I would like to ask you, really, about the XBRL. I think this is an important debate. In your testimony you noted that H.R. 1965, which exempts a large number of public companies from the requirement to use XBRL, would be a step backwards. Why do you see it as a step backwards? Could you elaborate a little bit?

Ms. GABALDON. That would basically permit 60 percent of the publicly traded companies in America not to use this tool which, I believe, is an important research tool for investors and certainly also useful for the SEC as it evaluates filers and also goes through the exercise of considering its own regulations.

In addition to the figure that you mentioned earlier, it appears that of small reporting companies, 69 percent incur annual costs of $10,000 or less annually. In the U.K., where they have some expe-

rience with this, some filings have come down to approximately 100 pounds per filing, or—

Mrs. MALONEY. Now, I have another question. This bill before us is intended to help small companies. But in my opinion, I believe that it hurts small companies. Because if small companies aren't included in the data set that analysts and investors use to analyze industries and make investments, then they are unlikely to attract much attention from the markets.

Investing in any—I think most people, investors large and small, want as much information as possible. So my question is, in addition to putting investors, analysts, regulators, and researchers at a disadvantage, do you think the bill would even put small companies at a disadvantage? And again, back to the professor.

Ms. GABALDON. I do, and I think that could happen on an individual basis as well as on a composite basis. If the United States has a reputation for permitting 60 percent of its companies not to provide this information, whereas other countries do provide this information in a readily accessible form, the number of overseas investors whom might be interested in looking at American investment opportunities is going to decline.

Mrs. MALONEY. Okay. I have always said that markets run more on trust than on capital. And one of the things that our economies had is more trust than other economies. People want to invest in America because they trust our regulation, they trust our markets, they trust our workers. I think we have a responsibility to keep that standard. And I feel that excluding 60 percent of the companies from disclosure is not the right way to go.

My time has expired, so thank you very much.

Chairman GARRETT. The gentlelady's time has expired.

Just moving down the row, the gentleman from Texas, Mr. Neugebauer, is recognized for 5 minutes.

Mr. NEUGEBAUER. Thank you, Chairman Garrett, and thank you for calling this important hearing. I look forward to reviewing these legislative proposals to enhance capital formation for small and emerging growth companies.

I think nearly everyone can agree that these unnecessary regulations are a burden both to individuals and the economy. But they are even a greater burden for our smaller businesses and startups. I was extremely pleased that in my TRIA legislation we were able to include some relief for end-users in using derivatives to hedge their risks. And we are examining some additional proposals in that same vein today.

Mr. Deas, one of the questions I have is, how much capital would end-users have to set aside for inter-affiliate swap transactions to comply with the requirements imposed by Title VII of the Dodd-Frank Act?

Mr. DEAS. Congressman, we don't have that number specifically for central Treasury units. But in a survey that we have done, the amount of capital if the end-user exemption from clearing and margining is not fully implemented, could be $260 million for the average non-financial member of the business roundtable.

Mr. NEUGEBAUER. That is a big number.

Mr. DEAS. Yes, sir.

Mr. NEUGEBAUER. What kind of problems did this Title VII create for the inter-affiliate derivative trading? How does that impact the trading?

Mr. DEAS. Yes, sir. There was an explicit exemption in the bill as originally passed for centralized Treasury units, but only those that act as an agent. We believe there is consensus that it was a drafting error, that a more common way in which we all operate these units as netting out these exposures and thereby producing that risk reduction of a lower volume of derivatives was omitted. And the proposed fix in H.R. 1317 would remedy that.

Mr. NEUGEBAUER. So the regulators really haven't been able to resolve that? It is going to take a legislative fix?

Mr. DEAS. Yes, sir. The CFTC issued a no-action letter in 2013, and amended it last year. But the fundamental difference is that for companies that operate as Dodd-Frank insists, and make boards of directors declare every year that they are in strict compliance with the Act, that no-action letter doesn't get to that fundamental issue. It merely says that the staff won't take an enforcement action. It skirts the issue of whether it is actually in compliance with the law or not. And by a plain reading, it would not be in compliance.

Mr. NEUGEBAUER. Mr. Quaadman, in the subcommittee that I Chair, the Financial Institutions Subcommittee, we have seen consolidation in our community banking area by almost 1,000; we have lost 1,000 community banks. And the primary reason, not just according to community bankers but according to some studies, has been the fact that this regulatory environment makes it very difficult for smaller institutions to be in compliance and to have a business model that is economic.

One of the things that I struggle with is that when we are trying to talk about providing capital formation for smaller companies and startups is people assume that everybody who is starting up a company or who operates a small business is a crook and is trying to take advantage of potential investors out here.

And so what we do is, we make the environment so burdensome out there that it is difficult to be in compliance and, more importantly, there is the cost of trying to navigate through that. And so at what point in time do we say, we have to at some point in time have some rules that make sense and some disclosure and some transparency, but yet allows these smaller startups to find it economic to access the capital market? Because otherwise, you are just going to see more and more and more private activity and not much public activity.

Mr. QUAADMAN. Chairman Neugebauer, I think you really hit it on the head, and that is why I raised that Census Bureau report earlier. Because ultimately what is going to happen is, the bigger companies are going to be able to spend the money and engineer their way out of it. What we are seeing with these reports is, we are seeing that it is on the lower end. With the smaller businesses, they are no longer being created.

And we all acknowledge that the employee participation rates are at the lowest they have ever been. We have seen sluggish job creation. And the reason for that is, if you take a look at SBA studies and the like, coming out of a recession, 90 percent of job cre-

ation happens in firms with 100 employees or less. That is exactly where we are not seeing the job creation. And so we need to have rules that are going to help build from the bottom up, because that is what we have always done.

Mr. MCHENRY [presiding]. The gentleman's time has expired.

And for Members' knowledge, there are 8½ minutes left on sustaining the ruling of the Chair, a procedural motion on the House Floor. It is the Chair's intention to keep the hearing going, and people can depart and return in order to ask questions.

We will now recognize Mr. Hinojosa for 5 minutes.

Mr. HINOJOSA. Okay, thank you. Thank you, Mr. Chairman. I would also like to thank the distinguished panel members for sharing their insights on this issue. When it comes to our economy and capital markets, the United States is the envy of the world. We are so not only because our economy values and rewards entrepreneurship and innovation, but because our markets are transparent, safe, and liquid. My first question is going to be for Mr. Shane Kovacs and for Mr. Tom Quaadman.

H.R. 1675 revises the SEC's Rule 701 by both raising and then indexing for inflation the permissible aggregate sales threshold of securities sold without certain disclosures to employees and to other parties as part of their compensation from $5 million to $10 million. Does raising the threshold to $10 million increase the risk that employees will not receive vital information about the company employees which they need to make informed decisions? Mr. Kovacs?

Mr. KOVACS. For companies like PTC, biotech emerging growth companies, we are in a position where we need to attract talent. We need to attract talent from other companies that may be larger and better capitalized, and able to compensate with cash more than maybe we could afford as a small, growing company. And therefore, we have to incentivize employees with stock and options in the company which has growth potential.

And certainly as a private company or public companies we need to do that. And for a private company, I can imagine that raising the threshold from $5 million to $10 million, in terms of the value that you are going to give to employees, without having to put together some large disclosure statement on the company and all those incremental costs, I don't foresee that raising that bar from $5 million to $10 million would really have any real impact as to putting the employees at risk. In fact, I would almost think the employees would applaud that because it would enable the companies to give more equity in the company to them in the form of compensation.

Mr. HINOJOSA. Okay.

Mr. Quaadman?

Mr. QUAADMAN. Yes, thank you, Mr. Hinojosa. Number one, the Jobs Act raised the number of employees who would be eligible for this, but we didn't change the threshold dollar level. Number two, with private companies—proprietary information—we are trying to look at this through the lens of a public company. These are private companies. By allowing proprietary information to get out into the public, which this could very well happen, that will destroy a company. That will destroy their ability to grow. So these are em-

ployees who are incentivized to succeed. It will allow firms to get the talent that they need.

And, I am just reminded that there is a gentleman by the name of Eddie Antar, who was known as "Crazy Eddie" in New York, who did everything possible to destroy his company, which he did. And he is now a consultant to go out there and tell regulators and people what you can do. Rule 701 is never anything that he has ever raised.

Mr. HINOJOSA. Thank you.

My next question is for Tom Deas. H.R. 1317 would exempt certain Treasury affiliates from clearing and margin rules. Are you concerned that said exemption would undermine transparency in the derivatives market by allowing some Wall Street banks to avoid clearing requirements for swaps if they are affiliated with a non-financial end-user?

Mr. DEAS. Congressman, I don't believe that the bill provides for that. From the inception of Dodd-Frank, it has been permitted for an operating subsidiary of a financial company that is engaged in commercial business activity to avail itself of the end-user exemption.

And we are talking about a central Treasury unit that has the risk-reducing activities of netting out these exposures which is to the benefit of the—lowering the systemic risk in the system. And it should be what we would all want.

And there are very extensive anti-abuse provisions in the bill that are utilized by the regulators that would stop any company from exceeding what is permitted under the law.

Mr. HINOJOSA. Your response helps me a great deal.

I think that my time has expired, and I yield back.

Mr. MCHENRY. I thank the gentleman from Texas. I will now recognize myself for 5 minutes. I just want to ask more broadly about capital formation and secondary markets. Mr. Quaadman, there is existing case law on the sale in secondary markets of restricted securities, right? And some would argue that you don't actually need to have congressional action for that to occur, and that would be correct, right? But as it now exists, there is friction and cost associated with that friction in the resale of those securities. Is that correct?

Mr. QUAADMAN. That is correct. And because we are talking about case law, we don't have a uniform set of standards. That is why I think the RAISE Act which you have proposed—you allow for the SEC to actually put in place a set of rules that will allow for those markets to function, to allow businesses to have liquidity. But most importantly, to actually create investor protections. Which, if we are talking about a hodge-podge of case law, there is a lot that can slip through the cracks.

Mr. MCHENRY. So greater investor protection with clarity.

Mr. QUAADMAN. Correct.

Mr. MCHENRY. Okay. But you talked about liquidity in the secondary markets. And so that question of liquidity, it does provide liquidity in the secondary markets for this resale. Why is that? First of all, is that important, and—

Mr. QUAADMAN. Yes, because what we are—

Mr. MCHENRY. —if so, why?

Mr. QUAADMAN. Yes, what we are seeing is as a lot of the different regulatory initiatives are coming online—so Basel III, Dodd-Frank, other things are coming online—we are increasingly seeing: one, liquidity crunches; and two, a lack of market-making activity.

Now, that gets even worse as you go down to the lower scale of business formation because you have traditional actors—let us say a community bank or whomever else—are being shut out of an ability to provide assistance to startups and people who are looking to create a business. So this type of liquidity is an important piece because there is a market demand for it.

Mr. MCHENRY. Okay. Market demand—so the RAISE Act will make it easier for private companies to raise capital?

Mr. QUAADMAN. Correct.

Mr. MCHENRY. Is that the case?

Mr. QUAADMAN. Yes, that is correct.

Mr. MCHENRY. Okay. So explain that functionality one more time here just so it is clear on the record.

Mr. QUAADMAN. Sure. What we need to have is—as I said, we have seen a tremendous drop-off in business creation. We are seeing a large drop-off in businesses overall. And we are seeing a lack of capital formation because of a number of different regulatory initiatives.

What the RAISE Act does is, it builds out what the courts have allowed in terms of these secondary markets. And it will inject liquidity but, most importantly, investor protections which help provide the trust and confidence that was mentioned before that markets operate on.

Mr. MCHENRY. Okay, so the ability to take that initial group of folks, for them to sell their securities, that actually provides that clarity and broadening that market a bit, right?

Mr. QUAADMAN. Yes.

Mr. MCHENRY. It will create better, basically, establishment of price, right?

Mr. QUAADMAN. Right.

Mr. MCHENRY. And with codified rules, it basically—a larger game plan, more folks can have assurances that they are participating in something that is safe and effective and legal?

Mr. QUAADMAN. Right. Because you are going to provide the information, you are going to provide the price discovery, and you are going to lower costs.

Mr. MCHENRY. So what about community banks as private issuers?

Mr. QUAADMAN. Again, community banks, as I said, are being shut out of providing help to startups. And community banks traditionally have provided that help because they know the businesses or they know the individuals who are trying to start a business. This allows for another way for community banks to provide that capital formation operation that they traditionally have through another means.

Mr. MCHENRY. Okay.

So Mr. Kovacs, in your experience in the world of biotech, is enhanced liquidity in the secondary markets important in biotech? And if so, why?

Mr. KOVACS. Absolutely. I think that is true, at least from my experience as a banker. Liquidity is always important in terms of attracting capital. There is all sorts of capital out there and it has restrictions on it. And restrictions are often driven both by the—mainly often by the liquidity and whether or not there is a resale market so some can get in and out of that investment.

Mr. MCHENRY. So something like the RAISE Act, would that help stimulate private avenues of financing?

Mr. KOVACS. I am less familiar with the intricacies of the RAISE Act proposal, but I can comment on liquidity being a good source to attract additional capital.

Mr. MCHENRY. Okay. I certainly appreciate it. I appreciate all of your answers to my questions. And with that, my time has expired.

I will now recognize Mr. Carney for 5 minutes.

Mr. CARNEY. Thank you, Mr. Acting Chairman, and thank you to the panelists for coming. I want to recognize and thank my colleagues on both sides of the aisle for working together on these bills. These are bills that we passed in the last Congress overwhelmingly. We are here again to consider them, to maybe improve them, and to get your feedback.

Mr. Deas, there is an FMC operation in the State of Delaware. We appreciate that presence there, and it is nice to see you this morning.

As you may know, Delaware is a center of excellence for corporate formation, corporate governance, and corporate law. Most of that is because of the expertise and the nature of our Delaware chancery court, where Delaware-based domiciled companies can get their disputes litigated quickly and by expert judges.

We spend a lot of time focusing on the issues here that we are talking about today. Some of my friends that work in the Division of Corporation alerted me to a problem that we were having in this country with IPOs, which led to my cosponsoring the IPO on-ramp bill with my friend, Mr. Fincher from Tennessee, whom I notice is not here.

So I would like to ask a couple of questions about that. I have been told by the folks in Corporations that IPO numbers are way up. And at least anecdotal feedback is that the IPO on-ramp bill was instrumental in the decisions that some of those emerging growth companies made to go public.

Mr. Kovacs, one of the things we have heard is that for bio companies and pharmaceutical companies, maybe the on-ramp isn't long enough. It is 5 years, as you may know, with different stages. Could you comment on whether that is an issue for bio and pharmaceutical companies, and whether we ought to look at that question?

Mr. KOVACS. Yes, I think what is interesting from the on-ramp, 5 years is actually, I think, an interesting and good runway. But it is some of the other limitations for emerging growth companies, when you are successful, that reduce that on-ramp. For instance, we have been the benefit of a strong capital market and a lot of interest in biotech, which has brought our stock price and our market cap above this $700 million threshold. And so now this year we will lose our ability of that 5-year runway, then we will have to become SOX-compliant under Section 404(b), which will incur addi-

tional burdens and cost to our company in—north of a million dollars. So—

Mr. CARNEY. So that would be helpful.

Mr. KOVACS. Yes.

Mr. CARNEY. And one of the things we hear, again somewhat anecdotally, from the people that I have talked to is that the blackout period, for want of a better term, where emerging growth companies can keep their information confidential as they explore the potential of going public, has been the most significant thing. Actually, not the 404(b) audit thing, which we thought would be the big incentive. Do you have any comments on how that might be improved and enhanced?

Mr. KOVACS. Yes. Investing, at least in biotech where I think there has been a huge boon in terms of the number of IPOs as a result of the Jobs Act, is complicated. Because the investors have to spend a lot of time going through pre-clinical data, thinking about—talks and issues. It is a complicated investment. And so to be on a roadshow, where you get a 30-minute interview, effectively, with all these investors isn't enough time to evaluate. And therefore, being able to go and do test-the-waters meetings while you are on file is important, as well as many companies like the idea of being able to file confidentially because the biotech market can swing positively and negatively pretty quickly.

And it is always sort of the tainted company if the market went away when you are on file and say, well, you couldn't get your deal done. So this allows companies to file and just be on file publicly for 30 days before you launch your deal. So both of those have been positive.

Mr. CARNEY. Any other panelists with comments, positive or negative? Please?

Ms. GABALDON. I would comment very positively with respect to the Jobs Act and the benefits that it has bestowed. I definitely think that there have been some huge advantages as far as the on-ramps. And I know that a lot of companies have been taking advantage of that, and we are seeing the results.

There are a couple of bills that affect the on-ramp and the EGCs, and I am a little concerned, particularly about the follow-on provision having to do with EGCs. I am not sure of its status right now, whether it is still part of the bill or not, but I think that specifically is quite problematic insofar as it would allow public filing 2 days before stock is to be issued, which seems to me to be an unworkably short period for the public to evaluate anything.

In addition, the idea of shortening the period between public filing and the roadshows from 21 to 15 days strikes me as a bad idea, and unnecessary, because right now the average is something like 40 days before the roadshow takes place. And the justification that, oh, this will allow a company to dive through a market window before the market goes down is, to my mind, just a way of saying that it is a way to take money from investors who immediately are going to experience a diminution in value.

Mr. CARNEY. Thank you very much. I see my time has expired. I yield back.

Chairman GARRETT. Thank you. The gentleman yields back.

I now recognize Mr. Hultgren.

Mr. HULTGREN. Thank you, Chairman Garrett. And thank you all so much for being here.

I want to start by saying that I am grateful that the Financial Services Committee is going to be considering a bill I have introduced, H.R. 1675, the Encouraging Employee Ownership Act of 2015. This bipartisan, common-sense law will make it easier for companies in Illinois and nationwide to offer their hardworking employees a stake in their own businesses.

My constituents in the 14th District in Illinois have shown me the value of employee ownership. For example, when you walk into Scot Forge, a locally employee-owned manufacturer, you notice their employees' energy from upper management on down to the shop floor. They are proud of their work because it contributes to their share in the business.

Companies like Scot Forge have an easier time hiring and retaining talented employees, and this is true in other industries such as the biotech field. Brian Hahn, chief financial officer of a biotech company, GlycoMimetics, Incorporated, testified that expanding opportunities for employee ownership would help innovative biotechs to attract talented workers and compensate them competitively without incurring additional compliance burdens.

Unfortunately, some companies are not offering employee ownership because regulations limit how much ownership they can safely offer. SEC Rule 701 mandates various disclosures for privately held companies that sell more than $5 million worth of securities for employee compensation.

This information includes business-sensitive information like financials, capital expenditures, and risk factors within the company. Businesses that want to offer their employees more ownership have to decide if they want to make these confidential disclosures that would greatly damage future innovations and put them into the wrong hands.

In 1999, an American Bar Association subcommittee expressed concerns with these disclosures, stating in a letter that these disclosures risked having this information come into the possession of a company's competitors. The letter continues that they could result in serious injury to the company. One would be naive to think this could be avoided with a confidentiality agreement. And this is not to mention the cost of preparing these disclosures.

The Encouraging Employee Ownership Act (EEOA) addresses this problem and opens up more opportunities for employees to share in the companies they work for every day. My bill is a simple, bipartisan fix that amends SEC Rule 701 to raise this disclosure threshold from $5 million to $10 million and adjusts the threshold for inflation every 5 years.

Last year's version of the bill set the threshold at $20 million, but as a bipartisan show of good faith we lowered it to $10 million. This won't put employees at risk of fraud. The SEC said, in their 1999 rulemaking, that there haven't been any major allegations of abuse of Rule 701, and this hasn't changed since.

They also noted that employees know a lot about the businesses and they don't need as much disclosure as the typical investor with no particular connection to the company. What's more, companies will have to comply with all pertinent anti-fraud and civil liability

requirements. This means that every investor will receive information that a reasonable investor would need before making an investment decision.

So I believe the EEOA will empower all levels of a business and help create a stronger working middle class. We should applaud employee ownership from the shop floor to the boardroom. I welcome your support for the Encouraging Employee Ownership Act of 2015, and I thank our generous cosponsors, Representatives Fitzpatrick, Stivers, Delaney, Polis, Higgins, and Sinema.

The first question I wanted to ask was to Mr. Quaadman. I have read and heard from several sources that companies are worried about the required disclosures containing confidential, business-sensitive information that could be harmful. I wonder if you could elaborate on the danger that these disclosures pose to private companies, especially if they were provided to former employees and got into the hands of competitors. Are there costs associated with these disclosures?

Mr. QUAADMAN. Yes, thank you, Mr. Hultgren, and thank you for introducing this bill. It is an important step forward also to implement the Jobs Act.

So I think with your statement, with your question, you sort of hit it on the head, right? Because number one is, there has been no history of abuse with Rule 701. But number two, and more importantly, you are dealing with start-up companies that are trying to grow and are using a proprietary model in order to grow and effectuate the next great idea. And the problem is, if that information leaks out, it could either hamper the ability of that company to be successful or it could actually destroy them.

So, again, the opponents of this bill are trying to impose a public company disclosure model on a private startup and it is apples and oranges. Or it is North Pole-South Pole; it is that diametric. So, again, companies, employees are incentivized to help the company be successful. Because if they are, that stock is going to be worth a lot of money.

At the same time, they have a good idea of what they are trying to do and how they are trying to get there. And, at the same time, owners of the company are trying to make sure that they have the talent to be successful. So this bill is a win-win.

Mr. HULTGREN. Thank you for that. I see my time has expired. I yield back, Mr. Chairman.

Chairman GARRETT. The gentleman yields back.

I now recognize Mrs. Wagner.

Mrs. WAGNER. Great. Thank you, Mr. Chairman, and thank you all for joining us today to discuss important legislation that will help empower small businesses to raise more funding and which will allow them to grow and create more jobs, my favorite, favorite topic.

Small businesses create more jobs than any other business sector in America, and are leading the way on exciting new products and technologies. In fact, studies have shown that startups create an average of 3 million jobs annually. Ensuring that small businesses are able to raise capital is absolutely essential to getting our economy back on track while we are still recovering from the financial crisis.

For that reason, I have introduced legislation, along with my colleague on the other side of the aisle, Representative Terri Sewell, H.R. 1723, the Small Company Simple Registration Act, which would streamline how small businesses file additional registration documents in order to continue offering securities to willing investors. In fact, this common-sense idea was originally proposed by the SEC's own working group on capital formation.

Mr. Kovacs, how are small issuers harmed by not allowing forward incorporation by reference for Form S-1 registration statements?

Mr. KOVACS. It is interesting. The friction costs associated with raising capital can be quite high. And any way that you can reduce those costs yields more capital to the companies that need it. By allowing forward incorporation on an S-1, per se, means that you don't have to be continually—if there is some delay in the offering, you are continually updating those statements. You just reference your Q when you are next filing. We do that all the time as a public company. We reference forward aspects of our proxy when we file our K. So this is just allowing less costs in terms of updating an S-1 if there is, for some reason, a delay or you are doing a follow-on offering inside of a year after your initial IPO.

Mrs. WAGNER. You may have answered my next question somewhat here. But how would allowing forward incorporation by reference for Form S-1 registration reduce and simplify disclosure burdens for smaller issues? Obviously, you talked about the cost factor, but there must be compliance issues and simplification of the process, correct?

Mr. KOVACS. Yes. I mean, there are time aspects, too. Companies that want to do another follow-on offering inside of a year of the IPO use S-1. We did it. We went public in June of 2013, we did a follow-on offering in February of 2014. We had to go and update the entire S-1. It required a couple of visits, a few weeks of time and outside legal counsel and—

Mrs. WAGNER. Weeks.

Mr. KOVACS. Yes, of going to get things done and updated. Whereas if we could have referenced our K, which was going to get filed about 2 weeks later, it would have been much simpler.

Mrs. WAGNER. In your opinion, would it be appropriate to also extend this provision to emerging growth companies?

Mr. KOVACS. Yes, I think so. We were an emerging growth company at the time, and it certainly would have been helpful.

Mrs. WAGNER. Mr. Quaadman, how else does the current SEC registration process make it more difficult for smaller issuers to raise capital?

Mr. QUAADMAN. First of all, just to answer your last question, I also would welcome an extension to emerging growth companies, as well.

Part of the issue is, and I think what your bill is getting at, is that if you create a company file can use incorporation as a way to streamline disclosures and get the information out to investors without repetitive disclosures. So what we are faced with here is that the explosion of disclosures, particularly for smaller companies, isn't providing material information to investors.

So what we need to do is to determine, and press on the SEC to determine, what are material disclosures, how can it be disclosed effectively? Because this will actually help investors get the information, it will help smaller companies communicate that information. And your bill is an important step forward in that.

Mrs. WAGNER. What are some of the other filing and disclosure burdens that disproportionately affect small business issuers?

Mr. QUAADMAN. So you start to look at things like historic stock price, disclosures about the public reading room at the SEC that individually sound like small things. But you start to add them up and add them up and they are costly and they are burdensome and there is a time opportunity cost. I was talking to a company that we were doing some regulatory meetings with who is also an emerging growth company. And he was talking about the fact that he has a choice right now: he can hire two compliance people to deal with more disclosures that are not going to give more information to investors; or he can hire scientists. He asks, "Which do you think I would rather do?"

Mrs. WAGNER. We hear it all the time. We hear it in every industry, not just the financial services sector—businesses that want to hire people to grow their business as opposed to hiring compliance officers, lawyers, people who are going through all of this red tape. I appreciate your indulgence, Mr. Chairman.

My time has expired, and I thank the panel very much.

Chairman GARRETT. Absolutely. Thank you. The gentlelady's time has expired.

Mr. Ellison, welcome back, and you are recognized for 5 minutes.

Mr. ELLISON. Yes, and I thank the chairman for the time.

I originally voted for H.R. 1965 last session. But after digging into the issue of XBRL, I have come to really wonder whether or not I cast the right vote. You don't hear Members of Congress admit that maybe they didn't vote the right way often, but I have to admit that I am not sure that I was right. And the reason has to do with some research I have done which shows that XBRL filing costs are lower than expected, according to some writers. And so, I actually think that it is probably a good idea to move toward a 21st Century searchable electronic database, and probably not a good idea to move away from it.

So I am wondering. Dr. Gabaldon, in February 2015 the investor advocate at the SEC, Rick Fleming, said H.R. 1965 would be harmful to disclosure. If we exempt more than two-thirds of the issuers, approximately 6,000 companies, from using XBRL-formatted reporting, do you think that this would be harmful to firms and markets?

Ms. GABALDON. It seems clear to me that it would. The United States would have a reputation as being not very technologically hospitable as far as would-be investors and would-be analysts are concerned. And I find that very concerning.

And I also think that in light of the fact that, frankly, the SEC's relationship with technology thus far has been anything but overwhelmingly impressive. EDGAR is a very difficult tool to use. Allowing them to move forward with something that does have some promise, that has been pioneered successfully in other countries

and appears to be very useful and cost-effective in those countries seems to me to be the clear way to go.

Mr. ELLISON. Okay. So have you had a chance to look at this article that I am holding in my hand? I don't know if they have given you a copy.

Ms. GABALDON. I believe so, yes.

Mr. ELLISON. Do you have any off-the-cuff sort of reflections on it?

Ms. GABALDON. I think that it really—

Mr. ELLISON. Just for the record, for clarity—sorry for interrupting—it says it is AICPA-XRL.US and then it is styled: "Research Shows XBRL Filing Costs Lower Than Expected."

Ms. GABALDON. Correct. And it does make it clear that 69 percent of small reporting companies experience an annual XBRL expenditure of $10,000 or less. There is a large number who are paying as little as $2,000 a year. To my mind, that is a very small amount. And I mentioned earlier as well that in the U.K., it has gone as low as 100 pounds for some types of filings. And I don't see any reason that couldn't be replicated here.

Mr. ELLISON. Okay. Some say that the cost of compliance is too high. That is their view. And as you just pointed out, this article indicates the costs are going in the downward direction. Do you think that the compliance costs are appropriate? Do you think that they are exorbitant? Do you think the trend is headed in the right direction?

Ms. GABALDON. The trend is encouraging as far as it really seems to come in under budget, so to speak, less than people were fearing would be the costs. And they do seem to be declining. And I do believe that the SEC gets a lot of benefit out of being able to run the numbers easily when it can check to see if one company is out of line.

In addition, they can make use of it as a tool to evaluate their own regulations, which seems to me to promise very clear benefits that are well worth the steadily declining costs.

Mr. ELLISON. So what do other countries do, say like Britain, Israel, Japan? What do they do?

Ms. GABALDON. They use XBRL. And in addition, the European Union in general is working towards something like XBRL if not XBRL itself.

Mr. ELLISON. I read that in June 2013 the European parliament approved a proposal that would assign European securities and markets authority the task of developing a single electronic format for financial statements filed with European exchanges. Any kind of reflections on that?

Ms. GABALDON. It seems that we will be a genuine outlier if we don't step into the 21st Century.

Mr. ELLISON. Okay. So if H.R. 1965 became law, would the United States run the risk of being behind foreign jurisdictions in terms of the sophistication of and ease of use for information contained in public filings? I think I know what your answer is, but I would like to give you a chance to elaborate.

Ms. GABALDON. It wouldn't just be running the risk, it would be a fait accompli at that point. We would be behind.

Mr. ELLISON. Okay. Thank you for your time, ma'am, and thank you to all our guests.

Chairman GARRETT. The gentleman's time has expired .

Mr. Poliquin, you are recognized for 5 minutes.

Mr. POLIQUIN. Thank you, Mr. Chairman. I appreciate it very much. And I want to thank everybody for being here today, and for addressing how we can have small businesses that really are the engine of growth in this economy and in hiring and providing our families with more opportunity. So I appreciate everyone taking the time to come here and be here today.

I represent Maine's 2nd District. If you haven't been there to vacation, you really should. It is a great place to go, and you can spend money. We are a State that needs that. So I invite all of you to come up when you have a chance.

I represent a highly rural part of our State, where in the last year alone, we lost 3 paper mills, 1,000 jobs, in Bucksport, East Millinocket, and in Old Town. And the reason for that, in part, is because in New England, and in particular in Maine, we have converted burning oil and coal to burning natural gas in order to produce electricity. And the electricity, of course, is used to run our machines to make our paper.

We are the greatest papermakers in the world, and we are surrounded by all these trees in Maine. But we have a real problem with this. So not only do we need to produce more product and get that product up to Maine by increasing the pipeline capacity and drive down the cost so we can be more competitive and keep these jobs going, we also need to make sure we have an opportunity for our paper mills—many of which are owned by other companies; they are subsidiaries of larger companies—to hedge their bets and be able to secure long-term natural gas and other commodity prices such that they can keep these mills open.

So doesn't it make sense—and Mr. Deas, I will ask you this question, if you don't mind, sir—that we can allow a parent company to be able to execute those financial transactions on behalf of their subsidiaries in order to make sure the entire enterprise is able to secure, in this case, natural gas or whatever they are trying to secure for the entire enterprise to make sure you keep the risk down, keep the cost down, be more competitive and keep these companies growing and creating jobs?

Mr. DEAS. Congressman, yes. And the first 18 years of my career was at Scott Paper Company and S.D. Warren Company in your State in the—

Mr. POLIQUIN. Sure. Thank you.

Mr. DEAS. —in the mills that you mentioned. And energy, of course, is a big part of that business and my business. And hedging those activities at the lowest cost involves netting out opposite-way trades. That happens in the foreign exchange market and other examples of exposure. And doing one trade with a financial counterparty, a bank—and a smaller amount—lowers costs and, ultimately, makes us more competitive.

Mr. POLIQUIN. And with no risk to the secondary market.

Mr. DEAS. No, sir. It actually reduces your systemic risk in the market by reducing the amount of external derivatives outstanding.

Mr. POLIQUIN. I would like to move on to another question if I can, and Ms. Hughes, I will direct this to you if I may, please. I support Congressman Hultgren's bill, H.R. 1675, that he just mentioned a moment ago, when it talks about how you can incent small businesses that are just starting up. And all the challenges and all the excitement you have with small businesses taking off, especially in your space, Mr. Kovacs.

But often, these companies are strapped for cash or have no cash. And as you mentioned earlier, sir, they have no product, they have no revenue stream. And so how in the dickens do you attract the capital that you want to make sure you grow your business and you can be successful for the investors and for those who are hired by the enterprise?

So Ms. Hughes, with your experience in this space and the number of companies that you folks get involved with, give us an idea of opportunities you might have run into in the past where you want to incent people, but you don't want to take on debt and maybe you can't borrow money because the company is so small.

Why not offer them a piece of the action, and why not offer them stock in the company? Doesn't that create an exciting environment for folks to really want to dig in, make the company successful, grow, produce products we want in this country, and hire more people?

Ms. HUGHES. I can say yes, absolutely. Every single time we have employees involved in the ownership of the company they are much more committed and much more interested in what is going on, improving the production and efficiencies within the businesses themselves.

I don't have a tremendous amount of experience in the start-up market, unfortunately. We deal with very small businesses, but most of the businesses we are involved with have revenues of about $10 million, and we are helping them through the next phase of growth. But absolutely, employee ownership is a real driver when trying to create value and growth over time.

Mr. POLIQUIN. And Mr. Kovacs, therefore, doesn't it make a lot of sense to support H.R. 1675 that Mr. Hultgren was talking about a little bit before? Doesn't that make a lot of sense?

Mr. KOVACS. I think it does.

Mr. POLIQUIN. Yes. Thank you very much.

I appreciate it.

Chairman GARRETT. Thank you. The gentleman yields back.

Mr. Hill is recognized for 5 minutes.

Mr. HILL. Thank you, Mr. Chairman, and I thank the panel for your patience and indulgence this afternoon. Thanks for being with us.

Ms. Hughes, I want to start with you, and tell you I was impressed by looking at Mr. Luetkemeyer's and Mrs. Maloney's bill on this SBIC simplification process. Having been a community banker and investor in SBICs, I certainly know a lot about duplicated regulation. We had the Fed and the State and the FDIC and the State insurance commissioner, the State securities commissioner, the SEC, and FINRA, and I am sure I am leaving someone out and we will get a letter from them. But I have a lot of empathy

for this issue of duplication. And hasn't the SBA had exclusive regulatory oversight over SBICs since the late 1950s?

Ms. HUGHES. Yes, 1958.

Mr. HILL. So, did the Dodd-Frank Act tell us to just inadvertently step on it in the private equity space, as they now have opened the door for duplicate regulation of SBIC managers or SBIC advisors?

Ms. HUGHES. Actually, I think that Dodd-Frank tried to get it right in that they recognized that SBICs were already regulated by a Federal regulator and they were excluding them. I think the catch was really that it is the solely commentary. So if you solely invest in SBICs, then you are exempt from registration. But I don't think anybody really thought through the fact that multiple licensees often get to a point where they have a very small piece of a fund left. And at that point in time, typically, when the debentures are repaid, you would hand back your SBIC license.

At that point, I now manage a dollar beyond a non-SBIC so my other SBIC monies prompt registration with the SEC.

And that would prompt duplicate registration and cost and burden. So I think the idea is to streamline it so that it—focus on the SBA has done a good job, they have done this for a long time, we are very closely regulated from the beginning to the end as they vet the management teams coming in. And we are not opposed to regulation, we appreciate their insights, but we just don't want it to be from multiple sources, I think is the point.

Mr. HILL. Yes, and I think it is good for the record to show the SBA has a long track record here, including a disciplinary action against bad actors who have SBIC funds that don't need another one. But it certainly should not result in duplicate oversight. I think they do a good job. And no one knows the SBIC space better than the SBA. And the cost of getting an SBIC approved is extensive. It is months and months—9 months, 12 months—and very expensive to fill out the highly specialized forms that are required there.

Ms. HUGHES. It is. We have become expert in that.

Mr. HILL. What would you say it costs to register to have an SBIC—

Ms. HUGHES. To get an—

Mr. HILL. I know it is the best bargain in Washington in legal prices. What would you say to that?

Ms. HUGHES. Through the fund-raising process, on average I would venture a guess that you are spending somewhere between $100,000 and $200,000, all in start-up costs, but certainly not all paid to the government. But certainly attorneys back and forth as everything is approved, all of the paperwork associated with checking the boxes, completely vetting your track record and those kinds of components, as well as the importance of being able to fundraise in the marketplace and bring private capital to the mix. To be able to invest in those small businesses is critical.

Mr. HILL. I know our State has really benefited over the years by an expansion of SBIC opportunities. And so, thank you for your comments. I certainly support the effort to streamline this and remove the duplication.

Mr. Kovacs, you mentioned Section 404 in kind of a sidebar in your testimony. Can you catch me up on—I thought small filers were exempt under 404 at a lower level of scrutiny. Can you talk to me about why you keep that on your list, please—

Mr. KOVACS. Yes, for emerging growth companies, you have 5 years before you become SOX 404(b)-compliant, which is where myself and my CEO sign off saying that we have internal controls. But that is when the auditors sign off, and therefore there are all sorts of additional SOPs and outside the auditors there is a lot more regulation around 404(b).

Normally, we would expect we would have 5 years to be 404(b)-compliant, but there are a few things that take that away from you. One is if you had a billion dollars of revenue. We are clearly far from a billion dollars of revenue; it is a small biotech. We have, really, no revenue today.

But our market cap has done well because people see that our drug is getting close to market and there is enthusiasm for the long-term potential in our company. And so our stock prices have performed and our stock has gone through the $700 million threshold. And now we are losing our emerging growth company status, even though we still really are an emerging growth company.

And so now I have to become SOX-compliant by next year. And I have to hire more people, I have to bring in outside consultants, and I have to pay my auditor more money to get ready for that.

Mr. HILL. Thanks for that clarification.

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

Chairman GARRETT. Thank you. The gentleman yields back.

Mr. Huizenga is recognized for 5 minutes.

Mr. HUIZENGA. Thank you, Mr. Chairman. I appreciate that, and it is my pleasure to have a bill that we are discussing today, as well. And I know some of you had referenced it, H.R. 686, the Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2015. It was interesting earlier, the chairman, towards the beginning, had talked a little bit about the recommendations that the SEC has developed and then not acted upon. This was one of those. It was 7 years running. A gentleman from our district or right near our district, Shane Hansen—a partner at Warner Norcross & Judd—who chaired the M&A section of the bar, approached me and said, "Look, we have been trying to move them along here, and we just simply cannot get this done. This makes a tremendous amount of sense."

And what it is, is under the current system there is a one-size-fit-all approach to SEC registration for brokers. And I felt that we needed to have a more tailored registration system for these smaller, family-owned, oftentimes privately-held mergers and acquisitions for these brokers.

I know, Mr. Quaadman, you have talked a little bit about this previously. I don't know if you care to comment on why you believe the SEC should have this more tailored registration, and maybe Ms. Hughes, as well?

Mr. QUAADMAN. Sure. Thank you, Mr. Huizenga, and thank you for reintroducing the bill.

As I said before, we support the bill. And I made reference in my opening remarks about the no-action letter with the SEC. I think

that was welcome. I frankly only think that they issued that no-action letter because you introduced the bill in the last Congress. Because the SEC has just not been willing to move on ideas that the emerging growth committee has been coming out with.

But more importantly, what the regulator can giveth, the regulator can taketh away. So we saw earlier this year, in January, on the Friday night before the Martin Luther King weekend, where on a corporate governance issue that the Chair issued guidance overturning a decision staff had made in what is known as the Whole Foods decision that had overturned decades of practice in terms of shareholder proposals.

So our concern here is that if it is just left to a no-action letter, you can get a new chairman next year, and a no-action can go away and we are right back to where we started.

Mr. HUIZENGA. Or a Chair could change his or her mind.

Mr. QUAADMAN. Correct. So we think that your bill is a sensible way to get the parameters out there, get it set in stone, get this done. And so we are not going to have any give and take that can make this go away.

Mr. HUIZENGA. And, Mr. Chairman, I would like to—and I will get to you, Ms. Hughes, or somebody else who was starting to speak. But I would like to submit for the record letters of support for H.R. 686 from: the Small Business & Entrepreneurship Council; the Business Brokers of Florida; the Nevada Business Brokers Association; the International Business Brokers Association; the Alliance of Merger and Acquisition Advisors; and the Association for Corporate Growth.

Chairman GARRETT. Without objection, it is so ordered.

Mr. HUIZENGA. Thank you. And I will note that this committee passed this bill last Congress on voice vote, where it hit the Floor. And as I try to tell constituents back home, yes, things actually do pass Congress. And, in fact, they are all shocked that this one passed unanimously, 422–0. Most don't believe that Congress can actually work that way, but we are hoping that we are going to have a similar action here in this term, as well.

But I don't know, Ms. Hughes, if you wanted to comment?

Ms. HUGHES. Sure. We do a lot of business with small M&A and business brokers who are transacting mostly small private companies. They truly add value. A lot of those companies are very interested in dealing with the smaller firms. They are a little bit afraid of the larger, bigger houses and would far rather deal with the guy down the street whom they have known for 20 years as they bring their company to market because it is their baby for which they are transacting, or they are trying to raise money to generate fine growth capital.

Ms. GABALDON. Could I quickly—

Mr. HUIZENGA. Yes.

Ms. GABALDON. I just wanted to say I think that in many cases, the guy down the street may be registered at this point in time. But in addition, I think it is critical to note that the SEC no-action letter has a number of protections that are built into it that I think are very important and that the committee should seriously consider.

Mr. HUIZENGA. And we just hope to codify a number of those things.

So with that, Mr. Chairman, I will yield back the balance of my time.

Chairman GARRETT. The gentleman yields back 9 seconds.

Ms. Moore, welcome to the subcommittee.

Ms. MOORE. Thank you so much, Mr. Chairman. And I want to thank you for your indulgence. I am not a member of this subcommittee so I am very grateful that you yielded the time. I want to apologize to the witnesses. I just cannot see any of your names from over here, from this vantage point, I have no idea with whom I am speaking. So, just indulge me.

I have a couple of bills that are under the jurisdiction of this subcommittee, and I want to talk about H.R. 1317, the End-User Affiliate Clearing Exception. I listened very carefully to Mr. Quaadman, on the end there, when you talked about the importance of legislating, even though the regulators sometimes issue these no-action letters. So I think this question is for Mr. Deas, about the no-action letter of the CFTC that really endorsed the idea that commercial businesses ought to be able to aggregate their swaps into a SCTU, as they indicated in their no-action letter which is similar to my bill.

So I guess I want to know, do you think that it is important to pass H.R. 1317? And can you just briefly address the notion that this bill could permit a large swap-dealing bank to buy a commercial business selling widgets, and then transact their entire swap business using this subsection of the end-user exception?

Mr. DEAS. Yes, thank you for that question. The basis of a no-action letter is that the action covered by the letter is probably not in compliance with law. But the staff, in this case the CFTC Division staff, is committing, for so long as that letter is outstanding, not to take an enforcement action. We all feel so strongly about compliance with law and that there is a special provision in Dodd-Frank that requires boards of directors of companies that avail themselves of the end-user exception for clearing and margining to affirm, every year, that they are in compliance with the law in order to use that end-user exception.

So it puts treasurers and other officers of the company in a very awkward position. And there has been broad, bipartisan support for this fix that is to just the drafting to make the intent clear and which everyone wants to achieve.

The second part of your question, this idea that there could be this kind of loophole. First of all, I would say that from the beginning, from the passage of Dodd-Frank, it has always been the case that an operating company engaged in appropriate end-user commercial activity that happens to be owned by a financial parent can avail itself—it was in the law—of the end-user exemption. What we are talking about is permitting other companies in that group to trade through a centralized Treasury unit and reduce the risk by reducing the amount, the volume, of derivatives outstanding through netting them in the central Treasury unit.

So this just clarifies what was really, we believe, the intent of the drafters. And we urge continued consideration for this bill.

Ms. MOORE. Thank you so much. And just briefly, can you explain the credit support language in the bill, and what that accomplished, and how it protects the system and provides regulators with the flexibility to tailor the regs?

Mr. DEAS. The credit support language is meant to assure that there wouldn't be some separate derivative activity outstanding that doesn't ultimately come back within the group, the parent company in the group. And so there is a provision providing for that kind of credit support for the inter-company derivative transactions.

Ms. MOORE. Thank you so much.

Thank you, Mr. Chairman, and I yield back the balance of my time.

Chairman GARRETT. The gentlelady yields back.

The vice chairman of the subcommittee requests recognition.

Mr. HURT. Thank you, Mr. Chairman.

I just have a couple of follow-up questions for Ms. Gabaldon. Were you familiar with the article that was circulated earlier and referred to in questioning?

Ms. GABALDON. Yes.

Mr. HURT. Who published that?

Ms. GABALDON. I don't know who—

Mr. HURT. AICPA.

Ms. GABALDON. AICPA and XBRL.

Mr. HURT. XBRL US?

Ms. GABALDON. Yes.

Mr. HURT. Mr. Kovacs, in his testimony, talked about XBRL contractors. So obviously, you have to do—if you are going to have to pay to have this work done because you can't do it in-house, you would get an XBRL contractor. Is that correct?

Ms. GABALDON. Yes.

Mr. HURT. And who do AICPA and XBRL US represent? They represent folks who are looking for—who are investing and who are in the analyst business?

Ms. GABALDON. The AICPA is an association for certified public accountants, and—

Mr. HURT. XBRL US—

Ms. GABALDON. That is a non-profit organization.

Mr. HURT. Okay, because in the list—

Ms. GABALDON. It is definitely an—

Mr. HURT. In the list of all of the different folks who were going to be disadvantaged by this proposal, you said investors would be disadvantaged, analysts would be disadvantaged. You said emerging growth companies would be disadvantaged. But you didn't say the folks in the XBRL contracting business would be disadvantaged. You think they would?

Ms. GABALDON. I think they have employees, too.

Mr. HURT. Okay. So I guess my last question for you is, is you understand this would be a voluntary—the bill would make this filing voluntary.

Ms. GABALDON. I do understand that, and I do also want to make the point that I don't think that the AICPA has any particular dog in the fight. And I think that is noteworthy, but—

Mr. HURT. Okay. Well, they have their name on this article. It doesn't say exactly where this came from. But I guess they have that much of a dog in the fight they published an article about it, correct?

Ms. GABALDON. I think that, in general, the AICPA engages in a lot of studies. I get the newsletter from them, as a law professor, that just talks about studies they have conducted that they think are going to be helpful to the readers.

Mr. HURT. All right.

Turning to Mr. Kovacs, do you understand that our proposal is voluntary?

Mr. KOVACS. Yes.

Mr. HURT. Then I guess my second question is, if you look at this article it says—it may be that a company pays $10,000, it may be that a company pays $20,000, or it may be that a company pays $50,000. Why would would any company pay $1 if the information is not something that they believe is useful to investors and analysts? Why would you pay even $1?

Mr. KOVACS. I can only speak for us; I think we would probably opt to not pay it.

Mr. HURT. Let me ask you this: If this were made law, would you all opt out of having to file XBRL?

Mr. KOVACS. Yes, at this point in time I think that would probably be the direction we would take. We would rather probably hire somebody as opposed to paying that to a third party.

Mr. HURT. Okay.

Mr. KOVACS. The hiring.

Mr. HURT. Even? Okay.

Mr. KOVACS. A scientist or someone like that.

Mr. HURT. I just have a few minutes.

Mr. Quaadman?

Mr. QUAADMAN. Yes. Mr. Hurt, so yes it is voluntary. Number two, what is important here is that XBRL is a delivery system, right? And that has been a very problematic system that 90 percent of investors aren't using. And people who have been involved with it acknowledge that there have been problems with it.

So the issue here is, can we get a better delivery system that uses electronics to get the information out there? But can we do it in such a way that if an emerging growth company doesn't want to be a guinea pig they don't have to be, so they can save their money?

The third part of your bill, about the cost-benefit analysis, actually provides that lever on the SEC to continue to improve the delivery system. So I think this provides the additional legislative pressure to get us into a 21st Century delivery system. So the information is still going to be there for investors, the delivery system here is going to—you can volunteer in and out.

And one thing I just want to note, as well—as far as the United States being an outlier, I had a meeting with the European commission, with the people who are dealing with their shareholder directive, last November. And they said, "You know what? A Latvian investor who invests in a U.K. company can put their money there, but they can't vote in the governance of that U.K. company. So tell us how you guys do it." So if we are going to have a voluntary

XBRL exemption for U.S. investors, we are still going to have the most sophisticated information and corporate governance system by far, and that is why we have the deepest capital markets. And actually, we think your bill helps us get into the 21st Century.

Mr. HURT. Thank you.

I yield back.

Chairman GARRETT. The gentleman yields back.

And looking around, I think that is all that we have as far as Members. Without objection, I seek unanimous consent to make the following written statements a part of the record: the Honorable Darrell Issa; the American Bankers Association; Americans for Financial Reform; the Depository Trust & Clearing Corporation; the Food Marketing Institute; the Independent Community Bankers of America; the M&A Source; the North American Securities Administrators Association; Shane Hansen, a partner at Warner Norcross & Judd; and XBRL US.

With that, we bring to a close today's Capital Markets Subcommittee hearing. As always, I thank the members of the panel.

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.

So with that, I again thank the panel, and this hearing is adjourned.

[Whereupon, at 4:26 p.m., the hearing was adjourned.]

A P P E N D I X

April 29, 2015

Statement for the Record
H.R. 432, the *SBIC Advisers Relief Act*
Rep. Blaine Luetkemeyer (MO-03)
Committee on Financial Services
Subcommittee on Capital Markets and Government Sponsored Enterprises
April 29, 2015

Mr. Chairman, thank you for holding this hearing today and for including H.R. 432. I also want to thank the gentlewoman from New York, Ms. Maloney, for her work on this legislation.

The *SBIC Advisers Relief Act* is common sense policy that streamlines the registration and reporting requirements for advisers to Small Business Investment Companies, or SBICs. These are advisers to investment funds that make long-term investments in U.S. small businesses, and have to the tune of more than $63 billion since 1958.

Under current law and for over 55 years, SBICs have been regulated by the U.S. Small Business Administration. The existing regulatory regime surrounding SBICs includes an in-depth examination of management; strong investment rules; numerous operational requirements; recordkeeping, examination and reporting mandates; and conflict of interest rules. These entities and the management of these entities are anything but unregulated.

This robust regulatory framework and the need for SBIC exemptions have been well recognized by Congress. The intent of Congress, in including some of these exemptions in Dodd-Frank, was to reduce the regulatory burden on smaller funds and SBICs. However, the law has resulted in some unintended consequences that must be addressed.

The *SBIC Advisers Relief Act* does three things:

1.) It allows advisers that jointly advise SBICs and venture funds to be exempt from registration, combining two separate exemptions that exist: one for advisers of SBICs, and a wholly separate one for advisers of venture funds.

2.) It excludes SBIC assets from the SEC's Assets Under Management threshold calculation.

3.) It exempts from state regulation advisers of SBIC funds with less than $90 million in assets under management, leaving those entities to be regulated by the SBA, as they are today.

Mr. Chairman, I think we can all agree that these changes are common sense. During a hearing in April 2014, H.R. 4200, identical legislation introduced in the 113th Congress, garnered praise from Members on both sides of the aisle and from the witnesses who testified. Those witnesses agreed that the legislation streamlines the regulatory system governing SBIC advisers. In the 113th Congress, H.R. 4200 passed the House Financial Services Committee by a vote of 56-0, and was passed by the House of Representatives without opposition.

Mr. Chairman, I want my colleagues to know that H.R. 432 is not only bipartisan but also includes changes suggested by the SEC. Most importantly, this legislation includes sensible provisions that prevent redundant regulatory mandates and allow for greater investment in America's small businesses.

I again want to thank Congresswoman Maloney for her help on this bill and ask my colleagues for their continued support.

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Hearing before the Subcommittee on Capital Markets and Government Sponsored Enterprises – Committee on Financial Services

U.S. House of Representatives

Capitol Visitor Center - Room HVD-210
Washington, DC 20515

"Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens"

Testimony of Thomas C. Deas, Jr. – Vice President & Treasurer, FMC Corporation

April 29, 2015

Good afternoon Chairman Garrett, Ranking Member Maloney, and members of the Subcommittee. I am Thomas C. Deas, Jr., Vice President and Treasurer of FMC Corporation and Immediate Past-Chairman of the National Association of Corporate Treasurers, an organization of treasury professionals from several hundred of the largest public and private companies in the country. FMC and NACT are part of the Coalition for Derivatives End-Users (the "Coalition"). Our Coalition represents companies across the United States that employ derivatives to manage business risks they face every day. Hundreds of companies have been active in the Coalition, which has sought financial regulation that promotes economic stability and transparency without imposing undue burdens on derivatives end-users. I am also privileged to serve as the Immediate Past-Chairman of the International Group of Treasury Associations of which NACT along with the national treasury organizations of approximately 30 other countries are a part. Our message is straightforward: financial regulatory reform measures should promote economic stability and transparency without imposing undue burdens on derivatives end-users. For U.S.-based multinational companies, the need for international harmonization of derivatives rules is especially important. Thank you very much for giving me the opportunity to speak with you today about the impact of derivatives regulation on end-user companies.

End-Users' Concerns with Derivatives Regulation

The Coalition supports your efforts to oversee the implementation of the Dodd-Frank Act. We very much appreciate the strong bipartisan efforts by the Members of the Committee on Financial Services and this Subcommittee on behalf of American companies who use derivatives to manage many of the risks they face in running their businesses every day. The Coalition's several hundred members remain very appreciative of the bipartisan effort many of you led that resulted in January of this year

in legislative relief for end-users from mandatory posting of initial and variation margin requirements for the derivatives positions of eligible end-users.

We support your efforts to redress problems with derivatives experienced during the financial crisis in 2008. End-users like FMC use derivatives to reduce risks arising from operating our businesses and do not engage the kind of risky speculative derivatives transactions that roiled the markets during the financial crisis. End-users comprise less than 10 percent of the total over-the-counter ("OTC") derivatives market and do not meaningfully contribute to systemic risk. The Coalition is gratified by the broad consensus that end-users should not be subject to regulations designed to reduce the risk of those who maintain derivatives positions that could pose risk to the financial system.

However, at this point over four-and-a-half years after passage of the Dodd-Frank Act, there are several areas where continuing regulatory uncertainty compels end-users to appeal for legislative relief from actions we believe will raise costs unnecessarily and hamper our ability to manage business risks with properly structured OTC derivatives. Among several areas of concern, I would like to invite your attention to three areas relating to cross-border transactions and international competiveness, particularly for U.S.-based multinational companies.

- Centralized Treasury Units engaging in inter-affiliate and external-facing derivatives transactions;
- Capital requirements for derivatives transactions; and
- Cross-border concerns.

Centralized Treasury Units Engaging in Inter-affiliate Derivatives Transactions

Throughout the legislative and rulemaking processes surrounding the Dodd-Frank Act, the Coalition has advocated for strong regulatory standards that enhance financial stability while avoiding needless costs. Many non-financial end-users utilize centralized treasury units ("CTUs") as a risk-reducing, best practice to centralize and net the hedging needs of affiliates. In fact, nearly half of the respondents to a survey of end-users by the Coalition use CTUs to execute OTC derivatives.

While the CFTC has recognized the undue burdens clearing requirements would place on corporate end-users that utilize this best practice and has attempted to ease these burdens through no-action relief, this well-intended relief is inadequate. In particular, many corporations are uncomfortable relying on no-action relief, because that relief only stipulates that agency staff will not undertake enforcement action for violations of the law; it does not change the law. In Europe, CTUs are not treated as financial entities. Consequently, European law does not apply clearing and other such requirements to CTUs of non-financial end-users.

Treasurers of non-financial end-users who operate CTUs that serve the risk-mitigating function of aggregating exposures on the books of a special-purpose subsidiary within their corporate group, netting the inter-affiliate exposures, and then entering into smaller derivatives with a bank or other swap dealer for the net amounts, could have to wind down those efficient units or meet burdensome new regulatory requirements that will be hard to justify. The alternative would be to retain more risk. This is because, as financial entities, these CTUs could be denied the end-user clearing exception despite the fact that they are only executing trades for non-financial end-user affiliates, which themselves, would otherwise be able to elect the end-user clearing exception.

The Coalition strongly supports H.R. 1317, which would clarify that certain swaps entered into with a CTU hedging the commercial risk of a non-financial affiliate are eligible for the end-user exemption from mandatory clearing and the requirement to post margin for their derivatives positions. This would also free CFTC staff from having to monitor end-users' compliance with the no-action guidance they had to update most recently on November 26, 2014.

Capital Requirements for Derivatives Transactions

With your help, end-users could successfully navigate the many regulatory issues we still face, only to find that the uncleared OTC derivatives we seek to continue using have become too costly because of much higher capital requirements. The Prudential Banking Regulators have now finalized rules implementing Basel III capital requirements which increase the capital bank counterparties would have to hold against derivatives in anticipation of a possible future deterioration in the financial markets such as that experienced in 2008. Additionally, anticipated bank capital measures, including the liquidity coverage ratio and net stable funding ratio, will further increase derivatives transaction pricing for end-users.

European policy makers have implemented capital charges on derivatives positions significantly more favorable to end-users than the U.S. Prudential Banking Regulators. Their approach is to recognize that end-users' hedging activities are in fact reducing risks; and so, should require less capital than activities of financial entities keeping open positions or making markets in derivatives. They intend to exempt non-financial end-users from certain of the additional capital requirements. The absence of a U.S. exemption could put American companies at a meaningful competitive disadvantage compared to our European competitors.

In summary, we believe the legislative intent of the Dodd-Frank Act was to exempt end-users from having to use their own capital for mandatory margining of derivatives transactions, diverting these funds from investment in business expansion and ultimately costing jobs. The imposition of additional capital requirements by U.S. Prudential Banking Regulators would undermine this intent by forcing our bank

counterparties to hold much more of their own capital in reserve against end-users' derivatives positions, passing on the increased costs to these end-users.

Cross-Border Concerns

The Coalition appreciates the important efforts being undertaken by U.S. and foreign regulators to resolve differences in how their regulations apply to cross-border transactions. Applying derivatives reform rules in a global marketplace is an inherently complex undertaking. Unlike most stock market transactions, derivatives create an ongoing relationship between parties that is not severed once the transaction has been consummated. Thus, many transactions exist between parties in different jurisdictions for many years. While the United States has completed many of its derivatives rules first, other regulators around the world – particularly those in Europe – are just now finalizing and implementing many of their rules. Consequently, derivatives end-users now find themselves simultaneously subject to multiple regulatory regimes. Understanding and implementing compliance structures for derivatives rules across multiple jurisdictions is a significant and costly undertaking. Accordingly, end-users are subject to incentives to avoid complication by limiting their transactions to counterparties located in their same jurisdiction. The lack of regulatory harmonization can cause fragmented and less efficient markets for end-users, and can raise the cost of delivering stable prices to consumers. It is critical that U.S. regulators continue to work closely with their foreign counterparts and move quickly to recognize equivalency and substituted compliance with foreign regulatory regimes when the objectives of foreign regulations are comparable to those under the Dodd-Frank Act and where foreign regulations do not unduly burden end-users.

Summary

Let me take a moment to summarize our principal concerns with the application of derivatives regulation to end-users:

- First, the imposition of clearing and margining requirements on CTUs that execute swaps on behalf of non-financial affiliates threatens to deny those companies the benefits of risk-reduction by netting out opposite-way trades and entering into smaller derivatives with their bank counterparties. This practice is considered overwhelmingly by treasurers of U.S.-based multinational companies to be the best and most efficient practice.
- Second, despite the legislative fix that now clearly exempts end-users from margining requirements, we still have the risk that the banking regulators will require excessive capital be held in reserve against uncleared over-the-counter derivatives – with the cost passed on to end-users as they attempt to manage their business risks. The unintended consequence of punitive capital requirements could be for some end-users to cease hedging risks or to pay hedging costs that put them

at a disadvantage against foreign competition operating where end-user exemptions have been made more effective.

- Finally, international harmonization is of great importance and is particularly relevant for derivatives end-users, as many have affiliates located across the globe in several different jurisdictions. Inconsistencies lead to increased costs, confusion and duplication that could lead end-users to abandon efficient hedging practices or cause them not hedge at all. In your oversight of the implementation of the Dodd-Frank Act, we urge you to encourage U.S. regulators to continue to work with foreign regulatory regimes to recognize equivalence between jurisdictions using an outcomes-based analysis.

Conclusion

Thank you again for the opportunity to testify today on these important issues.

We are very concerned that the regulatory burden on end-users of derivatives will result in higher costs to Main Street companies that will limit their growth, harm their international competitiveness, and ultimately hamper their ability to sustain and, we hope, grow jobs.

The consequences of getting derivatives regulation wrong will be borne by American business and ultimately our customers.

I will do my best to respond to any questions you may have.

Statement of Professor Theresa A. Gabaldon
Lyle T. Alverson Professor of Law
The George Washington University Law School

at

Hearing 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
and Reduce Regulatory Burdens"**

April 29, 2015
Room HVC-210 of the Capitol Visitor Center
Washington, D.C.

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

Introduction

I thank you for inviting me. I have comments on eight of the proposed bills. I have a few general comments before addressing the specifics of the bills as time allows. First, although the bills can broadly be characterized as degulatory, deregulation gives something up and it must be thought through carefully. I believe that the bills generally were prepared without appropriate regard to the opportunities for abuse, and without regard to the way the proposals would interact with other relatively recent deregulations. For instance, some of them need to be carefully reconsidered in light of the fact that Rule 144 now permits completely unregulated resales following a reduced holding period satisfied with generous tacking rules. Some need to take into account the JOBS-Act changes to Section 12(g) of the '34 Act that exclude what could be a very large number of investors from counting in determining which entities must register under the Act. The new rules, in the wrong hands, essentially could render registration under one or both of the '33 and '34 Acts optional, and it is not hard to imagine which option would be taken. I also am concerned that some of the proposals do not work coherently together, pushing for modernization on one hand and fighting it on another.

I'll now move to the specifics of the bills. Because my time is limited, I will start with the ones that I believe are most flawed and create the most opportunity for mischief and move to the ones that are not particularly objectionable but probably are not necessary.

1. The Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2015 (The M&A Brokers Bill) (H.R. 686)

I'll align myself with Oliver Wendell Holmes and say I believe that to know what a law is you must look at it as a bad man – updating to include a bad woman. As this bill is drafted it

literally would permit someone banned from the securities industry to publicly offer, and ultimately sell, the securities of shell companies to what could be hundreds of people who will, in one year, be permitted to resell the securities without any limits whatsoever. I don't suppose that is what is intended, but that is how it could – and in my opinion would – operate if allowed to pass in its current form.

Some of the defects can be remedied with bad actor provisions, exclusion of the involvement of most shells, and limiting all public offering activity, not just activity involving reporting companies. The SEC's M&A No Action Letter of early 2014 helpfully outlines possible improvements and most probably makes any legislation unnecessary.

Still, even if improved along the lines of the SEC's No Action Letter, what you are left with is a bill to allow unlicensed brokers who, if not registered as investment advisors, are federally unregulated, to compete with those who have put in the time and effort to register and who *are* willing to submit to inspection and other controls. The argument for deregulation supposes that this will bring down M&A costs for smaller companies, to which there are a few responses. One is that smaller companies might very well be better served by licensed professionals. Another is that the cut-offs for eligible privately held companies who need a price cut is extremely high. This relates to a concern that the provision, even if improved, has potential for exploitation by large private equity firms who already are pressing the envelope as far as avoiding registration is concerned. I do not doubt their ingenuity in structuring transactions that could capitalize on this exemption.

Another argument advanced for this particular deregulation is that whether an M&A transaction involves assets or securities may be driven simply by tax or other considerations. The counter to that is "so what?" It may be very well understood from the beginning that the sale of

securities will be involved. In any event, if securities are sold, the securities laws should apply unless there is some better justification than "the transaction could have taken some other form." Isn't it often the case that issuers that sell stock could have borrowed from banks instead?

In light of the time limitation, I will note that my written testimony at this point describes a number of technical issues, and move on to the next bill.

The technical issues presented by H.R. 686 include the following:

(1) There is no exclusion of bad actors.

(2) There is no exclusion for the placement of shares of shell companies (as opposed to the use of a shell created for purposes of accomplishing a legitimate corporate combination).

(3) Proposed '34 Act Subsection (15)(b)(13)(B)(ii) is evidently intended to permit exempt brokers to engage in the public offering of the shares of non-reporting companies. This is inconsistent with existing law and should be prohibited.

(4) Proposed Subsection 15(b)(13)(D), among other things, defines "control" and establishes certain presumptions. I recommend that instead of starting "In this paragraph:" the sub-section should start with "For purposes of this paragraph only:" in order to more clearly avoid use of the definition as an analogy in other situations. In addition, the subsection presumes control on the part of any member of a limited liability company. This is not warranted. The limited liability company form readily lends itself to passive members and publicly traded memberships. In addition, the subsection presumes control based on two 20 percent tests, which is quite a low level. Certainly control *may* exist at that level, but it should not for this purpose be presumed unless it is more likely to exist than not – and to me, that means majority ownership. Below that level, it does not seem to me to be too burdensome to require the broker seeking the exemption to satisfy him- or herself that control actually will transfer. Moreover, the final clause

of the control definition presumes control based on the amount a partner or limited liability company member has invested. Since general partners and limited liability company members already are presumed to have control, the net effect of this addition is to assume control by limited partners, which is perverse.

(5) Proposed Subsection 15(b)(13)(D) also defines "eligible privately held company." The financial tests (which I believe are set too high) are to be satisfied "In the fiscal year ending immediately before the fiscal year in which the services of the M&A broker are initially engaged . . .." This obviously anticipates that a company might outgrow the limits while the M&A broker is trying to broker a deal. It is a fine idea to address the situation for purposes of clarity, but better to have the test apply throughout the time the broker serves. This would appropriately discourage, but not forbid, the use of an unregistered M&A broker in a borderline case.

(6) Proposed Subsection 15(b)(13)(D) also defines "M&A broker." The first part of the definition literally permits the sale of securities without being limited to the M&A context. It could be improved by changing "transfer of ownership" to "transfer of ownership representing control." The existing breadth is supposed to be constrained by a series of "reasonable belief" tests, with no stated requirement of verification. For purposes of comparison, consider current Rule 506, which permits general solicitation on behalf of an issuer if sales are made only to accredited investors and sets out a verification requirement. In addition, one of the things a broker must reasonably believe is that those acquiring securities "acting alone or in concert, will control and, directly or indirectly, will be active in management." As a strict literal matter, hundreds of investors could act in concert to control if a sufficiently large percentage of ownership is being offered. This would even be presumed to be the case (see above) if limited liability company memberships are involved. Moreover, how is one "indirectly" active in

management? Even a requirement that one be directly active in management would be vague. This is problematic insofar as many limited liability company operating agreements provide for participation in management by all members, even when there are hundreds of members and it is perfectly obvious that very few will actually participate. (*See*, *e.g.*, U.S. v. Leonard, 529 F.3d 83 (2008)) Finally, there is no time constraint with respect to either the exercise of control or participation in management. As written, the provision would permit a broker who reasonably believed the tests would be met for a single day before the securities were re-sold to take advantage of the exemption.

(7) The final set of difficulties with Subsection 15(b)(13)(D) relate to the provision of information to purchasers. The concept of making information available prior to someone becoming legally bound is ill-suited to the context of many genuine M&A transactions – those involving collective decision-making. There, information should be provided a reasonable period before a vote is taken. Even in the case of individual decision-making, information should be delivered sufficiently in advance for reasonable contemplation. In addition, the information to be delivered should be more clearly enumerated. As it is, the language could be read as requiring a recent balance sheet and other information to be delivered only if the issuer has audited financial statements, which I do not believe is the intent. Finally, the allusion to information pertaining to the management, etc., should be an allusion to all *material* information.

2. The Reforming Access for Investments in Starup Enterprises Act

(The Resales to Accredited Investors Bill) (H.R. 1839)

I start my evaluation of this bill with the proposition that the common law Section 4(a)(1½) exemption is not broken and does not need to be fixed. This is particularly true in light of the relaxation of Rule 144, which now imposes only a holding period test before securities can

be widely and freely remarketed. Issuers are not permitted to take advantage of the proposed exemption, but as written it would be a perilously easy way for affiliates to flip securities either on their own behalf or the issuer's behalf, providing only that separate compensation for the service is not received. One can easily imagine, as well, that since accredited investors purchasing in a Rule 506 offering would be able to quickly resell on an accredited investor "platform," representations about investment intent would become meaningless. First tier and subsequent purchasers would assume no real holding risk and could be expected to evaluate their purchases less carefully. In addition, one could imagine issuers placing securities directly with accredited investors who indeed were willing to wait out the applicable Rule 144 holding period while hedging their risks. Registration under the '33 Act thus could be made optional.

There are other problems with the bill, including its failure to invoke bad actor and similar protections. In fact, it completely ignores the type of protection associated with private placements under Rule 506 and/or the existing resale rule of Rule 144A. The latter is particularly startling, since Rule 144A allows resales only to qualified institutional buyers – institutions with portfolios of $100 million or more or meeting certain other tests – whereas the bill would allow resales to much smaller, and presumably less sophisticated, buyers, including individuals who have one million in net worth.

Moreover, this bill would permit affiliate resales to accredited investors without the provision of information that the affiliate doubtless possesses, as well as permit "first-tier" accredited investors who received information from the issuer to resell without passing that information along. There is no reason for this, suggesting one more reason for sticking with 4(a)(1½). Lawyers giving advice on 4(a)(1½) transactions traditionally have advised as closely

paralleling a Section 4(a)(2) transaction as possible – including provision of available information.

Again, I will refer to more technical comments in my written testimony and move on, noting that the bill is remarkably flawed in a number of ways. It could be improved, although it is not clear why it would then need to exist.

My technical comments on the resales to accredited investors bill include:

(1) It should include protections no less than those provided under Rule 144A. Rule 144A requires the seller possess a reasonable belief as to the status of its purchaser, and provides guidelines. It also excludes securities listed on a national securities exchange or quoted in an automated inter-dealer quotation system (and certain other securities). Rule 144A requires buyer notification *and* requires non-reporting companies to provide certain information which, if requested by the buyer, must be received at or prior to the time of sale.

(2) It should include protections no less than those provided under Rule 506. These include a reasonable belief provision, restrictions on resale, and bad actor limitations.

(3) I specifically endorse the renumbering of the second Section (b) of '33 Act Section 4. I also would suggest that if Section 18 otherwise is to be amended (which I do not recommend), all of the cross references to Section 4 be updated.

(4) Proposed Section 4(d)(1) permits general solicitation if sales are over platforms available only to accredited investors. General solicitation should be prohibited if there is to be any genuine attempt to keep 4(a)(7) markets limited. An exception could be made for general solicitation over a platform taking the steps required in Rule 506(c)(ii) to assure that all participants are accredited investors. In addition, "platform" should be defined.

(5) Proposed Section 4(d)(2) states that securities sold under Section 4(a)(7) "shall be deemed to have been acquired in a transaction not involving any public offering." If this is intended to link the provision to Rule 144(a)(3) it should specify that there is a chain of transactions from the issuer or an affiliate. As it is, it leaves open the argument that someone purchasing from an accredited investor who is not an issuer or affiliate did not receive restricted securities. If it is intended to make it clear that since there is no public offering there is no distribution, and thus application of Section 4(a)(1) might be more likely, it is unnecessary as new Section 4(a)(7) would state its own exemption.

(6) Proposed Section 4(d)(3) would permit affiliates to resell securities without any worry that they are underwriters, creating a clear opportunity for abuse. In general, limiting the concept of underwriter to "persons receiving compensation from the issuer with respect to such sale" creates unfortunate ambiguity. For instance, how about someone who simply buys securities at a reduced price with the full intent of selling them to the public six short months later? Moreover, requiring compensation for underwriter status is a mischievous tinkering with the accretion of years of authority on the definition of "underwriter."

(7) Eliminating state authority over resales to accredited investors is unfortunate and unnecessary. Rule 144A does not preempt state regulation; nonetheless, the Rule 144A market has thrived.

(8) The new exemption should require that the seller not have purchased with a view to resale, and the purchaser should be required to represent investment intent.

3. Encouraging Employee Ownership Act of 2015

(The Rule 701 Bill) (H.R. 1675)

I will frankly align myself, not just with Oliver Wendell Holmes, but also with the Supreme Court in SEC v. Ralston Purina, 346 U.S. 119 (1953). There is no reason to believe that prospective investors who are employees of the issuer need less protection than other prospective investors. If anything, they are more vulnerable to coercion and suggestion. Thus, in 1999 I did not see the merit of excusing issuers of less than $5,000,000 of securities from the very moderate disclosure requirements then added to Rule 701. Even as it is, failing to require information to be given to all prospective employee purchasers creates inequity between employees who do have access to the information registration would provide and those who do not, as well as inequity between uninformed employees and other minority shareholders who might have received information pursuant to other exemptions. Accordingly, I think increasing the limit is a bad idea, and one that can't be excused simply by talking about inflation. Things have changed since 1999 in addition to the value of a dollar. We now have an amendment to Section 12(g) of the '34 Act that says purchasers under 701 don't count for triggering registration requirements. Large issuers thus could sell up to $10,000,000 of securities every year to an unlimited number of employees who would *never* be entitled to information about the company under either the '33 or '34 Acts. At inception, Rule 701 was intended for use by small start-ups and allowing free-wheeling use by larger issuers is unjustified.

I am aware that Professor John Coffee from Columbia University testified on a similar, but even more extreme, proposal last year. I am in complete agreement with him, and will quote him to the effect that "there is little hardship or burden in giving your financial statements to your employees. . . . 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."

I suppose that some may cite confidentiality concerns if financial information is put into the hands of employees. If that were the case, requiring disclosure for issuances over $10 million should be more concerning than for smaller issuances, since more employees presumably would be involved. Moreover, when you think about the logic of the non-disclosure argument, what you really are saying is "This information is so important it can't get out." Isn't that exactly the kind of information you'd need to make an informed investment decision? In any event, the correct method of dealing with confidentiality concerns is, of course, confidentiality agreements.

4. The Improving Access to Capital for Emerging Growth Companies Act (The EGC Bill) (H.R. 1659)

I have several reactions to this bill (also submitted last year in essentially the same form as H.R. 3623), none of which are favorable. First, I see no reason to reduce the time between public filing and an issuer's road show from 21 to 15 days. As I understand it, the actual average time is a little over 40 days. Moreover, I do see possible mischief if an issuer did try to take advantage of the proposed reduction. Although many EGCs are very large and can be expected to attract fairly immediate attention and analysis, some will be small. Truncating the time for public reaction simply seems like a poor, and untested, idea. The argument necessary to support truncation is that you want EGCs to be able to capitalize on market conditions before they change. This boils down to saying you want them to be able to sell securities before the price comes down, leaving investors holding the bag.

I am also concerned with the part of the bill that would permit EGCs to launch the SEC review process with a single year of financial statements. Financial statements are a critical part of the disclosure package, and the ability to compare years to discern trends is extremely important. I understand the purpose of the bill is to make sure that EGCs never wind up having

to provide more than two years of audited financial statements, but starting down the road to SEC review without the ability to compare years is a real strike against efficiency and, ultimately, investor protection. It also is completely unnecessary in any case in which an issuer already has two years of audited financials. At a minimum, issuers should be required to provide what they have. Moreover, I will observe that the requirement that the second year of financial be filed by amendment "before distribution of the preliminary prospectus" is meaningless, given that the public will have access, and begin forming opinions, as soon as the public filing occurs.

Although I have no particularly strong objection to the idea that a company initiating a confidential EGC process should be permitted to complete it even if it is no longer an EGC, I do not see this as a necessary amendment. It is unlikely to be a regularly recurring scenario, and companies that are close to the line probably should be encouraged to step into larger shoes if they think their baby shoes are likely to pinch.

The version of the bill I originally reviewed contained a "follow-on" provision permitting confidential treatment for a second ECG filing within a year, and provided for public filing a mere two days before securities were issued. I understand the bill has been revised to remove the provision, and it is well gone. There should be no reason for a second confidential bite at the apple, and a two day period for the public to form its opinions before *issuance* is more than odd, essentially assuming automatic effectiveness and sale the same day. This may be justified for well-known seasoned issuers, but not for EGCs.

5. The Disclosure Modernization and Simplification Act of 2015

(The Regulation S-K and Form 10-K Bill) (H.R.1525)

The bill proposes that the SEC issue regulations permitting issuers to submit a summary page on Form 10-K with cross-references (by electronic link or otherwise) to the material in the

Form 10-K. This strikes me as unobjectionable, but probably unnecessary. I believe cross-reference sheets already are permissible, and I believe analyst attentiveness and demand will prevent sliding down some slippery slope to vestigial 10-K reports.

I do object to the approach of the rest of the bill. The "act now, then study, then report and then act again" mandate to revise is no way to conserve, much less maximize, administrative resources. More important, re-examination of Regulation S-K already is underway, and the periods specified for various milestones are, by-and-large, unrealistic. I am sure we all recognize the Commission's difficulty in responding to the various Dodd-Frank Act provisions ordering implementation in particular time-frames. Intended or not, tenewal of this approach comes across as a somewhat mean-spirited attempt to embarrass an agency that has long been held in high esteem – and could serve to distract the Commission for the foreseeable future from its other significant tasks. In addition, the tone of the mandate overwhelmingly cuts in favor of limiting disclosure. I am concerned that the Commission might feel itself constrained from adding disclosure requirements that might be well-advised, such as specific (and needed) augmented disclosures with respect to short-term borrowing. Finally, as someone who in the 1970s heard vacuous exhortations like "more nuclear power, but safer," I can only say that the exhortation to "emphasize a company by company approach that allows relevant and material information to be disseminated to investors without boilerplate language or static requirements while preserving completeness and comparability of information across registrants" seems to be – how shall we say? – not particularly helpful. Again, it is needlessly insulting to a diligent and esteemed agency to suggest that they do not already have these concerns close to heart and that they are not trying to address them on an ongoing basis.

6. XBRL and Small and Emerging Growth Companies

(The XBRL Bill) (H.R. 1965)

It is somewhat perplexing that the S-K proposal urges modernization, while this exemption for EGCs from the requirement that financial statements be filed in Extensible Business Reporting Language (XBRL) is a step backward. This would permit a very large number of filers to avoid filing information in a manner that would permit it to be compared to the information of other filers – both those that are larger and those in the same size range (of under one billion dollars of gross revenue). This puts investors at a disadvantage. This puts analysts at a disadvantage. This puts the Commission at a disadvantage. It puts prospective academic researchers at a disadvantage. It may even put EGCs that don't file in XBRL at a disadvantage if investors can acquire information about other issuers more easily. In addition, although there is expense associated with XBRL, there is no reason to think it is any different than any other technology. XBRL will become easier and cheaper the more it is used.

7. Small Company Simple Registration Act of 2015

(The S-1 Forward Incorporation by Reference Bill) (H.R. 1723)

As noted by Professor John Coffee's testimony last year, the Commission's Government-Business Forum on Small Business Capital Formation has for some time called for changes to permit smaller reporting companies that have registered an IPO on Form S-1 to incorporate by reference other documents filed with the Commission. I believe something is lost in terms of SEC review of the documents reviewed, but acknowledge something is gained in cost savings. If the change is made, however, it should prompt reflection on the manner in which the entire package of information actually is made available to investors. The Commission's Electronic Data Gathering and Retrieval (EDGAR) system is an awkward and not very user-friendly research tool. Funding of a project to retool the system would be applauded in many quarters. In

addition, recognition of EDGAR's limitations prompts me to suggest that if the bill goes forward it specify that the issuer post an S-1 on its website that will be updated with a hyper-link to each document incorporated by reference at the time the document is filed.

8. Section 31 Fee Overpayments by Exchanges and Finra

(The Overpayment Bill (H.R. 1975)

I certainly do not oppose the reasoning of this bill, but I do urge that some thought be given to the actual mechanics of the cash flow. I assume that the overpayments meant to be addressed will have been spent or forwarded elsewhere. The money foregone in the future will have to come from some source, which should be identified.

Summary

I reiterate my concern that a number of the bills will lead to unanticipated abuse. I also note that the package of bills works to reduce disclosure in a number of ways. For instance, there predictably will be less disclosure of broker conflicts, less disclosure when securities are re-sold to accredited investors, less disclosure to employees, less comparability of disclosure by EGCs and less time for EGC disclosure to be considered. It is important to remember that reducing disclosure increases investor risk. Reasonable investors considering that risk well may factor it into pricing determinations. As a result, I believe it would be impossible to conclude that this packet of proposals would positively affect capital formation .

Hearing on "Legislative Proposals to Enhance Capital Formation
and Reduce Regulatory Barriers"
House Committee on Financial Services
Subcommittee on Capital Markets & Government Sponsored Enterprises
April 29, 2015

Testimony by Gayle G. Hughes
Partner & Founder, Merion Investment Partners
On behalf of the Small Business Investor Alliance
www.SBIA.org

Good afternoon Chairman Garrett, Ranking Member Maloney, and Members of the Subcommittee on Capital Markets and Government Sponsored Enterprises:

My name is Gayle Hughes and I'm a founder and partner of Merion Investment Partners (Merion), a family of private equity funds licensed by the Small Business Administration (SBA) as Small Business Investment Companies (SBICs). Merion is based outside of Philadelphia and was founded in 2003. Merion currently advises two SBIC funds and is involved in providing subordinated debt and equity to small businesses that have significant growth potential. I am here today representing the Small Business Investor Alliance (SBIA), which is the trade association of lower middle market private equity funds, SBICs, and business development companies (BDCs) and their institutional investors. SBIA members provide vital capital to small and medium-sized businesses across the country. I'm also here to express my support for the SBIC Advisers Relief Act.

Background

Before I delve into the details of why I'm here testifying today, it might make sense to share a little of my background, and the background of Merion Investment Partners. Over my 30 year career in the financial industry, I have worked with companies, from small entrepreneurial firms to Fortune 500 companies; I have found working with small businesses to be the most rewarding. As such, for the last 20 years, my partners and I have worked as a team investing and managing mezzanine debt and equity investments in small businesses. We have also worked closely with the management teams of the companies we invest in to help them achieve their growth objectives. For the first six years, our group worked within the framework of Mellon Growth Finance, a concept and team founded by my partner Bill Means, where we built a portfolio of small business investments that included several notable successes in the greater Philadelphia region.

As the core of our strategy was to invest in small entrepreneurial businesses and provide them with the financial wherewithal and management expertise to realize their growth objectives, we decided to pursue an SBIC license. As a result, we left Mellon Bank in 2002 and formed Merion. Our first SBIC license was approved by the SBA in August of 2003. We sought a second license, which was approved in January 2010, and we plan to seek a third license later this year. Today we advise total "assets under management" (AUM) of just over $105 million and employ a staff of six people in Radnor, PA to run our operations. Since 2003, our funds and management company have been examined 14 times by the SBA.

Since receiving our first SBIC license, we have invested nearly $190 million in 35 small businesses throughout the country. A large percentage of our investments are made directly with entrepreneurs and business owners, with Merion providing the only institutional capital. As such, we work closely with the businesses we invest in to help them professionalize their management, grow their business, and expand their teams. For example, we provided financing used to finance a growth opportunity for an IT services company located in northern New Jersey that tripled the firm's revenues, expanded its footprint and nearly doubled its employee base during our investment period. In a second example, we provided financing for two independent businessmen to acquire a catalog retail and e-Commerce business from an owner seeking a

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transition. Merion provided the capital for the management transition of this company located in central Virginia. As the new owners were better equipped to take advantage of certain growth opportunities, the company grew revenues at a 23% compound annual growth rate and increased its employment base by 67% during our investment period. In addition, I am pleased to note that of the 23 different states represented by members of the committee, Merion has made investments that are either headquartered in or have significant operations in 78% of those states.

Merion actively invests in small businesses and works closely with those entrepreneurs, their management teams and their equity investors, if any, to grow revenues, reach new markets, and expand their workforce and to provide a return to our investors. We have a strong record of success in this regard over our years of investing and unfortunately the cost and time associated with duplicative regulatory burdens would materially reduce the time we could be spending with small businesses focused on their growth and development.

"SBIC Advisers Relief Act" Fixes Duplicative Regulation Issue for Merion

Merion is currently facing a problem that a number of other investment advisers solely to SBIC funds have had to face and address, which arises during the wind-down phase and at the end of a particular SBIC fund's life. As each fund is a discreet pool of capital independently licensed by the SBA, traditionally once an SBIC has paid off their SBA debentures in full and is winding down its operations and exiting the small remaining pool of investments, it would turn in its SBIC license for that fund. This was an efficient solution, as it enabled the SBA staff to focus on the oversight of active funds (still engaged in investing) and it reduced the cost burden to the fund (and its investors) of ongoing compliance with the SBA regulations and reporting on a very small asset base. Merion reached this milestone in 2012 with its first fund.

As we embark on fund raising for our third fund, Merion III, the small investments remaining in our first fund, Merion I, would most certainly trigger full registration with the SEC, and associated regulatory burdens, if we do not retain our SBIC license on this small remaining pool of capital. This is because the combined capital of Merion I and Merion III would exceed $150 million of AUM and therefore be required to register with the Securities and Exchange Commission (SEC) as an investment adviser and be subject to duplicative cost and burden of both registering with the SEC, and ensuring ongoing compliance with the SBIC regulations and SBA oversight. These regulatory burdens would be a long-term expense and administrative drain for our fund. Often an orderly wind down of a fund can take one to two years, in order to meet the timelines of the remaining small businesses, as well as maximize returns for the investors. This would therefore create ongoing registration risk, and associated cost and burden over that time period for the fund managers.

This issue could be easily remedied through the passage of pending legislation, called the SBIC Advisers Relief Act, on behalf of which I am testifying today. The SBIC Advisers Relief Act, or H.R.432, was introduced in the House on January 21, 2015, by Representatives Blaine Luetkemeyer (R-MO), Carolyn Maloney (D-NY), and eight other bipartisan cosponsors. In the 113th Congress, the same legislation passed the House Financial Services Committee 56-0, and was approved by the House on a voice vote. Senators Mark Kirk (R-IL) and Joe Manchin (D-WV) introduced the Senate companion (S.2765) to the bill in the 113th Congress.

My written testimony explains in more detail the elements of this legislation, and why the solutions and clarifications it makes to the Dodd-Frank Act are necessary to ensure that smaller funds will be able to continue focusing on small business investing, rather than filling out regulatory paperwork. I would like to thank the Subcommittee for examining this bill today and I especially want to thank the sponsors of the legislation.

In addition to the SBIC Advisers Relief Act, the SBIA believes other legislation that is the subject of the hearing today will contribute to improving access to capital and reducing associated regulatory burdens in the capital raising and deal sourcing process. SBIA supports legislation that helps improve capital formation and reduce regulatory burdens for small businesses. Several bills are consistent with these goals including the Small Business Mergers, Acquisitions, Sales and Brokerage Simplification Act of 2015 (H.R. 686), the Disclosure Modernization and Simplification Act of 2015 (H.R. 1525), and the Improving Access to Capital for Emerging Growth Companies Act (H.R. 1659).

I. What is an SBIC?

Before discussing the benefits of the SBIC Advisers Relief Act, it makes sense to provide a quick overview of what exactly is an SBIC. SBICs are privately owned, managed, and operated equity investment funds that make long-term investments in U.S. small businesses and are licensed by the SBA. SBICs are highly regulated private funds that invest exclusively in domestic small businesses with at least 25% of their investments in even smaller enterprises. The program was created in 1958 to help overcome the scale challenges associated with small business investment, and in so doing spearheaded creation of the thriving venture capital industry we see in the country today. Given their clear public benefit, SBIC funds are the only explicitly permitted investment under the Volcker Rule that was set out in statute.

Currently, there are over 294 licensed SBICs across the country with over $22 billion in total assets. In Fiscal Year 2014, SBICs invested more than $5.2 billion in capital in domestic small businesses, adding to the $63 billion in total investments in small businesses provided since 1958. Well-known companies such as Costco, Apple, Federal Express, Outback Steakhouse, and Callaway Golf received SBIC financing when they began, growing into successful, profitable companies and employing thousands of Americans. SBICs also are based in many areas where traditional private equity is not, with funds based in Tennessee, Louisiana, Pennsylvania, Alabama, Arkansas, Illinois, Nebraska, Kansas, Virginia, Rhode Island, New York, New Jersey, Massachusetts, and Indiana, among others.

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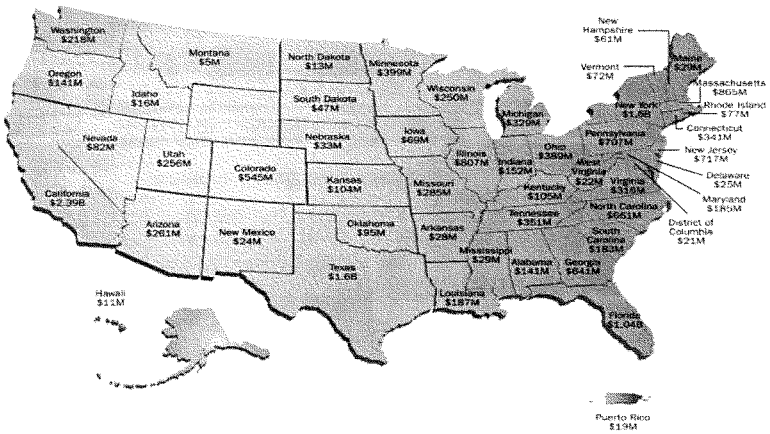
Total Small Business Investment Companies
Investments by State (FY 2010-2014)



II. Dodd Frank Prompted a Significant Change in How SBIC Advisers and Private Fund Advisers Were Regulated

Under the Dodd-Frank Wall Street Reform & Consumer Protection Act (Dodd-Frank), passed in 2010, the landscape for investment advisers changed dramatically for private equity funds. In writing Dodd-Frank there was discussion, and amendments were adopted, with the express intent of avoiding duplicative regulation and reporting by SBICs. Unfortunately, as the bill evolved there were drafting oversights that inadvertently undercut the premise of not redundantly regulating SBICs and preventing the resulting drain on the resources of small business investors. The changes required many private equity funds to register with the SEC as investment advisers, and smaller private equity advisers to provide limited reporting to the SEC or register with their state securities regulator. Registration for these smaller funds is not just filling out a few forms; it is a new way of life. SEC registration is expensive and, in many cases, the investment adviser rules are not very applicable to private equity funds dealing in non-public securities, which is common with small funds.

The initial cost to register with the SEC is often in excess of $100,000. Annual costs to comply with SEC investment adviser rules are often $50,000 or more per year. SBIA supports exempting small business investors from the Investment Advisers Act. The $150 million threshold that triggers SEC registration is too low and, at a minimum, should be raised. It is illustrative that one of the authors of Dodd-Frank, former Congressman Barney Frank, recently stated that Congress should consider amending the $150 million threshold with which private

equity firms must register with the SEC; while further highlighting that "in the crisis situation, we erred on the side of maybe being too inclusive."[1]

Dodd-Frank created a new "Assets under Management" or AUM test to determine the regulatory burden on investment advisers to private funds. Other types of fund advisers are specifically exempt from registration, such as venture funds (VC) and SBICs, but only if they "solely" advise those funds. The following chart explains the requirements:

Size or Type of Fund Test	Regulatory Regime
Investment Advisers that advise PE Funds more than $150 Million in AUM	*Required to Register with the SEC as an Investment Adviser.*
Investment Advisers that advise PE Funds between $100-150 Million in AUM	*Regulated by the SEC as an "Exempt Reporting Adviser," i.e., no registration, generally no examinations, but paperwork and reporting to the SEC.*
Investment Advisers that advise PE Funds with less than $90-100 Million in AUM	*Register with the state securities regulator, depending on state law and applicable state exemptions for private funds.* ***Currently, 25 states, plus the District of Columbia, do not have exemptions from registration for Advisers to SBIC Funds, resulting in duplicative regulation.***
Investment Advisers that "solely" advise VC funds	*Regulated by the SEC as an "Exempt Reporting Adviser," i.e. no registration, generally no examinations, but paperwork and reporting to the SEC.*
Advisers that "solely" advise SBIC Funds	*SBICs are already Regulated by the SBA. Therefore, Congress exempted from SEC Registration. Depending on state law, the Investment Adviser may have to register with the state regulator if there is no state exemption or order.*
Advisers that advise SBIC Funds and VC Funds	*SBICs and VC Funds lose both of their Exemptions and Must Register with the SEC if their AUM is greater than $150 Million. This Results in Duplicative Regulation from the SEC and SBA over SBIC Funds.*
Advisers that advise SBIC Funds and PE Funds	*The SEC includes the SBIC AUM in the SEC Registration calculation, triggering automatic registration if above $150 Million in AUM. This Results in Duplicative Regulation from the SEC and SBA over SBIC Funds.*

[1] Deborah Cohen, *Frank Pushes for Change to PE Registration Rule in Dodd-Frank-Reuters,* MIDDLE MARKET GROWTH, January 22, 2015, *available at:* http://www.middlemarketgrowth.org/frank-pushes-change-pe-registration-rule-dodd-frank-reuters/

The chart above explains the confusing and inconsistent framework that is currently in place due to the changes to the investment adviser regulation under Dodd-Frank. The SBIC Advisers Relief Act aims to clarify these inconsistencies and provide relief for smaller funds which are disproportionately impacted by duplicative and costly regulation. This bill is vital for a number of particular reasons.

Small business investors commonly have very few employees, sometimes as few as two. Small business investment funds, such as Merion, generally do not have legal departments, compliance teams, or extra employees to spare adhering to a complicated regulatory regime that is not designed for its type of investing. Adding additional overhead expenses for regulatory compliance teams and services damages the ability of small business investment funds to operate profitably and prevents them from dedicating all their time, energy, and capital to helping small businesses grow.

The cost of registration and additional compliance functions is high for smaller funds because their management fees[2] (which are a function of assets under management) are low when compared to much larger funds; however, smaller funds face many of the same compliance and reporting levels as larger funds. Absent the infrastructure of larger funds, smaller funds often have to pay outside counsel to help with initial and ongoing compliance costs.

Due to the relatively high compliance expense, managers of smaller funds are left with two choices – raise far more capital for their next fund to cover the fees for the added compliance costs or exit the business. Larger funds invest in larger companies, generally not small businesses. Neither option delivers a positive result for continuing the flow of capital to small businesses. For every $1 that we spend on compliance issues, that is $1 less that we have to further our mission to deploy capital and to help grow the economy. Therefore, all the time and money that is tied up by regulatory compliance will hinder economic growth and job creation.

The SBIC Advisers Relief Act seeks to eliminate duplicative regulation that imposes significant burdens and costs on small business investment funds by clarifying and eliminating inconsistencies in the regulatory framework in the Dodd-Frank Act. These modest changes are technical corrections that will ensure that small business investment will not be penalized and pushed out of the marketplace, and America's small businesses will receive the capital they need.

III. The SBIC Advisers Relief Act (H.R. 432)

The SBIC Advisers Relief Act is a common-sense, bipartisan, and effective clarification of the investment adviser regulation that will enhance the ability of small business investors to concentrate on making investments, rather than filling out forms. It concentrates on three targeted changes to current law. First, the legislation prevents venture funds from losing their

[2] Most private equity limited partnership agreements (LPAs) require costs associated with SEC registration and ongoing regulatory compliance to be charged as a management expense, being paid by the management fee, rather than a fund cost. Management fees are typically 2% of the total AUM of the funds being advised, and cover the costs of operating the investment adviser, paying staff and for office space, deal sourcing and due diligence, as well as other expenses.

exemption from SEC registration when entering the SBIC program. Second, the legislation helps advisers to both private equity funds and SBICs by removing the SBIC capital, which is already regulated by the SBA, from the AUM calculation for SEC registration. Third, the legislation prevents the duplicative registration of SBICs by federal and state securities regulators and returns SBICs to their original sole regulator - SBA.

1) Eliminating the Barrier for Venture Funds to Utilize the SBIC Program

The new ERA regime for venture funds in Dodd-Frank failed to provide sufficient guidance to the SEC on how to treat dual advisers of both venture and SBIC funds. The Dodd-Frank Act states that the SEC cannot register advisers that "solely" advise SBIC funds. The SEC then applied the term "solely" to mean that if an adviser oversaw a single penny outside of SBIC fund assets, then duplicative regulation was triggered. This was not the Congressional intent of Dodd-Frank and serves no practical investor protection or public benefit. 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 with another venture fund, they are now required to 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 business investments. This legislation would allow venture fund advisers to remain ERAs if they choose also to advise an SBIC fund.

This provision is particularly important when it comes to encouraging VC fund advisers to enter the SBIC program. As part of the Obama Administration's "Start-Up America Initiative," in 2012, the SBA implemented a new Early-Stage SBIC program to promote innovation and job creation by encouraging private sector investment in job-creating early stage small businesses. The purpose of the program is to target a gap in investment for early-stage companies outside the traditional venture areas of California, Massachusetts, and New York. If a VC fund adviser chooses to utilize the Early-Stage SBIC program, under current law, they will lose their exemption from SEC registration and be subject to the cost and burden of SEC registration. Congressman Mick Mulvaney (R-SC) put it best at a hearing on the legislation last Congress when he described the issue, explaining that "If A, you don't have to register with the SEC, if B, you don't have to register with the SEC, but if A+B, you do have to register with the SEC." Clearly, such an approach to securities regulation doesn't make much sense, nor is it protecting many investors.

a) The Regulatory Contradiction Faced by Noro-Moseley Partners

One of SBIA's members, Noro-Moseley Partners (Noro-Moseley), is a venture fund investment adviser founded in 1983, and based in Atlanta, Georgia. The fund has seven employees. Noro-Moseley is now investing in its 7th fund and focuses its investments on venture and early growth stage healthcare and IT companies across the United States. Noro-Moseley currently has four funds still operating, one small VC fund in wind down, one VC fund with about $150 million in AUM, one Early-Stage SBIC, and a parallel VC fund with $110 million in AUM split between the two parallel funds, for a final tally of $260 million AUM. Noro-Moseley received its Early-Stage SBIC license in 2013, as one of the first VC funds entering this new SBIC program. When

entering the program, they were advised by their attorneys that the SEC was likely to provide relief from SEC registration due to this very issue. Unfortunately, the SEC declined to provide such relief, after initial positive conversations. As a result, Noro-Moseley, because they entered the SBIC program and lost their VC "solely" exemption, was forced to spend over $100,000 in initial costs to register with the SEC, plus $25,000-to-$50,000 for annual, ongoing compliance costs. These are costs and time that could be better spent seeking out VC investments and getting capital to small businesses. Also, Noro-Moseley, themselves, have expressed doubt about whether they would have entered the SBIC program had they known they would be required to register with the SEC and incur the related compliance costs and burdens.

2) Exempting SBIC Capital from the SEC AUM Registration Threshold

Advisers that advise both SBIC funds and private funds, such as have to include the AUM of the SBIC fund in addition to the private fund they manage in calculating the threshold for SEC registration. This legislation would exempt already federally regulated SBIC capital from being included in the triggering calculation for SEC registration for those advisers jointly advising both SBIC and other small private funds, and prevent these advisers from being penalized for raising a large SBIC fund specifically formed to invest in domestic small businesses.

a) The Impact on Spell Capital Partners

In addition to Merion, one of SBIA's members, Spell Capital Partners, would be directly helped by this provision in the SBIC Advisers Relief Act. Spell Capital's focus is on staying small and investing in small, entrepreneurial companies primarily in the manufacturing space. The firm currently employs a staff of 16 people in Minneapolis, Minnesota. Spell Capital's SBIC fund has been examined twice by the SBA since they were licensed in March 2013. Their funds have created thousands of jobs and invested in many companies since the firm was formed over 25 years ago. Currently, Spell Capital has 21 companies in their portfolio that they have invested in debt, equity, or, in some cases, both.

Spell advises three funds: Fund III, a private fund with about $39 million AUM; Fund IV with $46 million AUM; and an SBIC with $86.6 million AUM. Under the current SEC AUM calculation, they are required to register with the Commission as a result of having over $171 million AUM with the SBIC capital included. All of their investors are accredited investors and include high net worth individuals, banks, insurance companies, family offices, and foundations. Spell Capital will soon be filing a Form ADV to register with the Commission and expect their initial registration costs, calculated in both time and financial costs, to be $75,000-to-$100,000, with annual estimated ongoing compliance costs to be $50,000-to-$80,000.

The SBIC capital Spell is advising is thoroughly examined and regulated by the SBA, while the private capital in their non-SBIC funds will still continue to be looked at by the applicable SEC or state regulator. The key here is that with this bill, all of the capital Spell oversees and their investment adviser will continue to be regulated in full by one sole regulator, rather than the SEC regulating the private and SBIC capital. This legislation will save the firm immense compliance- and time-based costs that will allow Spell Capital to focus on what they do best – investing in

innovative small companies in the manufacturing sector, which often do not have sufficient access to capital.

3) Duplicative Registration of SBICs

The authors of Dodd-Frank specifically prevented the SEC from registering advisers that solely advise SBIC funds, recognizing the need for only one regulator and identifying the lower pain thresholds of small business investors. However, this section of Dodd- Frank inadvertently opened up SBIC funds, regulated by the SBA since 1958, to duplicative regulation because it was silent on the concept of state regulation of federally licensed SBIC funds. Duplicative regulation at the federal level was considered and rejected. Unfortunately, it was erroneously assumed that this issue was settled, but state regulation of federally licensed SBICs was not expressly prohibited. Funds now have confusion, costs, and doubled regulatory burdens. A small number of state securities regulators have reserved the right to interpret Dodd-Frank as giving them authority to regulate the advisers of federally licensed SBICs which have less than $100 million in AUM. The SBIC Advisers Relief Act would return SBIC advisers solely advising SBIC funds below $100 million in AUM to federal oversight by their licensing agency, the SBA. States would still have authority to register advisers not solely advising SBICs.

a) Duplicative Regulation by State and Federal Governments

Another one of SBIA's members, Diamond State Ventures (Diamond State), a fund named as the SBIC of the Year in 2011 by the SBA, recently was impacted by this very issue in the state of Arkansas. Diamond State, based in Little Rock, has been involved in the SBIC program since 1999, and the team has successfully been licensed three times by the SBA to operate an SBIC, most recently in February 2014. The fund's investors are predominately banks (70%), along with pension funds, private foundations, and a few high net worth individuals. Diamond State is the sole SBIC in the state of Arkansas, a state underserved by private equity and small business investing. Diamond State has three employees. Since inception, Diamond State has made over 18 investments in small businesses located in the state of Arkansas, employing over 2,300 Arkansans and investing over $40 million in Arkansas companies. Diamond State is currently under the $100 million AUM threshold that would be required to avoid state registration. If they were above this threshold, they would be exempt from SEC registration and would remain solely regulated by the SBA.

Because of the murkiness of the securities laws across the states, when Diamond State raised their most recent federally licensed SBIC fund in January 2014, they consulted with the Arkansas Securities Commissioner to make sure they were staying on the straight and narrow. They were informed that because Arkansas did not have a "private adviser" exemption, they would be required to register with the state regulator[3], in addition to the regulation and oversight they already receive by the SBA. It is important to note that the SBA has conducted an on-site examination of Diamond State every year since 1999, and conducted a rigorous licensing review

[3] Note: There is no exemption for in-state investment advisers to private funds in the state of Arkansas: http://www.nasaa.org/industry-resources/investment-advisers/ia-switch-resources/state-investment-adviser-registration-information/arkansas/

of the entire team each time they have been licensed by the SBA. In the midst of determining whether registration applied to Diamond State, the fund spent over $50,000 in legal fees trying to figure out how to apply the state securities regulations to their federally licensed SBIC fund, which were designed to apply to brokerage firms and retail investment advisers, not advisers to private equity funds or SBICs. Further costs in time and money were imposed as the then two-person team spent the majority of their time for over three months working on this regulatory issue, rather than out searching for potential small business investments. In the end, the fund will have spent thousands of dollars to prepare for a potential exam with an Arkansas examiner who likely will have little to no understanding or experience with the regulations and requirements of the federal SBIC program or how this type of firm is required to operate.

There are inconsistent and confusing standards across the states. Some of the states that do not have an exemption have expressed to SBICs in their state that they recognize the existing SBIC registration exemption in Dodd-Frank and the legislative intent to avoid duplicative regulation so they don't need to formally register at the state level. Given that these states have had since July 2010 (when the investment adviser switch implementation began[4]) to update their laws, it seems unlikely they are planning on updating them in the near future. Moreover, many states that do exempt registration for SBIC funds over $100 million AUM under a "federally covered" adviser section of their state securities laws end up forcing the funds to enter a different regime at the state level because, technically, those funds are not registered with the SEC due to their SEC exemption in Dodd-Frank. This illustrates the immense confusion about the silence on this issue in Dodd-Frank and promotes significant regulatory uncertainty for funds. Congress intended for the SBA to be the sole regulator of SBICs, but did not make that clear in the drafting of the statute. This bill will provide the technical correction needed to provide clarity and consistency.

IV. SBICs Are Heavily Regulated by the SBA

SBICs are heavily regulated and closely supervised by SBA. This review and oversight starts before an applicant is permitted to file a formal license application with SBA and continues until such time as that license is surrendered or revoked. SBIC management undergoes an extensive background check prior to licensing. The regulatory regime has similarities to, but is also much more intense than, that applicable to other private funds that are regulated by the SEC. It is important to note that in contrast to the SEC and state securities regulators, the SBA reviews not only the investment adviser operations, it evaluates and vets the entire management team of the investment adviser *and* examines the operations and investments of the fund entity as well. Ultimately, if the SBA feels that an SBIC is being operated poorly, it can step in and force that fund into SBA liquidation – something that is not the case with a private fund regulated by the SEC or a state securities regulator.

The SBIC regulatory regime consists of an in-depth examination and review of the fund's management prior to licensing covering stringent investment rules, operational requirements, recordkeeping, reporting, examinations, conflict of interest rules, and other significant

[4] *The IA Switch, a Successful Collaboration to Enhance Investor Protection*, North American Securities Administrators Association, May 2013, p. 11, *available at:* http://www.nasaa.org/wp-content/uploads/2011/08/IA-Switch-Report.pdf

requirements. For a more in-depth understanding of the rigorous regulatory regime imposed on SBIC funds, we have provided a helpful addendum to this testimony.

V. SBIA Recommendation: Pass the SBIC Advisers Relief Act

Due to the tailored nature of this legislation, the necessity to clarify the elements of Dodd-Frank to eliminate duplicative regulation, and the fact that all of these funds will continue to be subject to regulation once this legislation passes, Congress and this Committee should act swiftly to pass the SBIC Advisers Relief Act.

VI. Other Legislation That Would Reduce Regulatory Burdens in Deal Sourcing and Capital Raising, Resulting In Improved Access to Capital

A number of other pieces of legislation under review at this hearing would be beneficial to SBIA's members. These include the Small Business Mergers, Acquisitions, Sales and Brokerage Simplification Act of 2015 (H.R. 686), the Disclosure Modernization and Simplification Act of 2015 (H.R. 1525), and the Improving Access to Capital for Emerging Growth Companies Act (H.R. 1659). These bills are very helpful in streamlining the regulatory process that companies and certain funds have to surmount in order to be available for small and mid-sized businesses to access capital.

A. M&A Broker Legislation (H.R. 686)

SBICs, as well as SBIA's other members, BDCs and traditional lower middle market private equity funds, often utilize M&A brokers to help match together smaller companies with capital providers. These brokers are often critical to smaller companies that might not be based in urban areas with easy access to the capital providers, and may not have a direct line of communication to a lender. M&A brokers currently operate in a difficult arena, in the mix between state and federal securities laws. While a recent SEC no-action letter provided some relief to these brokers[5], this legislation is needed to provide a permanent safe harbor for these brokers, and subsequent protection from heavy cost and regulatory burden associated with broker-dealer registration.

The recent SEC no-action relief is limited to specific circumstances, while passing H.R. 686 would contribute to a broader exemption for M&A brokers at the federal level. Providing relief for these M&A brokers will bolster middle market and lower-middle market M&A, which will lower costs for small and mid-size companies seeking to unlock their value through a sale or engaging in a financing transaction for future growth. While SBIA would prefer to address the problem of disparate regulatory and registration regimes in state blue sky laws, which H.R. 686 does not address, we believe this bill is a step in the right direction.

[5] M&A Brokers, January 31, 2014, available on the SEC's web site at https://www.sec.gov/divisions/marketreg/mr-noaction/2014/ma-brokers-013114.pdf

B. Disclosure Modernization & Simplification Act and the Improving Access to Capital for Emerging Growth Companies Act

SBIA represents a number of BDCs, which are reporting companies that would benefit from improved disclosure reform at the SEC. While the thrust of SBIA's effort has been involved in making a number of reforms in BDC Modernization legislation, we believe H.R. 1525 helps reduce some of the regulatory burdens and costs incurred by not only BDCs, but other reporting companies. H.R. 1525 directs the Commission to make certain common-sense changes to help reporting companies such as BDCs, and eliminate duplicative filing requirements and unnecessary paperwork. SBIA also supports the SEC studying how to modernize and simplify disclosure to ensure investors are receiving information that is actually relevant, clear, and material. This type of study is far overdue, and necessary to ensure the disclosure regime is updated for the 21st century investor.

SBIA member BDCs are eligible for Emerging Growth Company (EGC) status and almost all newly formed BDCs have elected to be treated as EGCs, illustrating the attractiveness of this new creation in the JOBS Act, and how helpful EGC status is as a BDC moves towards an initial public offering (IPO). This legislation makes helpful changes to the SEC registration and disclosure requirements to help EGCs access the capital markets more quickly, and move efficiently to IPO.

Biography – Gayle G. Hughes, Partner, founder of Merion Investment Partners and a former member of the Mellon Growth Finance team at Mellon Bank. Ms. Hughes has over 30 years lending experience and has spent over half of her career working with entrepreneurial firms providing growth capital via leveraged cash flow and mezzanine debt. Ms. Hughes was previously an investment banker at Marine Midland raising debt and equity capital for growing companies.

Ms. Hughes earned an AB Economic/Business at Lafayette College. Ms. Hughes has served through the years and currently participates as a Board member or in an observer role for certain of the Merion portfolio companies. She also serves on the Board of the Small Business Investor Alliance ("SBIA") and is a former President of the Northeast Region of the SBIA.

Addendum I to Testimony

Basic Overview of the Regulatory Regime for Small Business Investment Companies

A Small Business Investment Company ("***SBIC***") is a privately owned, managed, and operated equity investment fund that makes long-term investments in U.S. small businesses and is

licensed by the United States Small Business Administration ("***SBA***"). The SBA program is established under the statutory authority in the Small Business Investment Act of 1958, as amended, and SBA regulations promulgated thereunder. A principal reason to seek an SBIC license is to gain access to financing (called "***Leverage***") provided by SBA. Banks often invest in SBICs to obtain credit under the Community Reinvestment Act (the Dodd-Frank Act and the Volker implementing regulations continue to permit these bank investments). Leverage is in the form of 10-year loans, with no amortization until maturity and with interest generally payable semi-annually. Current Leverage authorization levels are $3 billion per year. A licensed SBIC can obtain Leverage in an amount up to twice the SBIC's private capital, but most stay well below this level. SBIC Leverage is provided at a zero subsidy rate, meaning there is no cost to the taxpayer. Since its establishment in 1958, the SBIC program has provided over $63 billion of funding to U.S. small businesses.

SBICs are heavily regulated and closely supervised by SBA. This review and oversight starts before an applicant is permitted to file a formal license application with SBA and continues until such time as the license is surrendered or revoked. SBIC management undergoes an extensive background check prior to licensing. The regulatory regime has similarities to, but is also much more intense than, that applicable to other private funds that are regulated by the Securities and Exchange Commission. The SBIC regulatory regime consists of an in-depth examination of the management, stringent investment rules, operational requirements, recordkeeping, reporting, examinations, conflict of interest rules, and other significant requirements. Below is an overview of the comprehensive regulatory and oversight environment applicable to SBICs.

Rigorous Licensing Process

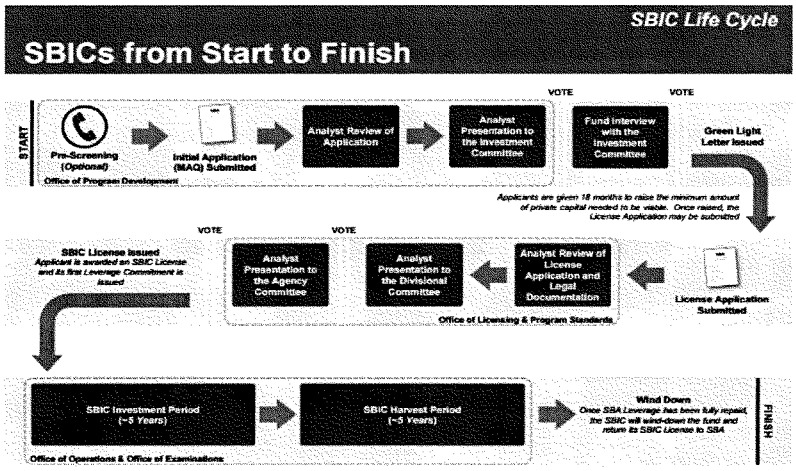
SBA uses a two-step licensing process for first time SBICs. In the first phase, an applicant completes and submits to SBA a form called a "Management Assessment Questionnaire ("***MAQ***"). This contains the elements of the applicant's business plan, as well as detailed information concerning the experience of each member of the team that will implement that business plan. SBA requires a minimum of two, substantially full time members of the management team, each with not less than five years of successful private investment experience at a decision-making level in the types of investments that the applicant proposes to make as an SBIC. The track record of successful applicants generally includes at least 10-15 investments with a reasonable number of completed realizations. SBA also considers how long and in what ways the management group has worked together. SBA views the track records of the managers and the cohesiveness of the management team of fundamental importance. No management team can be dominated by a single individual. The MAQ is reviewed by SBA's Investment Committee and, if the applicant appears qualified, the management team will be invited to SBA for an interview. After the interview, the applicant is either turned down or invited to file a formal application. The MAQ vetting process currently results in more than one-half of the initial applicants being turned down.

The formal license application contains additional information about the applicant and its management team, as well as organizational documents of applicant and its manager (usually a general partner). That application cannot be filed unless the applicant is able to show that it has

subscriptions and commitments from private investors of at least $15-20 million. An applicant must meet a diversity test between management and other investors and there must usually be at least three other investors investing at least 30% of the applicant's private capital.

SBA seeks to determine that that there is a quality management team that has a good chance of operating profitably and with the experience and capability to operate within the strict regulatory framework applicable to SBICs. The SBA examines the prospective SBIC management team for relevant investment experience; a realized track record of superior returns; a cohesive and strong management team culture; and an ability to manage cash flow to provide the assurance that the SBA Leverage will be repaid.

In addition to an exhaustive review of the team's track record, the SBA conducts a credit report and reference checks on each member of the team. An FBI background check is run on each to probe into any possible criminal histories. Lawsuits involving the management team members and their funds are examined. The SBA makes phone calls to check relationships with former investors, portfolio company officers, colleagues, and friends of each team member to determine the character of the team member, deal attribution, and verification of statements made in the application. Generally, this SBA review of the application takes a minimum of four months, but usually at least six. SBA's Office of General Counsel reviews the applicant's and its manager's organizational documents. Each side letter agreement between an applicant, its manager, and any investor of the applicant requires prior SBA approval. SBA requires that counsel to the applicant provide opinions to SBA covering formation, securities, and partnership tax issues. After the review is completed, a report and recommendation is made to SBA's Divisional Licensing Committee. If that Committee approves, the application is then reviewed by SBA's Agency Licensing Committee, consisting of SBA's most senior personnel. If the Agency Committee approves, the license is sent to the SBA Administrator for signature.



SBIC Regulations Class

All prospective team members of an SBIC licensee are required to attend a class on SBIC regulations conducted by SBA prior to the license being granted. The training class is a day-long session in Washington, D.C., intended to provide fund managers with an understanding of and insight into important SBIC regulations. Some of the topics covered at the training class include: 1) conflicts of interest rules for SBICs; 2) the types of companies in which an SBIC can invest and the types of businesses in which an SBIC is prohibited from investing; 3) the investment rules applicable to an SBIC, for example, the "cost of money" regulation which caps the amount of interest and other charges, control rules, and how idle funds must be invested; 4) reporting requirements, including portfolio valuation reports and capital certifications; 5) the annual SBA examination process and fees; and 6) distribution rules applicable to SBICs.

Office of SBIC Operations

Once licensed, SBA oversight continues to ensure that the SBIC operates within the regulatory framework and does not put at risk repayment of the Leverage that the SBIC draws. Each SBIC is assigned an SBA analyst and an SBA area chief. These SBA personnel have oversight responsibility by interacting with the SBIC, monitoring it, and reviewing its portfolio and reports. For the 300 SBICs in the program, there are approximately 13 analysts at the SBA, each assigned to approximately 23 SBICs. Analysts are responsible for collecting and analyzing reports from their SBICs, reviewing any potential regulatory violations, and providing assistance to SBICs to help in understanding and complying with the regulations. An SBIC usually meets once a year in person with its analyst to review the SBIC's financial performance and regulatory compliance history.

SBIC Recordkeeping Requirements

SBICs must establish and maintain accounting records using SBA's standard chart of accounts for licensees. SBICs must keep on-site all accounting and other financial records; all minutes of meetings of directors, stockholders, executive committees, partners, or other officials; and all documents and supporting materials related to its business transactions, except for any items held by a custodian. All documents must be preserved in accordance with statutory and regulatory guidelines.[6]

SBIC Reporting Requirements

The reporting process allows the SBA to ensure SBICs are complying with the comprehensive regulatory and financial responsibilities. Below are the major reporting requirements for SBICs:

- Requirement for Licensees to file financial statements with SBA (Form 468) – Once licensed, each SBIC is required to file with the SBA an annual financial report which includes an audit by an SBA-approved independent public accountant. Form 468 must be prepared in accordance with SBA's Accounting Standards and Financial Reporting Requirements for Small Business Investment Companies.[7]
- Requirement to file portfolio financing reports (SBA Form 1031) – SBICs are required to file a portfolio financing report within 30 days of the closing date for each financing of a small business.[8]
- Requirement to report portfolio valuations to the SBA – SBICs are required to file the value of its loans and investments within 90 days of the end of the fiscal year in the case of annual valuations and within 30 days following the close of other reporting periods. SBICs must also report any material adverse changes in valuations at least quarterly (within 30 days following the close of the quarter).[9] Valuations of an SBIC's portfolio companies must be in accordance with required SBA valuation guidelines.
- Other items required to be filed by licensee with SBA – SBICs are required to file copies of reports provided to investors, documents filed with the Securities and Exchange Commission, and documents pertaining to litigation or other legal proceedings, including criminal charges against any person who was required by the SBA to complete a personal history statement in connection with the SBIC's license.[10]
- A Capital Certificate is filed from time to time as the SBIC draws funds from its investors. These certificates permit SBA to monitor the SBIC's "Regulatory Capital," a fundamental concept in ensuring the SBIC is not capitally impaired[11], is charging a

[6] 13 CFR Section 107.600
[7] 13 CFR Section 107.630
[8] 13 CFR Section 107.640
[9] 13 CFR Section 107.650
[10] 13 CFR Section 107.660
[11] 13 CFR Sections 107.1830-1850

management fee within SBA guidelines[12], and investments in any one portfolio and its affiliates do not exceed the permitted limits.[13]

SBIC Examinations

SBA examinations are regulatory compliance audits. [14] While required by law to be performed at least every two years, in practice, they are performed much more frequently. During Fiscal Year 2013, audits of SBICs using Leverage were conducted every 11.6 months and audits for non-leveraged funds (no credit risk to the U.S. Government) were conducted every 16.5 months. Examiners look to see that the SBICs' investments were made in accordance with the regulations. If not, the examiner makes a "finding" which is then forwarded to the Office of Operations. That Office reviews the exam report and the "finding" and determines if a violation has occurred. Oftentimes, the finding/violation is resolved by changing the terms of the investment to remove the offending term. The SBA assesses fees for the examinations.[15] A base fee is assessed based on the total assets of the SBIC and adjustments to the base fee are made if the SBIC has no outstanding regulatory violations at the time of the exam.

SBIC Conflicts of Interest Rules

Since 1958, the SBIC Office of Operations ensures that SBICs comply with applicable conflict of interest rules.[16] If an SBIC is found in violation of any conflict of interest rule, a number of options are available: the fund can disinvest; the fund can change the terms of the investment to address the conflict issue; additional leverage could be denied; or the fund could potentially be transferred to liquidation. Below are examples of some of the conflict of interest rules governing SBICs:

- SBICs may not provide financing to an "associate." The precise definition of an associate of an SBIC is defined in Section 107.50. It includes: a) an officer, director, employee, or agent of a Corporate Licensee; b) a control person, employee, or agent of a partnership licensee; c) an investment adviser/manager of any licensee, including any person who contracts with a control person of a partnership licensee to be the investment adviser/manager of such licensee; d) any person regularly serving a licensee on retainer in the capacity of attorney at law; or e) any person who owns or controls at least 10 percent of any class of stock of a licensee.
- SBICs may not finance the associate of another SBIC while the other SBIC finances the first SBIC's associate.
- SBICs may not borrow from a portfolio company, any of its officers, directors, or owners, or their close relatives.

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[12] 13 CFR Section 107.510
[13] 13 CFR Section 107.740
[14] 13CFR Section 107.690
[15] 13 CFR Section 107.692
[16] 13 CFR Section 107.730

- SBICs may not provide financing to a small business for the purpose of discharging an obligation to the SBIC's associate or to free other funds for that purpose.
- SBICs may not provide financing to a small business for the purpose of purchasing property from the SBIC's associate.
- Co-investing with associates generally requires prior SBA approval to demonstrate that the terms and conditions are fair and equitable to the SBIC.
- SBA approval is needed to designate an associate to serve as an officer or director of a portfolio company if the associate has more than a five percent equity interest in the portfolio company.
- An SBIC cannot self-deal to the prejudice of a small business in which the SBIC has invested, the SBIC, the SBIC's owners, or SBA.

Other SBIC Rules

The SBIC regulatory regime includes:

- Required certifications for each portfolio company financing that the SBIC enters into – SBICs must file the Size Status Declaration (Form 480) to certify that the small business fits within the SBA small business size standard; SBA Form 652 to certify the small business will not illegally discriminate; Form 1031(see SBIC Regulatory Requirements above); and certifications that the investment qualifies for use of specialized debenture Leverage, either LMI (low and moderate income) debentures or energy saving debentures. [17]
- Requirements to obtain information from portfolio concerns – SBICs are required to obtain information for initial financing decisions, including the financial statements, plans of operation, cash flow analyses, and other documents necessary to make the investment decision.[18]
- Changes in ownership, control, or structure of licensee – SBICs must get prior approval from the SBA for certain changes in the structure of the SBIC. These requirements are detailed in Section 107.400 – 107.475.
- Portfolio concentration limits (overline) – The current portfolio concentration limits place a 10% cap of the total capital in any single portfolio company. If an overline violation occurs, the fund will work with the SBA to take action by reducing its investment or disinvest in the portfolio company.[19]
- Terms of investment (maturities, rates, amortization, fees) – When making investments in small businesses, the financing terms must comply with applicable SBA investment regulations. Any investment in a small business must be for a minimum of one year and must be no longer than 20 years.[20] The maximum rate of amortization on loans and debt securities cannot be amortized faster than straight line for the first year. The small

[17] CFR Section 107.610
[18] CFR Section 107.620
[19] CFR Section 107.740
[20] CFR Section 107.830 and Section 107.840

business cannot be required to redeem equity securities earlier than one year from the date of closing unless it meets certain conditions, and the redemption price for equity security investments must conform to specified rules.[21] The SBA defines "cost of money" as the interest rate ceiling and limitations on fees charged to small businesses. These regulations are designed to protect the small businesses from overreaching.[22]

- Any transfer of an ownership interest in an SBIC requires pre-approval by SBA.
- SBICs generally must clear any distribution made to its owners with SBA. Generally, SBICs can distribute net profits, but cannot reduce capital more than 2% in any year without prior SBA approval.[23]
- No new manager or officer of an SBIC may be appointed without prior SBA approval.[24]
- The organization documents of the SBIC and its manager cannot be amended without the prior consent of SBA.
- SBICs that draw Leverage cannot enter into secured lending arrangements with third parties.[25]
- A change of control of an SBIC requires prior SBA approval.[26]
- There are restrictions on common ownership and control of two or more SBICs, absent SBA approval.[27]
- SBA must approve the management agreement and the management fee that an SBIC with Leverage can pay and sets a cap on that fee.[28]
- SBA restricts the categories of expenses that the SBIC can pay.[29]

Referrals to the Office of Inspector General (OIG)

If any person believes an SBIC has operated outside the law, that person can refer the situation to the OIG. Portfolio companies are able to make these referrals. If the referral is made by a person outside the SBA, it is usually made directly to the Office of Inspector General. In many instances, a disgruntled portfolio company executive not happy with the decisions made by the SBIC raises the issue. Referrals from within the SBA are generally substantive. As a result of such referrals, some SBICs have had licenses revoked and their principals have faced criminal charges. In other instances, applications have been withdrawn due to inaccurate statements made by a principal.

SBIC Office of Liquidations

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[21] 13 CFR Section 107.850
[22] 13 CFR Section 107.855, Section 107.860, and Section 107.900
[23] 13 CFR Sections 107.1500-1590
[24] 13 CFR Section 107.160
[25] 13 CFR Sections 107.550-570
[26] 13 CFR Sections 107.400-430
[27] 13 CFR Section 107.460
[28] 13 CFR Section 107.510
[29] 13 CFR Section 107.520

SBICs that fail to comply with regulatory requirements, depending upon the seriousness of the violation, can be transferred to the Office of Liquidation. For an SBIC so transferred, SBA oversees the wind down and liquidation of the fund. A management-led wind down can be undertaken under SBA oversight if SBA determines that it is reasonably likely that SBA will fully recover all amounts owed to it (including repayment of Leverage) and there has not been any management malfeasance. Existing management remains in place, often with a reduced management fee, and an SBA-approved wind up plan must be followed. SBA also has the power to put an SBIC into court-supervised receivership. This alternative is often used where SBA believes that management should be removed, SBA perceives the likelihood of losses, and/or where suspicion exists of management malfeasance.

1100 H Street, N.W. Suite 1200 Washington, D.C. 20005 (202) 628-5055 **SBIA.org**

Shane Kovacs

Executive Vice President & Chief Financial Officer,
PTC Therapeutics, 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 and Reduce Regulatory Burdens

April 29, 2015

Executive Summary

- PTC Therapeutics (PTC) is a growing biotechnology company based in South Plainfield, NJ. The Biotechnology Industry Organization (BIO) represents PTC and more than 1,100 other innovative biotech companies, the vast majority of which are pre-revenue small businesses.
- PTC undertook a successful IPO in June 2013 using key provisions in the Jumpstart Our Business Startups (JOBS) Act. More than 140 biotech companies have gone public as emerging growth companies (EGCs) under the JOBS Act, a dramatic change from the constricted IPO environment prior to the law's enactment.
- A healthy public market is key to funding the search for innovative, next-generation medicines and maintaining the U.S. as a global leader in 21st century industries like biotechnology. BIO supports policies that *increase* the flow of capital to innovative small businesses and *decrease* capital diversions from the lab to unnecessary compliance burdens.
- BIO supports the Small Company Disclosure Simplification Act (H.R. 1965), which would exempt EGCs and certain low-revenue issuers from the costly eXtensible Business Reporting Language (XBRL) reporting requirement while requiring the SEC to study and improve the compliance mechanism. BIO believes that growing companies should not have to bear the costs of XBRL until it has been demonstrated to be cost effective and useful to investors.
- BIO supports the Disclosure Modernization and Simplification Act (H.R. 1525), which would require the SEC to review Regulation S-K in order to reduce the regulatory burden on small issuers and eliminate duplicative, outdated, and unnecessary compliance requirements.
- BIO supports the Small Company Simple Registration Act (H.R. 1723), which would allow smaller reporting companies (SRCs) to use forward incorporation by reference on Form S-1.
- BIO supports the Reforming Access for Investments in Startup Enterprises (RAISE) Act (H.R. 1839), which would enhance the secondary market for Regulation A+ offerings.
- BIO supports the Encouraging Employee Ownership Act (H.R. 1675), which would reduce the disclosure burden on firms that offer stock options to their employees.
- BIO supports the Improving Access to Capital for Emerging Growth Companies Act (H.R. 1659), which would broaden the impact of the JOBS Act's IPO On-Ramp.

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Testimony of Shane Kovacs

Good afternoon Chairman Garrett, Ranking Member Maloney, and Members of the Subcommittee. My name is Shane Kovacs, and I am the Executive Vice President, Chief Financial Officer, and Head of Corporate Development at PTC Therapeutics, Inc. (PTC). PTC is a growing biotechnology company located in South Plainfield, New Jersey. We have 250 employees in New Jersey – nearly double our headcount from when we went public two years ago. Our IPO was fueled by the vital capital formation provisions in the Jumpstart Our Business Startups (JOBS) Act, and I want to thank the Subcommittee for the part it played in enacting that game-changing law. I look forward to talking with you today about how the JOBS Act impacted the capital formation ecosystem for growing biotech companies and what steps Congress can take to build upon its success.

PTC, BIO, and the Impact of Innovation

From the beginning, PTC has been dedicated to the search for and discovery of treatments to address the unmet needs of patients suffering from devastating diseases. The company was founded in 1998 by our current CEO, Dr. Stuart Peltz, who was focused on developing an RNA biology platform to combat ultra-rare genetic diseases. We currently have three late-stage clinical programs, focused on treating Duchenne muscular dystrophy, cystic fibrosis, and spinal muscular atrophy. These rare conditions are extremely debilitating, particularly in children, and patients do not currently have any viable treatment options. Our programs are designed to improve the lives of patients and their families – a mission that our company believes is core to its existence.

PTC's dedication to scientific advancement as a means to save lives and help patients is not unique in the biotech industry. The Biotechnology Industry Organization (BIO), of which PTC is a member and on whose Board our CEO serves, represents over 1,100 companies like PTC that are driving the search for cures and breakthrough medicines. The vast majority of BIO's members are small businesses. These emerging innovators are laser-focused on a targeted handful of product candidates, and have a lean staff comprised mostly of scientists and clinicians working to advance the next generation of medicines. The scientific potential of this work is astounding – modern science has given us the keys to unlock the secrets to curing and treating illnesses like cancer, diabetes, epilepsy, multiple sclerosis, cystic fibrosis, Alzheimer's, and HIV/AIDS. Millions of patients suffer from these debilitating diseases across the country and around the world, and biotech innovators are working hard every day to save and improve their lives.

In addition to the life-changing impact that groundbreaking R&D can have on patients and their families, emerging biotech innovators are also key economic drivers. Small biotechs like PTC support nearly 8 million jobs nationwide. Further, these are high-quality, high-paying jobs – the average biotech salary is over $88,000 annually, and compensation regularly tops $100,000 in the drug development space. PTC's home state of New Jersey has seen the impact that a thriving biotech industry can have on a state's economy. The industry supports over 210,000 jobs in our state, contributing more than $33 billion to New Jersey's GDP. PTC has been the beneficiary of the world-class research institutions around the state, and our employees have gone on to work at the universities, healthcare foundations, pharmaceutical companies, and other emerging biotechs that make the Garden State a hotbed of innovation.

Supporting Biotech Capital Formation

New Jersey has seen the impact that federal policymaking can have on innovative industries like biotechnology. Since the passage of the JOBS Act, 12 New Jersey biotechs have gone public using provisions in the law. Other states have seen a similar effect – over 140 biotechs have gone through with an IPO in the three years since the JOBS Act was enacted. To put that in perspective, the three years prior to the JOBS Act saw fewer than 40 biotech IPOs. Further, the JOBS Act has allowed many companies to go public earlier in their development timeline. The last three years have seen 25 IPOs by biotechs in the earliest stages of research (pre-clinical R&D and Phase I clinical trials), compared to just one pre-clinical or Phase I IPO in the five years before the JOBS Act.

Biotech investment is riskiest at the earlier stages of development – scientists discover thousands of compounds for every one that makes it through the FDA approval process – but early-stage innovation is critical to the health of the biotech industry and to patients waiting for breakthrough treatments and cures. The JOBS Act has allowed younger companies to access public financing, driving capital to early-stage research that holds the potential to lead to the next generation of innovative medicines. It is clear that smart policymaking can have an impact on the capital formation ecosystem for innovative companies, and I am thankful that the Subcommittee is once again taking steps to support the growth of America's small businesses.

The JOBS Act has been so successful in the biotech industry because it represents a perfect balance of capital formation incentives and appropriately tailored regulations. This important law allows enhanced access to investors, increasing the capital potential of a public offering, and then reduces the regulatory burden on emerging growth companies, decreasing the amount of capital diverted from R&D. This one-two punch is critical for biotech innovators and has increased the viability of the public market for growth-stage businesses looking to fund their capital-intensive development programs.

For small biotech companies, there are two main roadblocks to growth – the complexity of advanced science and the high costs of breakthrough research. The science of saving lives is complicated, and policymaking can't make genetic targeting or protein modification any less difficult. On the other hand, policymaking can certainly make it easier to fund the research and clinical trials necessary to discover and develop a life-saving medicine.

It can take more than a decade and cost over $1 billion to bring a single groundbreaking treatment from laboratory bench to hospital bedside. At PTC, our total spend over the course of 17 years is over $800 million and we are *just now* on the precipice of our first FDA-approved product reaching patients in the U.S. To complicate matters even further, the entire biotech development timeline is undertaken without the benefit of product revenue. PTC had never taken in a dollar in product revenue before our Duchenne treatment was approved in Europe last year. Early-stage biotech companies do not have the luxury of using the sale of one product to finance the development of another. Rather, the entire cost of drug development is borne by external investors.

Because these pre-revenue small businesses utilize only investment dollars to fund their work, they place a high value on policies that incentivize investment in innovation and prioritize resource efficiency. Any policy that increases the flow of innovation capital to emerging companies could lead to funding for a new life-saving medicine – while any policy that diverts capital to unnecessary and costly regulatory burdens could lead to the same treatment being left on the laboratory shelf. I applaud the Subcommittee for taking steps to incentivize capital formation by considering legislation that will make it easier to access

innovation capital and preserve that capital by reducing the regulatory burden on biotech small businesses.

H.R. 1525, the Disclosure Modernization and Simplification Act

One bill being considered by the Subcommittee, Chairman Garrett's Disclosure Modernization and Simplification Act (H.R. 1525), provides a valuable way of looking at America's current reporting regime for public companies. This legislation would direct the SEC to review and revise Regulation S-K to reduce the regulatory burden on smaller issuers and to eliminate compliance requirements that are duplicative, overlapping, outdated, or unnecessary. This commonsense directive takes aim at the one-size-fits-all nature of much of the public company reporting regime. By directing the SEC to specifically emphasize a flexible approach that scales or eliminates burdensome disclosures, this bill would slow the damaging diversion of capital from science to compliance that many of these rules represent.

The spirit of this legislation should guide how Congress and the SEC approach *all* regulatory requirements for smaller issuers. Forcing small businesses to file the same reports as multinational corporations represents a significant cost burden that can stymie the growth of an early-stage innovator – without providing additional benefits to investors. The Disclosure Modernization and Simplification Act specifically requires the SEC to ensure that all companies, large and small, continue to provide "all material information" to investors – a standard that BIO strongly supports. For emerging biotechs like PTC, an informed investor is a good one. In fact, the testing-the-waters process created by the JOBS Act has been so successful for the biotech industry because it allows companies a platform to disseminate *more* and *more detailed* information to potential investors. But the information that these investors want and need does not always align with what is required by the SEC. Investors find value in biotech companies by understanding scientific milestones and clinical trial progress – not financial disclosures that simply show a decade-plus of R&D expenses. And yet small, pre-revenue biotechs are often required to file the same reports as revenue-generating, profitable corporate behemoths. Other industries surely face their own unique circumstances, and many small businesses across all sectors of the economy endure the cost burdens of overregulation – yet a blanket one-size-fits-all approach prevails.

H.R. 1965, the Small Company Disclosure Simplification Act

A key example of the pervasive one-size-fits-all approach to public company reporting is the eXtensible Business Reporting Language (XBRL) compliance regime. As it currently stands, the XBRL reporting requirement is the definition of a costly regulatory burden that diverts capital from science to compliance – without a corresponding benefit to the company or its investors.

From a financial standpoint, there are three key data points that biotech investors need to understand: 1.) how much cash the company has on hand, 2.) what the company's cash burn rate is, and 3.) how much time that cash will buy the company until it needs to conduct another offering. Outside of those high-level metrics – none of which are the true focus or purpose of XBRL – investors should spend their time learning as much as they can about the company's science, the diseases it is treating, the patient population, the FDA approval pathway, and a hundred other variables that will *actually* determine the company's ultimate success or failure.

Despite widespread knowledge of what information impacts biotech investment decisions, all public companies – regardless of size – are required to provide their financial statements in

the XBRL interactive data format. XBRL "tags" certain data points in an issuer's filing statement and exports them in a standardized layout. The ostensible goal of XBRL is to make financial data comparable across issuers, but it falls prey to the one-size-fits-all problem that inflicts so many reporting requirements. The data that is supposedly comparable is heavily weighted toward traditional metrics that might be useful to an investor evaluating profitable multinational corporations – but that provide little to no insight into the health of an emerging, pre-revenue biotech. Investors largely realize this shortcoming of XBRL and thus do not utilize XBRL reports to evaluate emerging companies. Yet every single public company faces an identical XBRL compliance requirement.

In addition to failing to provide useful information for investors, XBRL reporting is very costly for resource-constrained small businesses. As its name implies, XBRL is actually its own computing language – one that requires specific expertise outside the bounds of traditional financial or accounting training. Companies need experts in the XBRL language to properly file the appropriate reports, so we must turn to external contractors to complete our XBRL filings. The cost of an external XBRL contractor is significant for an emerging company, reducing the capital available for more vital functions like research and development. At PTC, we spend over $50,000 annually on XBRL compliance. The capital we spend on XBRL fees could go to support our clinical testing, but instead we pay for a report that investors do not want or need.

In addition to the high costs of XBRL, the compliance mechanism also puts time pressure on our team at the end of each fiscal year and quarter. Outsourcing to an XBRL expert requires that the internal team complete the traditional filing statement with enough time to spare for the external contractor to complete the XBRL process before everything is due to the SEC. The timeline for quarterly and annual filings is already condensed for small issuers because of our limited compliance staff, and reducing it by a week or more to give the XBRL consultants time to finalize the filing adds pressure on a company's finance team. Further, the risk of a misstatement (a risk which every small company CFO takes pains to minimize) increases as time is compressed and the number of people working with the data swells. Thus, the traditional filing statement must be perfect and complete (i.e., not in draft form and requiring zero future revisions) *before* it goes to out the door to begin the XBRL process. The time pressure that this puts on a small issuer is significant and burdensome.

The time and cost pressures of XBRL are substantial for an emerging innovator – yet, to reiterate, the resources poured into meeting the reporting requirement do not provide any benefit to small company investors. Before I joined PTC I worked at Credit Suisse for 12 years and I don't recall a single investor or potential partner clamoring for XBRL reports or other similar data. As CFO of PTC, I spend a great deal of time talking my investors through our company story, our regulatory pathway, and our clinical results – but I have never received a question about the data that are included in an XBRL report.

Because the costs of XBRL in its current form far outweigh its benefits, BIO and I strongly support the Small Company Disclosure Simplification Act (H.R. 1965), sponsored by Rep. Robert Hurt. This bill would broaden the IPO On-Ramp created by the JOBS Act by exempting emerging growth companies (EGCs) from the requirement to provide financial statements in the XBRL format. The IPO On-Ramp has been extremely beneficial for PTC and other emerging biotechs, allowing us five years to find our feet on the market and focus on growing our company before the full reporting regime kicks in at the dawn of year six. Adding XBRL to the list of regulatory requirements that small companies have an opportunity to ease into fits the spirit of the JOBS Act and would provide important regulatory relief for growing innovators.

Along with the EGC exemption from XBRL reporting, the Small Company Disclosure Simplification Act would also institute a temporary exemption for low-revenue companies while the SEC studies how to improve the compliance mechanism. I appreciate the need for transparency, and, as I have said, biotechs go to great lengths to keep their investors informed. If XBRL can be reformed to provide transparency without unreasonably burdening small companies, I support that goal. That's why I am encouraged that Rep. Hurt's bill gives the SEC the opportunity to study the existing XBRL regime and provides an opportunity for reform. Moving XBRL away from a one-size-fits-all approach while maintaining data transparency and recognizing the importance of resource efficiency at small companies could be an important step toward improving the regulatory framework for emerging businesses.

I applaud Rep. Hurt for introducing the Small Company Disclosure Simplification Act to give the SEC time to improve XBRL while providing temporary regulatory relief to emerging growth companies and low-revenue small businesses, and I encourage the Subcommittee to support this important legislation.

H.R. 1723, the Small Company Simple Registration Act

I applaud the Subcommittee for considering additional legislation that reconsiders the one-size-fits-all framework of so many rules and regulations that impact small companies. For example, Reps. Ann Wagner and Terri Sewell have introduced the Small Company Simple Registration Act (H.R. 1723), which would allow smaller reporting companies (SRCs) to use forward incorporation by reference on Form S-1. Filing Form S-1 in preparation for an IPO is an extraordinary undertaking – and it is very costly for a pre-revenue business. The inability to use forward incorporation by reference on this extremely complex form means that a small company must file amendments to its S-1 each quarter it is on file waiting to go public in order to update the relevant financial information. Using forward incorporation by reference would eliminate that cost burden for the smallest issuers.

BIO and I believe that the Small Company Simple Registration Act is an important first step toward reforming Form S-1. However, most biotechs do not qualify as SRCs because the high costs of conducting innovative research, as well as the strong valuations for innovative companies, mean that their public float exceeds the $75 million limit in the SRC definition. BIO and I believe that eligibility to use forward incorporation by reference should extend beyond SRCs to include EGCs. Connecting the Small Company Simple Registration Act with the IPO On-Ramp would build on the success of the JOBS Act and further reduce the cost burden for pre-revenue biotechs considering a public offering.

H.R. 1839, the Reforming Access for Investments in Startup Enterprises (RAISE) Act

In addition to the IPO On-Ramp provisions in Title I of the JOBS Act, BIO was also a strong supporter of the Regulation A reforms included in Title IV. BIO believes that the increased Regulation A+ offering limit of $50 million – a significant change from the $5 million limit under the previous Regulation A exemption – will provide a valuable fundraising option for capital-intensive biotech companies. The relative ease of conducting a Regulation A+ offering is extremely important to growing biotechs given their need to efficiently use investment capital, and the increased offering limit will better reflect the reality that groundbreaking research is a costly endeavor.

Rep. Patrick McHenry has introduced legislation, the RAISE Act (H.R. 1839), that I believe will further enhance Regulation A+ by ensuring that the legal framework at the SEC

supports the secondary market for the shares offered and sold in Regulation A+ offerings. Without enhanced liquidity on the secondary market, investors could be hesitant to participate in Regulation A+ offerings – but Rep. McHenry has taken the important step to codify the regulatory framework for the resale of restricted securities, enhancing the capital potential of a Regulation A+ offering and ensuring that Title IV of the JOBS Act will have its intended impact.

H.R. 1675, the Encouraging Employee Ownership Act

I am also pleased that Reps. Randy Hultgren and John Delaney have introduced the Encouraging Employee Ownership Act (H.R. 1675), which would reform SEC Rule 701 to allow a wider pool of companies to effectively compensate their employees. By reducing the disclosure burden on firms that offer stock options to their employees, the bill would support a valuable compensation practice that allows small businesses to hire the most highly skilled workers. BIO and I support an effective disclosure regime that preserves the ability of innovative biotechs to attract talented workers and compensate them competitively without incurring additional compliance burdens.

H.R. 1659, the Improving Access to Capital for Emerging Growth Companies Act

Similarly, the Subcommittee is considering the Improving Access to Capital for Emerging Growth Companies Act (H.R. 1659), introduced by Reps. Stephen Fincher and John Delaney. This bill would make technical changes to the IPO On-Ramp in the JOBS Act to ensure it is working as effectively as possible for a wide range of growing businesses. In particular, BIO and I applaud the provision in H.R. 1659 that would allow EGCs to use confidential filing when considering a follow-on offering. Confidential filing has been a key success point of the JOBS Act, allowing companies to time the market and ensure their IPO is as successful as possible. Confidential filing supported PTC's IPO, and I am encouraged that Reps. Fincher and Delaney are taking steps to enhance follow-on offerings as well.

Additional Capital Markets Enhancements

I am encouraged that the Subcommittee is taking proactive steps to enhance capital formation and reduce regulatory burdens for small businesses. BIO and I welcome efforts to support the search for innovation capital at growing companies, and we hope to work with the Subcommittee to enact certain additional reforms that will bolster the fundraising potential of emerging biotechs.

Sarbanes-Oxley and SEC Rule 12b-2

BIO urges Congress and the SEC to take a discerning look at any and all regulations that govern public company disclosures, with the goal of achieving a commonsense, appropriately tailored regulatory environment. For example, BIO supports adding a revenue component to the non-accelerated filer definition in SEC Rule 12b-2, which governs numerous regulatory requirements – including compliance with Section 404(b) of Sarbanes-Oxley (SOX), from which non-accelerated filers are exempt.

SOX Section 404(b) represents a significant cost burden for a pre-revenue company, costing up to $1 million annually – a large sum that comes directly from investment dollars intended for research yet does not offer much protection to investors. SOX is simply the most costly of a cadre of regulatory burdens that divert capital from the lab but fail to provide value to an emerging company or its investors.

Growing biotechs are uniquely harmed by Rule 12b-2's company classifications because the groupings are based on public float. The high cost of biotech research coupled with strong investor interest in life-saving medical advancements means that growing biotechs often have a high public float despite their simple corporate structure and lack of product revenue. Rule 12b-2's reliance on public float as a marker for size begs the question: what does a pre-revenue biotech company with a public float of $400 million truly have in common with a $400 million widget-maker? The biotech is highly valued because it is working toward a groundbreaking treatment that may, *years from now*, save millions of lives. The widget-maker, on the other hand, is highly valued because it is manufacturing millions of widgets *today*. These two companies have little in common beyond their valuations, yet are bound by the same disclosure regime.

BIO supports adding a revenue component to the non-accelerated filer definition in order to give the SEC more accurate company classifications and reduce the regulatory burden on growing businesses. By defining an issuer with annual product revenues below $100 million as a non-accelerated filer, a reformed Rule 12b-2 with a revenue test would more accurately reflect the nature of small public companies. BIO also believes that the $75 million public float ceiling for non-accelerated filers is outdated and does not reflect today's market – and thus should be increased to $250 million. These important reforms were included in the Rep. Michael Fitzpatrick's Fostering Innovation Act, which was approved by the Financial Services Committee in the 113th Congress.

Many growing biotechs, including PTC, have also felt the pressure of the public float ceiling included in the JOBS Act's IPO On-Ramp. Despite the common portrayal of Title I as a five-year On-Ramp, our five years are not actually guaranteed. If a growing company's public float spikes over $700 million during its first five years on the market – a distinct possibility for a biotech with promising science – it could lose its EGC status and the attendant benefits, including its SOX exemption. This leads to uncertainty and the possibility of an increased cost burden that would divert funds from the lab. Indeed, PTC is currently gearing up for SOX compliance despite the fact that we theoretically still have 3 years left in our IPO On-Ramp. I believe that Congress could strengthen Title I of the JOBS Act by providing certainty for EGCs and guaranteeing the IPO On-Ramp for a full five years.

SEC Office of Small Business Policy

BIO also supports efforts to expand the mission of the SEC Office of Small Business Policy to include an emphasis on capital formation. Currently, the only responsibility of the Office is to hold the annual Government-Business Forum on Small Business Capital Formation. BIO is an annual participant in the Forum, but we believe that the Office has far greater potential than such a singular focus. There are bright minds and hard workers staffing the Office – perhaps, at Congress's direction, they could undertake new efforts, in conjunction with the business community, to incentivize capital formation, create an effective disclosure regime, and support the growth of small public companies.

Public Company Accounting Oversight Board

Similarly, BIO believes that the Public Company Accounting Oversight Board (PCAOB) would benefit from an expanded voice from small businesses in its decision-making process. The Board already benefits from the expertise of the investment community via its Investor Advisory Group; BIO believes that emerging companies similarly have insights to offer, especially given the impact that the PCAOB's regulations have on small businesses. BIO would welcome enhanced dialogue between the business community and the PCAOB –

perhaps via a small business ombudsman – in an effort to ensure that investors' capital is spent effectively.

BIO and I applaud the Subcommittee for recognizing the important intersection of capital formation and commonsense regulation, and we look forward to working with the Subcommittee as it engages on these important issues.

Conclusion

The extraordinary success of the JOBS Act in the biotech industry means that the work of the Subcommittee has taken on increased import for emerging biotech companies. The search for capital in our industry is always ongoing – it does not end at the IPO. As such, I strongly support efforts by Congress and the SEC to enhance the capital formation ecosystem and incentivize funding for the next generation of breakthrough medicines.

In addition to capital *formation*, emerging biotechs like PTC put a high value on capital *efficiency*. Every dollar spent on unnecessary regulatory burdens is an investor dollar diverted from the lab. The decades-long development timeline associated with groundbreaking science means that most small biotechs will still be pre-revenue (and thus dependent entirely on investment capital) when their five-year JOBS Act On-Ramp expires. For many innovators, the dawn of year six on the public market will bring with it a new, costly compliance burden. BIO and I believe that a move away from the existing one-size-fits-all regulatory regime will support the growth of these companies beyond the IPO On-Ramp, incentivizing scientific advancement and sustaining small innovative businesses as they continue their efforts to bring life-saving treatments to patients who desperately need them.

I am thankful that Congress was able to pass the JOBS Act three years ago, which supported PTC's public offering, and I am hopeful that it will be able to enact further legislation – like the bills being considered today – that could support the search for breakthrough treatments at the next generation of emerging growth biotechs. I appreciate your dedication to these vital issues, and I look forward to supporting your work in any way I can.

Statement of the U.S. Chamber of Commerce

ON: Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens

TO: House Committee on Financial Services

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

DATE: April 29, 2015

1615 H Street NW | Washington, DC | 20062

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.

Chairman Garrett, Ranking Member Maloney, and members of the Capital Markets and Government Sponsored Enterprises Subcommittee: My name is Tom Quaadman, vice president of the Center for Capital Markets Competitiveness ("CCMC") at the U.S. Chamber of Commerce ("Chamber"). The Chamber is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector and region. I appreciate the opportunity to testify before the subcommittee today on behalf of the businesses that the Chamber represents.

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

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

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

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

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

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

5. The U.S. financial system is highly connected and what happens to one financing source causes spillover effects in other parts of the system. So for example, if excessive regulation restricts access to, or the operation of, the IPO and secondary markets for publicly traded companies, the resulting loss of liquidity will act as a disincentive to private equity and venture capital activity as well.

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

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

Over the past several years we have seen our capital markets lose efficiency with a resulting decline in the number of businesses becoming public companies, as well as a sharp drop in the number of public companies overall. Many reasons exist for these outcomes—the financial crisis, stale regulatory systems that fail to keep up with the needs of a 21st century economy and legislative and regulatory initiatives that are changing fundamental practices that have been in place for decades.

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

New research shows that the country's rate of new business creation has dropped by more than 30 percent during the recession and has been excruciatingly slow to bounce back. The consensus among economists is that young businesses—rather than small businesses in general—represent the most reliable, consistent source of job creation. Small business, historically, creates about two-thirds of our nation's net new jobs. Small firms employ almost half of the private sector workforce, and they make up about half of our nonfarm gross domestic product. They are a major source of both innovation and economic stability, not to mention opportunity for upward mobility.

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

II. Legislative Proposals

1. Swaps Data Repository and Clearinghouse Indemnification Act (H.R. 1847)

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

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

We support the bipartisan language from H.R. 1847, the Swap Data Repository and Clearinghouse Indemnification Correction act of 2015 an earlier version of which he House of Representatives passed in the 113th Congress by a vote of 420-2.

2. Holding Company Registration Threshold Equalization Act (H.R. 1334)

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

Regrettably, despite the clear intent of Congress, the SEC did not interpret the law so as to allow savings and loan holding companies to take advantage of the new thresholds. Savings and loans perform nearly identical functions as do banks and, since the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), are overseen by the same regulators. While there may have been historical reasons for a lending institution to structure itself as a savings and loan

as opposed to a bank, today there is essentially no difference between the operations or regulatory oversight of the two.

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

3. Small Business Mergers, Acquisitions, Sales and Brokerage Simplification Act (H.R. 686)

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

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

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

4. Improving Access to Capital for Emerging Growth Companies Act (H.R. 1659)

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

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

5. The SBIC Advisors Relief Act (H.R. 432)

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

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

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

This legislation passed the House of Representatives by voice vote during the 113th Congress.

6. The Disclosure Modernization and Simplification Act (H.R. 1525)

In the eight decades since the securities laws were enacted, public company disclosure requirements have increasingly expanded and more complex, as evidenced by the voluminous annual and quarterly reports filed today. A 2012 report by Ernst & Young estimated that the average number of pages in annual reports devoted to footnotes and Management's Discussion and Analysis ("MD&A") has quadrupled over the last 20 years. Should this trend continue, companies would be devoting roughly 500 pages to MD&A by the year 2032.[2]

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

And retail shareholders aren't alone. A recent study by Professor David Larcker found that 55% of institutional investors surveyed[3] felt the proxy was too long and 48% believe the proxy is too difficult to read and understand.

The Chamber has welcomed the efforts by SEC Chair White and SEC Corporation Finance Director Keith Higgins to start a project to address these long outstanding issues. Last year the Chamber released a report proposing several disclosures that are obsolete that should be removed or modified.[4] However, we are concerned that the SEC project is being delayed by inertia.

The Disclosure Modernization and Simplification Act would address this issue by requiring the SEC to eliminate any outdated, duplicative, or unnecessary and to further scale disclosure requirements for EGC's and other small issuers. We fully

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[2] Ernst & Young report can be found at:
http://www.ey.com/Publication/vwLUAssets/ToThePoint_BB2367_DisclosureOverload_21June2012/$FILE/TothePoint_BB2367_DisclosureOverload_21June2012.pdf

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

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

support this approach, as it would focus the SEC on some of the more noncontroversial items that could be addressed and ensure that our disclosure systems are modernized.

7. Small Company Disclosure Simplification Act (H.R. 1965)

This legislation would provide a temporary and optional exemption for small issuers from the eXtensible Business Reporting Language (XBRL) requirements administered by the SEC. While XBRL was created in order to move away from a paper-based system of financial disclosures, it remains a work in progress and has experienced a number of growing pains. As a result, it has proven to be yet another hurdle placed in front of growing businesses that are looking to gain full access to America's robust capital markets.

H.R. 1965 would allow the SEC to fix some of the deficiencies associated with XBRL. The optional exemption for emerging growth companies (EGCs) and small issuers appropriately grants company boards and their shareholders the ultimate authority to decide whether or not using XBRL is in the best long term interest of the company. This is preferable to a top-down mandate from the SEC for issuers of all sizes to comply with a system that is clearly facing a number of short-term issues.

Furthermore, Congress made it clear when the JOBS Act was passed the bifurcation of securities regulation can help promote capital formation for small companies. This is why Congress created an "on-ramp" in Title I of the JOBS Act and excluded EGCs from a number of onerous mandates that were inhibiting their ability to grow and create jobs. H.R. 1965 is consistent with this approach, and the Chamber supports its adoption.

8. Encouraging Employee Ownership Act of 2015 (H.R. 1675)

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

The 1988 rule adopted a threshold level of $5 million for Rule 701 securities sales, above which mandated disclosures are required that treat employee sales more like public offerings. Such disclosure of confidential financial information to the public could have deleterious consequences and raise the costs of such offerings for

private companies. Moreover, the current threshold—now nearly three decades old—does not account for the JOBS Act's 12(g) exemption. Modernizing the rule would therefore help the 12(g) provisions included in the JOBS Act to reach their full potential.

Importantly, H.R. 1675 also includes a provision that would index Rule 701 for inflation once the new threshold is enacted. The Chamber strongly supports this provision as it would help Rule 701 keep continuous pace with the growth and size of the American economy, and mitigate the chances that the exemption again becomes outdated in the future.

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

9. Small Company Simple Registration Act (H.R. 1723)

This legislation would allow smaller reporting companies to incorporate by reference on their S-1 registration statement any filings that are made after the date in which the S-1 becomes "effective." This would help reduce duplicative and unnecessary filing requirements on small issuers, while still maintaining important investor protection and disclosure requirements that are important to well-functioning capital markets.

It is worth noting that the provision in this bill has been included in past recommendations of the SEC's own Government-Business Forum on Small Business Capital Formation, held annually at SEC headquarters. Like many of the recommendations produced every year at the forum, the SEC has failed to act in order to modernize the S-1 and other registration statements, so Congress has an important role to play in here to help businesses gain access to the capital markets.

10. The Reforming Access for Investments in Startup Enterprises (RAISE) Act (H.R. 1839)

The Chamber commends Mr. McHenry for introducing this legislation, which would help foster a robust secondary market for the resale of restricted securities that were acquired in a private placement. While past court decisions have had the effect of allowing the resale of certain private offerings, restricted securities remain an illiquid market and could benefit from a modernization of current SEC rules.

While the JOBS Act took a number of steps to help companies go public, it also included a number of provisions that allow businesses to stay private for a longer period of time (e.g. by modernizing 12(g) shareholder thresholds). Because of this, it is important that Congress and the SEC take steps to ensure strong and liquid secondary markets for private companies. The RAISE Act is a step in that direction, and the Chamber fully supports its adoption.

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

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

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

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

12. A bill to amend the Securities Exchange Act of 1934 to require the SEC to refund or credit excess Section 31 payments

Under Section 31 Securities Exchange Act of 1934, self-regulatory organizations (SROs) and national securities exchanges are required to pay transaction-based fees to the SEC in order to defray the costs to the agency for overseeing and examining these bodies. Although the SEC makes at least annual adjustments to the Section 31 fee rate, entities need to do a fair bit of projecting what their responsibility will be for a given time period.

SROs and the national exchanges are therefore caught in a bit of a Catch-22 when it comes to Section 31 fees. If they underpay the required amount, they are subject to enforcement action by the SEC. If they overpay the amount, there is no way for them to be refunded or to have the overpayment amount credited against future payments.

This legislation would provide a degree of certainty for SROs and exchanges by allowing such overpayments to be credited against future Section 31 responsibilities. Since these payments are often passed on to the investing public, allowing for such credits would ultimately benefit investors who trade in the public markets. The Chamber fully supports this approach and commends the Subcommittee for including this legislation as part of today's hearing.

III. Need for Action

It should be remembered these bills are necessary because the SEC has been slow or unwilling to modernize these regulations in the past. While the SEC has a renewed focus, legislation is still needed to keep the regulators feet to the fire and prevent inertia from asserting itself. Regulatory inertia would mean that the problems will fester and American competiveness will fall even further behind.

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

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

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

IV. Conclusion

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

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

Building Success. Together.

James Ballentine
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Congressional Relations
and Political Affairs
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April 23, 2015

The Honorable Steve Womack
1119 Longworth House Office Building
Washington, D.C. 20515

Dear Representative Womack:

On behalf of the members of the American Bankers Association (ABA), I am writing to express our strong support for H.R. 1334, the Holding Company Registration Threshold Equalization Act introduced by you, Jim Himes (D-CT), Ann Wagner (R-MO) and John Delaney (D-MD).

This bipartisan legislation would extend to savings and loan holding companies (SLHCs) the Securities and Exchange Commission shareholder registration and deregistration thresholds enacted under the JOBS Act.

The JOBS Act did not expressly extend the new shareholder thresholds to savings and loan holding companies (SLHCs) as defined by the Home Owners Loan Act. However, Congress did not intend to treat SLHCs differently from bank and bank holding companies. H.R. 1334 would correct this oversight and extend the shareholder registration and deregistration requirements to SLHCs.

As you are aware, this bill passed the House last Congress by an overwhelming bipartisan vote of 417-4 and we look forward to its passage again in the 114th Congress.

We appreciate your leadership on this issue and we look forward to working with you on this measure.

Sincerely,

James C. Ballentine

cc: Members of the U.S. House of Representatives

AMERICANS
FOR FINANCIAL REFORM
ACCOUNTABILITY • FAIRNESS • SECURITY

Americans for Financial Reform
1629 K St NW, 10th Floor, Washington, DC, 20006
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April 29, 2015

Dear Representative,

On behalf of Americans for Financial Reform (AFR), we are writing to express our opposition to several of the bills under consideration in today's subcommittee hearing, as well as our support for HR 1847, the "Swaps Data Repository and Clearinghouse Indemnification Act".[1]

AFR opposes HR 686, the ""Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2015", HR 1317, "A bill to amend the Commodity Exchange Act and the Securities Exchange Act of 1934 to specify how clearing requirements apply to certain affiliate transactions", and HR 1965, "The Small Company Disclosure Simplification Act". Due to the number of bills included in today's hearing, we have not completed our review of all items of legislation included in the hearing. We may after further review express additional views on the other proposed bills under discussion today.

HR 1317 would expand the exemption to Dodd-Frank clearing requirements by making it easier for financial entities with commercial affiliates to take advantage of the exemption from Dodd-Frank clearing requirements. The requirement that standardized derivatives transactions be cleared through a central counterparty is a fundamental financial system safeguard established by the Dodd-Frank Act, and by loosening it HR 1317 would create additional risks to the financial system.

The Dodd-Frank Act already clearly exempts commercial entities using derivatives to hedge legitimate commercial risk from clearing requirements. However, financial entities can only qualify if they are hedging risk on behalf of an affiliated commercial company and are acting as the agent of the commercial affiliate. HR 1317 would remove these limitations and leave in place only a requirement that the financial entity is somehow hedging or mitigating the risks of a commercial affiliate. As many purely financial trades can be interpreted to somehow 'mitigate the risks' of the broader corporate group, including commercial affiliates, this limitation is vague and non-specific.

This seemingly technical change could have far-reaching implications. As the non-partisan Congressional Research Service stated in an analysis of this bill, it "could potentially allow large banks to trade swaps with other large banks and not be subject to the clearing or exchange-

[1] Americans for Financial Reform is a coalition of more than 200 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith based and business groups. A list of AFR member groups is available at http://ourfinancialsecurity.org/about/our-coalition/

trading requirements as long as one of the banks had a nonfinancial affiliate."[2] There are numerous major financial entities that have commercial affiliates and could claim that there was some relationship between their derivatives activities and mitigating risk for some commercial affiliate. For example, the Senate Permanent Subcommittee on Investigations has recently documented that the major Wall Street banks often combine commodity production and trading activities, and that these "financial companies often traded in both the physical and financial markets at the same time, with respect to the same commodities, frequently using the same traders on the same trading desk."[3] HR 1317 would significantly reduce the ability of the CFTC to police risk management for this kind of co-mingling of commercial and financial activities.

There are cases in which financial affiliates of commercial entities may genuinely be hedging the production-related risks of commercial affiliates but may not in a narrow sense be acting 'as an agent' of the commercial affiliate. Through administrative action, the CFTC has already permitted such affiliated 'central treasury units' (CTUs) to make use of the clearing exemption in a wide range of cases.[4] The agency has thus made clear that it is taking a broad interpretation of what it means to hedge 'on behalf of the [commercial affiliate] and as an agent', and is eager to accommodate legitimate hedging needs. But if this restriction were eliminated entirely, as this legislation would do, then the CFTC would be dramatically limited in its ability to address attempts by financial entities to evade risk management requirements by claiming that they were mitigating the risk of commercial affiliates, an evasion that would be invited by this legislation.

We oppose this legislation and believe statutory change is unnecessary. If Congress wishes to make some statutory change in this area, it should be limited to clarifying the CFTC's discretionary authority to accommodate the CTU model on a carefully controlled basis, and should incorporate the various controls that have been included in the CFTC's administrative actions in this area. There should be no general reduction in CFTC authority to manage this complex area of derivatives regulation.

HR 686 would eliminate SEC broker-dealer registration requirements for merger and acquisition brokers. While a much narrower version of this legislation could be acceptable, we believe that this legislation poses risks to investors and to the fair conduct of our financial markets.

As currently drafted, HR 686 has multiple flaws:

- It lacks needed investor protections such as provisions to prevent bad actors from taking advantage of exemptions from registration to evade enforcement of securities laws.[5]

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[2] Congressional Research Service, "CRS In Focus: HR 37 Derivatives Provision May Create Broader Exemption", January 26, 2015.
[3] United States Permanent Subcommittee on Investigations, "Wall Street Bank Involvement With Physical Commodities, Majority and Minority Staff Report", Permanent Subcommittee on Investigations, United States Senate, November 20, 2014.
[4] Commodity Futures Trading Commission, Division of Clearing And Risk, "No-Action Relief For Swaps Entered Into By Eligible Treasury Affiliates", CFTC No-Action Letter 13-22, June 14, 2013; Commodity Futures Trading Commission, Division of Clearing And Risk, "Further No-Action Relief For Swaps Entered Into By Eligible Treasury Affiliates", CFTC No-Action Letter 14-44, November 26, 2014.
[5] North American Securities Administrators Association, "NASAA Letter to Senators Manchin and Vitter Re S 1923", September 8, 2014

- The legislation applies the M&A broker exemption far too broadly, to any acquisition of a company with gross revenues of $250 million or less. This goes far beyond transactions involving the purchase of local small businesses, and would permit numerous deals involving companies of significant size to avoid broker-dealer oversight.

- The lack of an effective provision to prevent transfer to a shell company means that the broker could effectively also take control of the transferred company in a private-equity type transaction.

The potential application to private equity is concerning, as the exemption from broker-dealer registration would restrict the SEC in policing this complex area and interfere with ongoing SEC investigation of potential abuses in private equity involving unregistered broker-dealer activities.[6]

This legislation is also unnecessary, as the SEC has already taken administrative action to exempt merger and acquisition brokers from broker-dealer registration, while preserving capacity to enforce needed investor protections.[7]

Finally, we would also point out that numerous registered broker-dealers who comply fully with SEC broker-dealer conduct requirements are active in arranging deals to sell companies, and this overly broad legislation would expose them to competition from unregulated entities that would not have to comply with important investor protection requirements such as suitability standards. We believe this is inappropriate.

HR 1965 would exempt over 60% of publicly traded companies from requirements to file machine-readable financial statements. AFR opposes this legislation. By banning the SEC from requiring most companies in the market to file computer-readable financial data, this legislation would strike a serious blow against progress in bringing financial reporting into the 21st century. The legislation also directly contradicts recommendations from SEC staff and the SEC's Investor Advisory Committee which call on the agency to move to an open data disclosure system in order to benefit investors, issuers, and the public.[8]

Should Congress wish to address issues in the SEC's implementation of open data requirements, the answer is not to simply exempt the bulk of the market from any requirement to provide machine-readable data to investors. Instead, Congress should take steps that assist the SEC and the issuer community in moving data disclosure forward into the modern era of computerized,

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[6] Buccacio, Katherine, "Republicans Look to Ease PE Regulatory Burden", Private Equity Manager, January 13, 2015; Morgenson, Gretchen, "Private Equity's Free Pass", New York Times, September 27, 2014.
[7] Securities and Exchange Commission, "No-Action Letter Re M&A Brokers", January 31, 2014 [Revised February 4, 2014].
[8] Securities and Exchange Commission, "21st Century Disclosure Initiative. Toward Greater Transparency: Modernizing the Securities and Exchange Commission's Disclosure System", January 2009;
Securities and Exchange Commission Investor Advisory Committee, "Recommendations of the Investor as Owner Subcommittee Regarding the SEC and the Need for the Cost Effective Retrieval of Information by Investors", July 25, 2013.

machine-readable information. Such steps could significantly improve financial sector transparency.

HR 1847 would eliminate Dodd-Frank requirements that derivatives clearinghouses and data repositories indemnify the government for any litigation costs resulting from information sharing arrangements. AFR supports this legislation.

For some years AFR has been concerned with the slow pace at which domestic and international regulators are implementing derivatives data reporting mandates under the Dodd-Frank Act. The requirement that derivatives data be reported to regulators in a form that can be aggregated and used to measure total risk exposures across the financial system is an important part of the improved capacity to monitor systemic risk that should be created by new financial regulations. Clear, consistent, and usable derivatives data would be extremely beneficial to both banking and market regulators in controlling risk, and could create important indirect benefits for financial institutions themselves, many of which still face issues in their own internal systems for aggregating risk exposures.

Unfortunately, progress in derivatives data reporting has been slow, and some of the data collected does not appear to be in a form that can be aggregated. There are many reasons for this slow progress, but it is clear that the ability to share derivatives data between different national regulators and data repositories is crucial for effective data reporting. It appears that the indemnification requirements in Dodd-Frank are creating a barrier to such information sharing. The replacement of these indemnification requirements with a simpler confidentiality agreement, as proposed in HR 1847, would be beneficial in encouraging needed sharing of derivatives data between different jurisdictions and entities. We thus favor this legislation.

Thank you for the opportunity to express our views on this legislation. Should you have additional questions on this issue, please contact Marcus Stanley, AFR's Policy Director, at marcus@ourfinancialsecurity.org or 202-466-3672.

Sincerely,
Americans for Financial Reform

DTCC

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April 29, 2015

The Honorable Scott Garrett
Chairman, House Financial Services Subcommittee
on Capital Markets and Government Sponsored Enterprises
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Carolyn B. Maloney
Ranking Member, House Financial Services Subcommittee
on Capital Markets and Government Sponsored Enterprises
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Garrett and Ranking Member Maloney,

On behalf of The Depository Trust & Clearing Corporation ("DTCC"), I applaud the recent introduction of H.R. 1847, the *Swap Data Repository and Clearinghouse Indemnification Correction Act* by Representative Rick Crawford (R-AR), and the Subcommittee's consideration of the legislation today.

H.R. 1847 is a bipartisan piece of legislation that would eliminate the Dodd-Frank Wall Street Reform and Consumer Protection Act's ("Dodd-Frank") requirement for swap data repositories ("SDRs") to obtain indemnification agreements before sharing information with regulators. A legislative remedy is the only way to remove these provisions that threaten global information sharing and systemic risk oversight.

The indemnification requirements in Section 21(d) of the Commodity Exchange Act ("CEA") and Section 13(n)(5)(H) of the Securities Exchange Act of 1934, as amended by Dodd-Frank, require—prior to sharing information with various regulatory authorities[1]—that (i) registered SDRs receive a written agreement from each entity stating that the entity shall abide by certain confidentiality requirements relating to the information on swap transactions that is provided, and (ii) each entity must agree to indemnify the SDR and the Commodity Futures Trading Commission ("CFTC") or Securities and Exchange Commission ("SEC"), respectively, for any expenses arising from litigation relating to the information provided.

[1] Such regulatory authorities include U.S. prudential regulators, the Financial Stability Oversight Council, the Department of Justice, foreign financial supervisors (including foreign futures authorities), foreign central banks, and foreign ministries.

In practice, these provisions have proven to be unworkable. These requirements run counter to policies and procedures adopted by regulatory bodies globally to safeguard and share information, pose a significant barrier to the ability of regulators globally and within the U.S. to effectively utilize the transparency offered by SDRs, and may have the effect of precluding U.S. regulators from seeing data housed at non-U.S. repositories. It is important to note that these provisions also limit access to and sharing of data among U.S. authorities such as the CFTC, SEC, the Federal Reserve Bank, and the Office of Financial Research.

Concerns regarding global information sharing have been echoed by regulatory officials and policymakers globally. In an August 2013 report, the Committee on Payment and Settlement Systems and the Board of the International Organization of Securities Commissions highlighted that legal obstacles may preclude trade repositories from providing critical market data and encouraged the removal of legal obstacles or restrictions to enable effective and practical access to data.[2] During a February hearing this year before the House Agriculture Committee, CFTC Chairman Timothy Massad stated that removal of the indemnification provisions would facilitate the sharing of information and collaboration among regulators to monitor risk.[3] CFTC Commissioner J. Christopher Giancarlo and Commissioner Mark Wetjen also identified indemnification as a priority issue and expressed support for a legislative fix during an April hearing before the House Agriculture Subcommittee on Commodity Exchanges, Energy and Credit.[4] In addition, SEC Commissioner Michael Piwowar recently voiced his concern and called for removal of the indemnification provisions.[5]

DTCC strongly supports legislation that would fix this problem and encourages the Committee to support H.R. 1847. This non-controversial, technical amendment would help to ensure regulators and the public obtain a consolidated and accurate view of the global over-the-counter ("OTC") derivatives marketplace.

Ongoing Support for Legislative Fix

Legislation such as H.R. 1847 is the only viable solution to address the unintended consequences of the indemnification provisions. As you know, legislation similar to H.R. 1847 was introduced in the 113th Congress and passed the House in a 420-2 recorded vote. The *Swap Data Repository*

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[2] *See* CPSS-IOSCO, Authorities' access to trade repository data (Aug. 2013).

[3] For example, Chairman Massad stated that if legislation "did remove [the indemnification] provision, then it would facilitate . . . the sharing of information." *See* 2015 Agenda for CFTC: Hearing Before the H. Comm. On Ag., 114th Cong. (2015) (colloquy between Chairman Massad and Congressman Eric Crawford).

[4] *See* Testimony of CFTC Commissioner J. Christopher Giancarlo Before the U.S. House of Representatives, Committee on Agriculture, Subcommittee on Commodity Exchanges, Energy, and Credit (April 14, 2015); *available at* http://agriculture.house.gov/sites/republicans.agriculture.house.gov/files/images/Giancarlo%20Testimony.pdf; *see also* Testimony of Mark Wetjen, Commissioner, CFTC, Before the U.S. House Committee on Agriculture, Subcommittee on Commodity Exchanges, Energy, and Credit (April 14, 2015); *available at* *http://agriculture.house.gov/sites/republicans.agriculture.house.gov/files/images/Wetjen%20Testimony.pdf*

[5] Commissioner Michael Piwowar, Secs. and Exch. Comm'n, Remarks at the International Swaps and Derivatives Association 30th Annual General Meeting (Apr. 22, 2015).

and Clearinghouse Indemnification Correction Act of 2013 (H.R. 742) focused on resolving issues surrounding the indemnification provisions and confidentiality requirements of Dodd-Frank by removing the provisions from the law. H.R. 742 was supported by the SEC[6] and three CFTC Commissioners.[7] Additionally, in a May 2013 letter[8] to the Senate Committee on Agriculture, Nutrition & Forestry, the Americans for Financial Reform ("AFR") noted that H.R. 742 was a "non-controversial technical correction that could improve regulatory effectiveness." Further, in March 2015, AFR stated in testimony before the Senate Committee on Banking, Housing and Urban Affairs that the organization supported the legislation.[9] In the same hearing, the U.S. Chamber of Commerce also announced its support for removal of the indemnification provisions.[10]

In June 2014, the House passed the *Customer Protection and End-User Relief Act* (H.R. 4413) to reauthorize the CFTC and amend certain CFTC provisions included in Dodd-Frank. A key component of H.R. 4413 was the addition of legislation, including H.R. 742, which passed the House Agriculture Committee and the House of Representatives with overwhelming bipartisan support.

DTCC is pleased that removing the indemnification provisions from Dodd-Frank remains an ongoing priority for the current Congress. Earlier this year, the House passed H.R. 37, which also included indemnification correction provisions.

DTCC encourages swift passage of H.R. 1847, and looks forward to continuing work with the Subcommittee on strengthening the global financial marketplace.

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[6] *See* Chairman Elisse Walter, Secs. and Exch. Comm'n, Remarks at the American Bar Association Spring Meeting, Regulation of Cross-Border OTC Derivatives Activities: Finding the Middle Ground (Apr. 6, 2013).

[7] *See* Commissioner Jill Sommers and Commissioner Scott O'Malia, Dissenting Statement, Interpretative Statement Regarding the Confidentiality and Indemnification Provisions of Section 21(d) of the Commodity Exchange Act, *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/sommers_omailadissentstatement; *see also* Dodd-Frank Derivatives Reform: Challenges Facing U.S. and International Markets: Hearing Before the H. Comm. on Agric., 112th Cong. (2012) (Commissioner Bart Chilton expressing support for a legislative solution), transcript *available at* http://agriculture.house.gov/sites/republicans.agriculture.house.gov/files/transcripts/112/112-35New.pdf.

[8] Letter from Americans for Financial Reform (May 3, 2013), *available at* http://www.ag.senate.gov/download/?id=90d5a93c-5a4e-458c-9a67-e2135b17aff8.

[9] *See* Testimony of Marcus M Stanley, Policy Director, Americans for Financial Reform, Before the Securities, Insurance, and Investment Subcommittee, Committee on Banking, Housing, and Urban Affairs (Mar. 24, 2015), *available at* http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=a2014b6b-e08e-49f8-98b8-0d946871bf30.

[10] *See* Statement of the U.S. Chamber of Commerce on Capital Formation and Reducing the Small Business Burdens, To Senate Subcommittee on Securities, Insurance, and Investments (Mar. 24, 2015), *available at* http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=1eed5aaf-18f7-45f0-b3db-6e63d1d001d9.

About DTCC
DTCC is a user-owned cooperative that serves as the primary financial market infrastructure serving the U.S. capital markets across multiple asset classes, including equities, corporate and municipal bonds, government and mortgage-backed securities, money market instruments, mutual funds, insurance, alternative investment products and OTC derivatives.

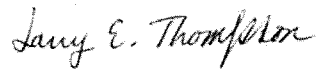
DTCC has operating facilities and data centers around the world and, through its subsidiaries, automates, centralizes, and standardizes the post-trade processing of financial transactions enabling thousands of institutions worldwide to issue securities and raise capital to build businesses. DTCC provides critical infrastructure to serve the financial marketplace and its constituents, including investors, commercial end-users, broker-dealers, banks, insurance carriers, and mutual funds.

DTCC has extensive experience operating repositories to support derivatives trade reporting and enhance market transparency. Through regulated DTCC subsidiaries, DTCC supports regulatory reporting regimes in the U.S., Europe, Japan, Australia, Singapore, Hong Kong, and Canada.

DTCC's subsidiary, the DTCC Data Repository (U.S.) LLC ("DDR"), is provisionally registered as an SDR with the CFTC for credit, equity, interest rate, foreign exchange, and commodity derivatives in the U.S. DDR began accepting trade data from market participants on October 12, 2012 – the first day that financial institutions began trade reporting under Dodd-Frank. DTCC – through its Trade Information Warehouse – has been providing public aggregate information for the credit default swap market on a weekly basis, including both open positions and turnover data, since January 2009. This information is available, free of charge, on www.dtcc.com.

Additionally, DTCC – in collaboration with SWIFT – operates the Global Markets Entity Identifier ("GMEI") utility to assign legal entity identifiers ("LEIs"). The GMEI utility has assigned LEIs to and maintains reference data corresponding to more than 175,000 legal entities across more than 140 jurisdictions, representing approximately 50 percent of all global LEIs that have been assigned.

Sincerely,



Larry E. Thompson
Vice Chairman and General Counsel

Cc:

Honorable Jeb Hensarling
Chairman, House Financial Services Committee

Honorable Maxine Waters
Ranking Member, House Financial Services Committee

April 14, 2015

Dear Member of Congress:

On behalf of the Food Marketing Institute (FMI) and our member companies, I am writing to urge your support for *the Encouraging Employee Ownership Act of 2015* (H.R. 1675 / S. 576).

The Food Marketing Institute proudly advocates on behalf of the food retail industry. FMI's U.S. members operate nearly 40,000 retail food stores and 25,000 pharmacies, representing a combined annual sales volume of almost $770 billion. Our more than 1,225 food retail and wholesale member companies cover the spectrum of diverse venues where food is sold, including single owner grocery stores, large multi-store supermarket chains and mixed retail stores. A number of these companies are privately held entities whose employees would benefit from passage of *the Encouraging Employee Ownership Act.*

This legislation is a common-sense update to Securities and Exchange Commission (SEC) Rule 701 to account for inflation. Specifically, it would increase the threshold requiring burdensome and confidential disclosures that currently discourage private companies from offering their employees stock-based compensation. This update is long overdue, and we applaud the bipartisan efforts of Senators Pat Toomey and Mark Warner and Representatives Randy Hultgren and John Delaney for introducing this legislation in the U.S. Senate and House of Representatives.

Under current regulations, SEC Rule 701 allows companies to offer employees compensatory stock without going through costly SEC filing requirements and without risking public disclosure of company information, as long as the aggregate sales price or amount of securities sold is under a predetermined limit. *The Encouraging Employee Ownership Act* will increase this limit from $5 million to $10 million and index it for inflation every five years.

Since its introduction, privately held companies have relied on Rule 701 to provide stock and similar stock-based compensation - e.g., stock options - to employees. This has proven popular among a wide variety of private companies, including a number of FMI-member companies, and their employee shareholders. Unfortunately, the outdated disclosure threshold has not been increased to account for inflation and the expense associated with exceeding it now discourages the use of stock-based compensation. When *the Encouraging Employee Ownership Act* is

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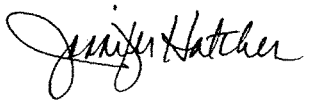
enacted our member companies' associates will be the beneficiaries of increased ownership opportunities; this is good for the long-term fiscal growth of both the associates and the companies.

I strongly encourage you to support *the Encouraging Employee Ownership Act of 2015*. If you have any questions, please feel free to contact me.

Sincerely,



Jennifer Hatcher
Senior Vice President, Government and Public Affairs
Food Marketing Institute

Status and Comparison of the SEC M&A Broker No-action Letter and H.R. 2274 – S. 1923 *the Small Business Mergers, Acquisitions and Sales Brokerage Simplification Act*

By Shane B. Hansen, Partner
Warner Norcross & Judd LLP

December 19, 2014

Summary and Status Update

H.R. 2274, *the Small Business Mergers, Acquisitions, and Sales Brokerage Simplification Act of 2013*, and its identical Senate companion bill, S. 1923 (together, the *Bill*), would amend the Securities Exchange Act of 1934 (the *Exchange Act*), to create an exemption from federal broker-dealer registration for "M&A brokers" who facilitate mergers, acquisitions, sales, and similar transactions involving privately held companies. While H.R. 2274 unanimously passed the U.S. House of Representatives in 2014, the 113th Congress adjourned without the U.S. Senate acting on the Bill. It is anticipated the Bill will be reintroduced in 2015.

Two weeks after the Bill passed the U.S. House, the Securities and Exchange Commission (*SEC*) staff issued the "M&A Broker" no-action letter dated January 31, 2014, to six securities lawyers (the *NAL*). This NAL is generally available to any intermediary assisting with the transfer of a privately held company's ownership under its stated facts, circumstances, and conditions. Unlike most no-action letters, the application of this NAL is not limited to the persons requesting the guidance and relief. The SEC Division of Trading and Markets staff's letter concludes it would not recommend enforcement action if, without registering with the SEC as a broker-dealer, an M&A broker engages in covered activities if all of the NAL's conditions are satisfied.[1]

While, in effect, the NAL has granted similar exemptive relief to what the Bill would add to the Exchange Act, the NAL does not bear the authority of a rule or order officially adopted by the SEC's five commissioners, and so it is limited in its legal effect.[2] The NAL is effective today for M&A brokers who satisfy its stated facts, circumstances, and conditions unless and until the SEC staff—present or future—chooses to change its stated position. The SEC staff's position is not legally binding on a court and does not apply to state securities regulation.

[1] For additional information about the background and substance of the NAL and the Bill, please refer to the article, *Simplifying Securities Regulation of M&A Brokers*, first published in the *Michigan Business Law Journal*, available at: http://www.michbar.org/business/BLJ/Spring2014/hansen.pdf.
[2] See the SEC's explanation of its no-action letters on its website at: http://www.sec.gov/answers/noaction.htm#.

The NAL and the Bill share fundamental public policy underpinnings, which is not coincidental because they share a common origin[3] and represent extensive discussions about M&A brokers that started in 2006 with the SEC staff and state securities regulators. Discussions with SEC staff about the terms of a possible no-action letter commenced on June 6, 2013, the same day as the Bill's introduction in the U.S. House. The NAL uses many terms and contains conditions that are the same or similar to those in the Bill. Notably, under both the NAL and the Bill, the target company must be privately held by the seller and, after the transaction's closing, the buyer must have acquired control and be actively involved in operating the business.[4] The definition of an "M&A broker", the types of covered M&A transactions, and, with the exception of its size, the definition of a "privately held company" are the same. "Control" concepts are the same but with slightly different presumption thresholds, as noted below. There are several notable differences.

Most differences between the NAL and the Bill arise from the inherently fact-specific nature of a no-action letter when compared to the general nature of a statutory amendment. A few substantive differences resulted from the timing of the Bill's introduction on June 6, 2013, and the NAL's release eight months later, as well as an amendment just prior to H.R. 2274's mark-up by the U.S. House Financial Services Committee. The SEC requested that the Committee modify the Bill to create a self-executing exemption, rather than requiring a simplified form of notice-filing registration as was initially proposed. This amended version of H.R. 2274 then unanimously passed the Committee (57-0) on November 14, 2013, and it unanimously passed the U.S. House (422-0) on January 14, 2014. Changes made to accommodate the SEC's request inadvertently deleted certain disqualifications, as noted below.

Comparison of the NAL and the Bill

- The NAL does not include any limitation on the size of a privately held company. Under the Bill the size of the target company was limited to being either: (i) less than $25 million in "earnings before interest, taxes, depreciation, and amortization" (commonly called EBITDA); and/or (ii) less than $250 million in gross revenues. The size was measured by the company's historical financial accounting records for the most recently completed fiscal year. The concept of a size limitation was included in the Bill in view of an earlier suggestion of the SEC staff.

- The NAL uses a 25% threshold to create a presumption of a buyer's acquiring control of the target company. This threshold is commonly used by the SEC in a variety of contexts such as reporting ownership in Form BD and when approval is required for a firm's change of control. The Bill uses a 20% threshold because the U.S. Small Business Administration uses this threshold to prescribe when a business owner must give a personal financial guarantee to support an SBA loan to the company.

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[3] See the Report and Recommendations of the Private Placement Broker-Dealer Task Force of the Business Law Section of the American Bar Association, 60 Business Lawyer 959-1028 (2005) available on the SEC's website at www.sec.gov/info/smallbus/2009gbforum/abareport062005.pdf).

[4] These conditions are closely related to the public policy considerations articulated by the U.S. Supreme Court in *SEC v. Ralston Purina Co.*, 346 U.S. 119; 73 S. Ct. 981; 97 L. Ed. 1494 (1953).

- The NAL includes statutory "bad actor" and "public shell" disqualifications; substantially similar disqualifications were in H.R. 2274 as first proposed and introduced, but were later inadvertently deleted by Congressional legislative counsel in accommodating the SEC's request for the Bill to create a self-executing registration exemption, rather than a notice-filing registration system. The NAL expressly permits a "business combination related shell company", which in essence is an entity created specifically for tax and various transaction-related business purposes. The SEC "public shell" disqualification pertains to so-called "reverse mergers" in which a private company merges into an inactive "public shell" company and thereby becomes publicly traded. When reintroduced in 2015, the Bill is expected to include these disqualifications.

- The NAL expressly requires that the target company be an "operating company" that is a "going concern". The Bill did not include these terms because, for example, small business owners sometimes hold business-related real estate assets in a separate legal entity that is neither an operating company nor a "going concern". Sometimes a start-up business may not yet have become operational. Sometimes a company's sale may be precipitated by financial troubles or it may be purchased out of a bankruptcy proceeding, and so might not be deemed a "going concern". Whether or not a company is a "going concern" may not be readily evident or conclusively determined, creating uncertainty over the availability of the exemptive relief, particularly for M&A brokers specializing in corporate work-outs, turn-arounds, and reorganizations.

- Both the NAL and the Bill require the buyer to be, directly or indirectly, actively involved in operating the business after closing. The NAL provides non-exclusive examples, including the power to elect executive officers and approve the annual budget, or by service as an executive or other executive manager. The Bill is silent on these details.

- Both the NAL and the Bill prohibit an M&A broker from having custody of client funds or securities. The NAL further proscribes that an M&A broker may not have the ability to bind a party to an M&A transaction. The Bill is silent on this point.

- The NAL proscribes that an M&A broker or its affiliates may not provide financing for an M&A transaction. So, for example, a bank could not provide commercial financing to a transaction facilitated by a bank-affiliated M&A broker. Similarly, a private equity or venture capital fund buyer could not use a fund-affiliated M&A broker for its own acquisition transactions. The NAL does permit an M&A broker to assist a party in obtaining financing; provided, that any related compensation is disclosed to the client and, in doing so, the M&A broker complies with all applicable laws including, as applicable, the Federal Reserve Board's Regulation T. The Bill is silent on these points.

- The NAL acknowledges that an M&A broker may advertise the availability of a privately held company for sale as such (in contrast to the sale of its securities), presumably to avoid the question of whether the advertising is "general solicitation" for a securities transaction. The Bill is silent on this point.

- Under the NAL a qualifying M&A transaction may not involve a public offering of securities; that is, the transaction must qualify for a private offering exemption from securities registration. Recognizing that privately owned businesses are sometimes acquired by publicly traded companies in stock-for-stock mergers or exchanges, the Bill is more finely tailored to preclude an M&A broker from engaging "on behalf of an issuer in a public offering". The Bill would allow an M&A broker to assist the seller of a privately owned company that is being acquired by a publicly held buyer using its securities, rather than cash, to fund the transaction.

- The NAL expressly states that the securities acquired in the M&A transaction will be "restricted securities" within the meaning of Rule 144(a)(3). While the Bill is silent on this point, existing law results in the same characterization and legal treatment of the securities acquired by the buyer in the transaction.

- The NAL and the Bill both allow for acquisitions structured as stock-for-stock mergers or exchanges. In these transactions the seller will receive the buyer's securities. The Bill requires the buyer to provide basic financial and management information to the seller. The NAL does not include this investor protection.

- Recognizing that, as an independent intermediary, an M&A broker cannot know or dictate a buyer's post-closing conduct, the Bill requires an M&A broker to "reasonably believe" the buyer will acquire control and actively manage the business after the transaction's closing. This belief could be established, for example, in and evidenced by the M&A broker's engagement letter. The NAL is silent on this nuance.

Looking Ahead

Both the NAL and the Bill only address the requirements of federal securities laws. Working through the North American Securities Administrators Association (*NASAA*), state regulators are developing a complementary model rule under state securities laws. If adopted by NASAA, the model rule would be available for use by each state to implement in accordance with its own administrative procedures. Some states already have broker-dealer registration exemptions directly applicable to M&A brokers (e.g., California, Colorado, Ohio, and Texas). Some states have transaction-based exemptions not specifically related to M&A transactions (e.g., transactions involving "institutional investors" as state-defined or construed). A model rule will help to bring a more uniform approach to state-level securities regulation of M&A brokers.

The NAL is presently effective. The Bill, including technical corrections to add back those disqualifiers inadvertently deleted during mark-up, is expected to be reintroduced in the 114th Congress. Stay tuned for more federal and state developments affecting M&A brokers in 2015.

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No-Action Letters

An individual or entity who is not certain whether a particular product, service, or action would constitute a violation of the federal securities law may request a "no-action" letter from the SEC staff. Most no-action letters describe the request, analyze the particular facts and circumstances involved, discuss applicable laws and rules, and, if the staff grants the request for no action, concludes that the SEC staff would not recommend that the Commission take enforcement action against the requester based on the facts and representations described in the individual's or entity's request. The SEC staff sometimes responds in the form of an interpretive letter to requests for clarifications of certain rules and regulations.

The no-action relief is limited to the requester and the specific facts and circumstances set forth in the request. In addition, the SEC staff reserves the right to change the positions reflected in prior no-action letters.

You can find a compilation of Staff No Action, Interpretive, and Exemptive Letters from the Divisions of Corporation Finance, Investment Management, and Trading and Markets, and the Office of the Chief Accountant in the "Staff Interpretations" section of our website.

We have provided this information as a service to investors. It is neither a legal interpretation nor a statement of SEC policy. If you have questions concerning the meaning or application of a particular law or rule, please consult with an attorney who specializes in securities law.

SHANE B. HANSEN
BIOGRAPHICAL SUMMARY

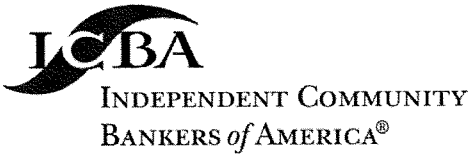
SHANE B. HANSEN is a partner and co-chairs the Funds and Investment Services Practice in the law firm of Warner Norcross & Judd LLP. His law practice concentrates in the area of financial services regulation, primarily involving federal and state securities and banking laws and related rules. He advises banks, broker-dealers, M&A advisors and business brokers, investment advisers, investment managers, private fund advisers, family offices, financial planners, and registered representatives about a wide range of business, corporate, contract, compliance, and regulatory topics, and frequently speaks on compliance topics. He has substantial experience involving formations, mergers, acquisitions, and sales of financial services firms and practices. He was recognized in *The Best Lawyers in America®, Corporate Law and Securities Regulation, 2007 through 2014 editions* and named a "super lawyer" in the 2006, 2007, and 2009 through 2013 editions of *Michigan Super Lawyers®*.

Mr. Hansen served as the lead counsel and primary draftsman of H.R. 2274, the *Small Business Mergers, Acquisitions, and Sales Brokerage Simplification Act of 2013*. This bill would amend the Securities Exchange Act of 1934 to clarify and simplify federal broker-dealer regulation of M&A advisers and business brokers. Mr. Hansen presented oral and written testimony before the Committee on Financial Services of the U.S. House of Representatives. The bill unanimously passed the U.S. House of Representatives on January 14, 2014, and is pending before the U.S. Senate.

Mr. Hansen is a member of the Business Law Section Council, State Bar of Michigan (2014-present) and is a long-time active member of both the Section's Securities and Financial Institutions Committees. He is the immediate past chair the Committee on State Regulation of Securities in the Business Law Section of the American Bar Association (2011-2014). This ABA committee is comprised of more than 600 lawyers, paralegals, state regulators, and law professors from around the country. He co-chairs its Subcommittee of Liaisons to Securities Administrators in the U.S. and Canada (2007-present), producing an annual report on state securities law developments. He is also an active member of the ABA's Committee on Federal Securities Regulation. Other professional memberships and associate memberships include the Compliance and Legal Society of the Securities Industry and Financial Markets Association (SIFMA), the Financial Services Institute (FSI), the Investment Adviser Association (IAA), the Financial Planning Association (FPA), and the National Society of Compliance Professionals (NSCP). Mr. Hansen graduated with honors from the University of Michigan Law School in 1982. He graduated with high honors from Albion College in 1979.

Warner Norcross & Judd LLP is a full service law firm with over 220 attorneys practicing from eight offices located in Grand Rapids, Southfield, Holland, Kalamazoo, Muskegon, Lansing, Midland, and Macomb County, Michigan. The firm's Funds and Investment Services Practice is an interdisciplinary group of attorneys and securities compliance consultants with substantial experience in the matters important to financial and investment services providers and others who may be subject to federal and state securities laws, rules and regulations, as well as FINRA rules, regulation, and enforcement. Client matters include corporate, contracts, formation and registration, compliance, mergers and acquisitions, as well as preparing for and responding to examinations, enforcement, customer arbitration, and litigation. Other common client matters include human resources, labor, and benefits, trusts and estates, and tax issues. The firm represents a wide range of clients from large to small, with various business models, and located in various parts of the country.

More information about Shane and Warner Norcross & Judd LLP can be found on the Internet at: www.wnj.com. He can be reached at 616-752-2145 or shansen@wnj.com. 9047941-10/20/2014



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Secretary
JOHN H. BUHRMASTER
Immediate Past Chairman
CAMDEN R. FINE
President and CEO

April 27, 2015

The Honorable Steve Womack
U.S. House of Representatives
Washington, DC 20515

The Honorable Jim Himes
U.S. House of Representatives
Washington, DC 20515

Dear Representative Womack and Representative Himes:

On behalf of the more than 6,000 community banks represented by the Independent Community Bankers of America, I write to thank you for introducing the Holding Company Registration Threshold Equalization Act of 2015 (H.R. 1334) and to express our strong support for your bill. H.R. 1334 would correct an oversight in the drafting of the 2012 JOBS Act that denied thrift holding companies the intended benefits of a key provision of the Act.

Title VI of the JOBS Act raised the threshold number of bank shareholders that trigger SEC registration under the Securities Exchange Act of 1934 from 500 to 2,000. The JOBS Act also raised the deregistration threshold from 300 shareholders to 1,200 for banks and bank holding companies. However, due to an oversight in the drafting of the statute, the new thresholds do not apply to thrift holding companies. H.R. 1334 would correct this oversight in statute.

Thrifts and thrift holding companies are subject to the same oversight, supervision, and financial reporting requirements as banks and bank holding companies. The enhanced oversight and regulation of banks is the rationale for affording them higher shareholder registration and deregistration thresholds under the JOBS Act. That being the case, there is no policy reason for denying thrift holding companies, subject to the same oversight and regulation, the benefits of the higher thresholds.

Thank you again for introducing H.R. 1334. Fixing the registration and deregistration thresholds for thrift holding companies is a component of ICBA's Plan for Prosperity. We look forward to working with you to advance this important legislation.

Sincerely,

/s/

Camden R. Fine
President & CEO

CC: Members of the House Financial Services Committee

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Congress of the United States
House of Representatives
Washington, DC 20515–0549

COMMITTEE ON THE JUDICIARY

COURTS, INTELLECTUAL PROPERTY, AND THE INTERNET SUBCOMMITTEE
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COMMITTEE ON FOREIGN AFFAIRS

THE MIDDLE EAST AND NORTH AFRICA SUBCOMMITTEE

TERRORISM, NONPROLIFERATION, AND TRADE SUBCOMMITTEE

April 29, 2015

The Honorable Jeb Hensarling
Chairman
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Chairman:

I write regarding H.R. 1965, which is on the capital markets subcommittee's agenda for today's legislative hearing. The "Small Company Disclosure Simplification Act" seeks to address the SEC's six-year failure to make data reporting useful for investors and worthwhile for public companies by restricting the agency from using the eXtensible Business Reporting Language (XBRL) data format to collect financial information from most corporate issuers.

As has been widely recognized by the technology industry[1], academic observers[2], and members of the House Financial Services Committee[3], the SEC has not fully enforced the quality of the XBRL data it collects, has continued to redundantly require both a document version and an XBRL data version, and has articulated no detailed plan to transform its whole disclosure system from documents into data. As a result, markets and investors distrust XBRL data and public companies - which would benefit from lower capital costs if XBRL data were more fully used - are subject to unnecessary costs[4].

Human- and machine-readable data reporting would best serve investors[5], allow companies to automate some compliance tasks, and give the SEC more efficient ways of analyzing disclosures. Unfortunately, in its current form the Small Company Disclosure Simplification Act would make this transformation more difficult. By simply banning data reporting for most companies, the proposal would erect a statutory barrier to long-term modernization.

Modernized data reporting by using searchable formats, rather than outdated documents, can reduce the regulatory burden faced by public companies, deliver better information to investors and markets, and make the SEC's processes more efficient. Based on conversations with several members of the

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[1] http://thehill.com/blogs/pundits-blog/finance/232417-congress-should-not-undo-progress-on-financial-data-reform
[2] http://www.datacoalition.org/connecting-big-business-regulation-to-big-data-columbia-report-shows-the-need-for-action/
[3] https://www.youtube.com/watch?v=QZvZiYbjBU0&sns=em
[4] www.aicpa.org/interestareas/frc/accountingfinancialreporting/xbrl/pages/xbrlcoststudy.aspx
[5] http://www.sec.gov/news/speech/022015-spchraf.html

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Financial Services Committee, I believe there is an opportunity to work together on legislation that would offer small companies short-term relief, limited in scope and duration, while also pushing the SEC to pursue the longer-term modernization we all agree is necessary.

For this reason, I sent the attached letter to the Committee on March 13, 2014, when the Small Company Disclosure Simplification Act had first been introduced as H.R. 4164. I stand ready to work with the Committee to reduce the regulatory burden on businesses while moving regulators away from antiquated and unsearchable forms of reporting in the same way as the DATA Act for federal spending.

Thank you for your attention to this important matter.

Sincerely,

Darrell Issa
Member of Congress

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STAFF DIRECTOR

ONE HUNDRED THIRTEENTH CONGRESS

Congress of the United States
House of Representatives

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

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March 13, 2014

The Honorable Jeb Hensarling
Chairman
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Chairman:

Today the Committee on Financial Services is scheduled to mark-up H.R. 4164 the "Small Company Disclosure Simplification Act," which will establish exemptions from the Securities and Exchange Commission's eXtensible Business Reporting Language (XBRL) filing requirements. I recognize and respect your Committee's legislative jurisdiction over SEC compliance, but I believe H.R. 4164 will complicate open data modernization and necessary improvements to the SEC XBRL program. I write to request an opportunity to work with you and Representative Hurt to improve on H.R. 4164 to help small businesses by instituting sensible reforms to the SEC XBRL program.

The Committee on Oversight and Government Reform has a long history of bipartisan legislative and oversight work in federal data standards. The House adopted data standards for federal financial data crafted by the Oversight Committee (H.R. 2146, the DATA Act) on a vote of 388-1. The Oversight Committee is engaged in ongoing oversight work involving the SEC's XBRL program

I agree with Representative Hurt that the SEC XBRL program needs improvements, but XBRL is a critical tool for reducing barriers to capital formation for smaller companies. XBRL is the global financial data standard.[1] According to TagniFi, a data broker for firms that develop investment analysis software, "[t]agged financial data is the future of securities analysis" because it "levels the playing field for investors and

[1] More than twenty-five countries have adopted XBRL including Brazil, Canada, China, France, Germany, India, Israel, Japan, Korea, Singapore, Spain, Sweden, the United Kingdom and Australia. *See* International SBR and XBRL, Standard Business Reporting, http://www.sbr.gov.au/about-sbr/about-us/international-sbr-and-xbrl (last visited Mar. 12, 2014).

increases their ability to analyze smaller companies that do not have coverage from Wall Street analysts."[2]

The SEC XBRL rule is now five years old.[3] Even the smallest public companies have been required to submit XBRL files since 2011. Exempting small companies may save them a few thousand dollars each year, but the legislation in its current form exempts public companies that earn up to a quarter of a billion dollars a year in revenue – a full 61% of all public companies.

Rolling back the requirement will obscure the small companies that need visibility in capital markets the most. Exempt companies would be essentially invisible to modern analytic tools. As Alfred Berkeley, former President of the NASDAQ Stock Market and currently the Chairman of an investment management company, said:

> By allowing companies to avoid reporting financial results in the SEC's standardized language, companies will be left out of the computerized screens that investors like my company use to search for new investments. Being left out of search mechanisms is akin to being left out of a search engine on the web: you will not be discovered by many investors. As a result, costs of capital will increase, not decrease.[4]

H.R. 4164 is intended to fix a regulation where costs outweigh the potential benefits, however the benefits are only now being realized. A press release announcing the introduction of H.R. 4164 asserted that less than 10% of investors utilize XBRL data.[5] Calcbench Inc., a major analytics provider, estimates that number to be much higher:

> [A] significant number of large financial information providers now use XBRL as a part of their data gathering, allowing for faster and more detailed information to be passed on to their customers. As such, we now estimate that greater than 40% of investors are currently receiving the benefits of XBRL. We expect that number to be near 100% in two years.[6]

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[2] Letter to Rep. Hurt from Chad Sandstedt, TagniFi, (Mar. 12, 2014) *available at*: http://www.tagnifi.com/letter-to-rep-robert-hurt-regarding-proposed-xbrl-exemption/.

[3] U.S. Securities and Exchange Commission, Final Rule: Interactive Data to Improve Financial Reporting, Securities Act Release No. 33-9002 (Jan. 30, 2009) ("Interactive Data Rule"), *available at*: http://www.sec.gov/rules/final/2009/33-9002.pdf.

[4] Email from Alfred Berkeley to Campbell Pryde and Hudson Hollister (March 11, 2014).

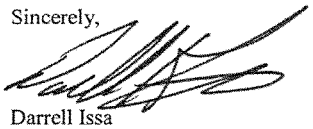
[5] Press Release, Rep. Robert Hurt, Robert Hurt Introduces Legislation to Help Small Companies Access to Capital (Mar. 6, 2014) *available at*: http://hurt.house.gov/index.cfm/press-releases?ID=95F58162-2114-4E61-A58E-4227BBBC0106.

[6] Letter to Rep. Hurt from Alexander Rapp and Pranav Ghai, Calcbench (March 12, 2014) *available at*: http://www.calcbench.com/Content/resources/Calcbench%20HR4164%20Response.pdf.

The XBRL rule was written with the understanding that the XBRL data must be available to investors before investors have an incentive to incorporate the data into their business processes. Benefits were expected to develop overtime. However, the SEC has done a poor job communicating to the market about its strategic vision for XBRL and modernized reporting. While the Division of Economic and Risk Assessment has provided steady information on what compliance might look like, the SEC has yet to tell issuers that compliance is important or valued.

Our interests regarding the XBRL program are in alignment. We want regulations that are more beneficial than costly. We want to minimize burdensome regulatory requirements while boosting capital formation. I believe that, working together, we can advance legislation that will create an optimal regulatory environment that begins to lessen the burdens of compliance for issuers and provides access to information that stimulates the capital formation that issuers need.

Sincerely,



Darrell Issa
Chairman

cc: The Honorable Elijah E. Cummings, Ranking Minority Member

April 24, 2015

The Honorable Jeb Hensarling
Chairman, House Financial Services Committee
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member, House Financial Services Committee
Washington, DC 20515

The Honorable Scott Garrett
Chairman, House Capital Markets Subcommittee
Washington, DC 20515

The Honorable Carolyn Maloney
Ranking Member, House Capital Markets Subcommittee
Washington, DC 20515

RE: **Support HR 686**
The Small Business Mergers, Acquisitions, Sales and Brokerage Simplification Act of 2015

Dear Chairman Hensarling,
Ranking Member Waters,
Chairman Garrett, and
Ranking Member Maloney:

On behalf of The M&A Source, we respectfully request that you co-sponsor HR 686, The Small Business Mergers, Acquisitions, Sales and Brokerage Simplification Act of 2015, and to add your strong and active support to promptly passing this needed and overdue legislation. This bipartisan bill and its counterpart S.1010 appropriately revise regulatory burdens on small business owners and their advisors. We anticipate that HR 686 will help squeeze out obstacles created by counter protective regulations; ones that add risks and costs without demonstrating commensurate benefits to any party. It should enhance private business commerce, protect and create jobs, and improve the efficient flow of capital for small to medium businesses.

The House of Representatives introduced, considered, and unanimously passed an identical bill, HR 2274, early in 2014 by a vote of 422-0. A corresponding bill was then introduced in the U.S. Senate, but it was not acted upon before the session concluded.

After HR 2274 passed the House, the Securities and Exchange Commission released its "M&A Brokers" No Action Letter reflecting a staff view supporting an even less restrictive application of current law than would be created by under HR 686. While the No Action Letter alone is somewhat helpful, it lacks the sufficiency of law and, absent provisions codified in HR 686, it is simply inadequate to clarify the issues to provide a fair, balanced, and reliable platform for small to medium sized business buyers and sellers, or their advisers.

Further evidencing validity of the public policy concept embodied in HR 686, is the recently published Model Rule Exempting Certain M&A Brokers from State Registration, as released for public comment by the North American Securities Administrators Association (NASAA). Once adopted, this rule promulgates a recommended rule into the states' regulatory schemes comporting well to the SEC's M&A Brokers No Action Letter and to the provisions under HR 686.

As business brokers and M&A advisors, we have unique knowledge and understanding of the importance of HR 686 and S 1010 to buyers and sellers of businesses and of the broader economic benefits to employees, communities, and the effective flow of capital for entrepreneurs and privately held businesses.

- Vague and inappropriate requirements as to an unclear potential need for generalized securities registration are burdensome and do not provide value in the specific context of selling an operating business to a buyer who takes active control of the decisions, management, the assets and operations, and control, on his or her own behalf.

- Jobs are preserved and created when new entrepreneurs acquire and grow existing businesses. This enhances and protects the lives and livelihoods of countless middle class wage earners, while keeping employees from layoffs and further straining the social safety net.

- Fresh ideas, capital infusions, and vigor associated with businesses sold rather than shuttered are major contributors to the economic vitality of communities and the country.

- M&A advisors and business brokers are valuable assets and service providers in assisting buyers and sellers in negotiated transactions for the sale of businesses.

- Eliminating the specter caused when M&A brokers are required to register and comport with a burdensome, expensive and inapplicable scheme will facilitate the flow of capital to small businesses; the driving force to growing our nation's economy, tax revenues, and job growth.

As you will have seen by correspondence from others on this subject, passing HR 686 and S 1010 are supported by a vast preponderance of groups comprising the M&A advisors and business brokers who uniquely know, understand, and professionally serve the privately held business segment addressed by HR 686.

This request for your support of HR 686 is submitted by The M&A Source, a leading non-profit associations of professionals who specialize in business ownership transitions, acquisitions and sales of private businesses through negotiated transactions.

Sincerely,

Joe D. Lindsey
Chairman, The M&A Source

WRITTEN STATEMENT OF WILLIAM BEATTY

PRESIDENT, NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC. AND

WASHINGTON SECURITIES DIVISION DIRECTOR

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

"Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens"

APRIL 29, 2015

WASHINGTON, DC

Introduction

Good Afternoon, Chairman Garrett, Ranking Member Maloney, and Members of this Subcommittee, on behalf of the North American Securities Administrators Association, Inc. (NASAA), I am pleased to submit this statement to the House Committee on Financial Services for inclusion in the record of the hearing entitled "Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens," held on April 29, 2015 by the Subcommittee on Capital Markets and Government Sponsored Enterprises.

NASAA was organized in 1919, and is the oldest international organization devoted to investor protection. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico and the U.S. Virgin Islands, and its mission is to serve as the voice of securities agencies responsible for grassroots investor protection and efficient capital formation.

State securities regulators have protected Main Street investors for the past 100 years, longer than any other securities regulator. Ten state securities regulators are appointed by Secretaries of State, five are under the jurisdiction of their states' Attorney General, several are appointed by their Governors and cabinet officials and others work for independent commissions or boards. State securities regulators closely interact with the business community and investors in their state, fostering a collaborative relationship with compliant registrants through accessibility and communication.

Collectively and individually, state securities regulators enforce state securities laws by investigating suspected investment fraud, and, where warranted, pursuing enforcement actions that may result in fines, restitution to investors and jail time. State securities regulators ensure honest financial markets by licensing registrants – both firms and investment professionals – and conducting ongoing compliance inspections and examinations. They work with issuers to ensure that securities offerings include legally required disclosures, thus resulting in a transparent and fluid securities market.

State Securities Regulators and Capital Formation

NASAA members are at the forefront of fostering capital formation for small businesses, entrepreneurs and investors in their state. We share Congress' desire to improve the U.S. economy through improved access to capital for small and emerging businesses. The reality of new technologies, new modes of investing, and a global, interconnected marketplace, requires new ideas and creative solutions. Toward this shared goal, state securities regulators and NASAA have been involved in numerous efforts to facilitate capital formation, promote U.S. job growth and protect investors.

State regulators provide a level of accessibility to local, small business issuers and investors that is unavailable from any federal regulator. In Washington, for example, the Securities Division conducts sustained outreach to entrepreneurs, small business development centers, and other local groups regarding vital information that businesses need to know if they are contemplating raising capital. We provide assistance through all stages of a growing company's business operations, from formation through the issuance of securities, and help to ensure that small businesses have access to the capital needed to start or grow their business in a manner consistent with both state and federal regulations.

State securities regulators also are accountable to residents of their states, including both investors and local businesses that seek to raise capital. We must answer questions from investors, businesses, local legislators, and the local media regarding offerings that have been registered, as well as those that have not been granted registration. This accountability factors into the way state securities regulators review applications for registration, including the adequacy of disclosures to prospective investors.

Before commenting on the specific proposals before the Subcommittee today, I would like to take an opportunity to update the Subcommittee on some recent and exciting steps NASAA and its members have undertaken to promote responsible capital formation in your districts and communities.

Establishment of Electronic Filing Depository System

Last fall, NASAA implemented an electronic filing system called the Electronic Filing Depository (EFD) to allow private company issuers to electronically file a Form D for Regulation D, Rule 506 securities offerings in one or more states. This system interfaces with the SEC's EDGAR system and enhances the efficiency of the regulatory filing process for certain exempt securities offerings. It also allows the public to search and view, free of charge, state Form D filings.

Coordinated Review for Regulation A Offerings

NASAA successfully designed a modernized and simplified review process for Regulation A offerings. NASAA's "Multi-State Coordinated Review Program," which was first implemented in April 2014, allows for filings to be made in one place and distributed electronically to all states. Coordinated Review also sets up a streamlined and coordinated review process among all the states in which an issuer has filed.

Intrastate "Crowdfunding" and Related State Exemptions

As of today, 23 states and the District of Columbia have enacted state-based "equity" crowdfunding laws, or other limited offering exemptions, and more than a dozen other states are working on similar laws.[1] While equity crowdfunding on a federal level is not yet legal, states have found creative ways to work within existing federal exemptions to enable local businesses to reach potential customers.

NASAA Capital Formation Roundtable

Next month, NASAA will host a Capital Formation Roundtable in Washington, DC that will bring together state securities regulators and stakeholders from private industry, the public sector, and academia. The Roundtable will be attended by small business owners, entrepreneurs, practitioners, representatives of venture capital, representatives of several major exchanges, and others. One goal of the Roundtable is to create a forum within which NASAA members can learn more about the priorities of these stakeholders, and work with them to help shape the future of capital formation at the state level. NASAA is very excited about the new initiative.

[1] NASAA jurisdictions that have established exemptions by statute, regulation or order include Alabama, Arizona, Colorado, District of Columbia, Georgia, Idaho, Indiana, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Mississippi, Montana, Nebraska, New Mexico, Oregon, Tennessee, Texas, Vermont, Virginia, Washington, and Wisconsin. States that have established exemption by rulemaking include Mississippi, New Mexico, Oregon, Texas, Idaho, and the District of Columbia.

NASAA Comments on Legislation Now Before the Subcommittee

Today's hearing involves 12 legislative proposals that address different aspects of securities and banking law. Several of the proposals are new, or significantly amended versions of legislation introduced and discussed in previous years. I will address each proposal as it relates to the securities laws and investor protection.

In addition, a number of bills before the Subcommittee closely resemble legislation that was considered but not enacted during the 113th Congress. Although NASAA previously testified regarding certain of these proposals, including at hearings held by this Subcommittee, I will address these proposals in my statement today as some members of the Subcommittee have expressed continued interest in NASAA's views.

Finally, there are several bills before the Subcommittee about which NASAA has no position. I will not address the merits of those bills in my statement.[2]

1. The Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2015 (H.R. 686)

Over the past five years, state securities regulators have worked closely with the American Bar Association, M&A practitioners, and other stakeholders, to fashion a streamlined registration framework for persons acting as M&A brokers. These collaborations served as the basis for the development of a state model rule which exempts M&A brokers from state securities registration pursuant to certain conditions,[3] as well as for legislation introduced in the 113th Congress, H.R. 2274.

As originally proposed in the 113th Congress, H.R. 2274 would have established a statutory exemption for M&A brokers, subject to key features, including: (1) the establishment of a streamlined electronic registration requirement with the Securities and Exchange Commission ("SEC"); (2) the disqualification of any broker or an associated person who is subject to suspension or revocation of registration; (3) the inapplicability of the exemption to any M&A transaction where one party or more is a shell company; and (4) the inapplicability of the exemption to M&A transactions involving a company with earnings in excess of $25 million, and gross revenue in excess of $250 million.

NASAA was pleased to support H.R. 2274 when it was introduced in the 113th Congress as it struck a good balance between the legitimate interests of all stakeholders while maintaining vital protections for investors and businesses.[4] Unfortunately, when that bill was considered by the Financial

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[2] At this time, NASAA does not have any public position on the following bills being considered by the Subcommittee: (1) H.R. 1334, the "Holding Company Registration Threshold Equalization Act of 2015; (2) H.R. 1317, a bill to amend the Commodity Exchange Act and the Securities Exchange Act of 1934 to specify how clearing requirements apply to certain affiliate transactions, and for other purposes; (3) H.R. 1847, the Swap Data Repository and Clearinghouse Indemnification Correction Act; (4) H.R. 1975, a bill to amend the Securities Exchange Act of 1934 to require the Securities Exchange Commission to refund or credit excess payments made to the Commission.

[3] Notice of Request for Comment Regarding a Proposed NASAA Model Rule Exempting Certain Merger and Acquisition Brokers From Registration Pursuant to State Securities Acts. (January, 2015). Available at http://www.nasaa.org/wp-content/uploads/2015/01/Proposed-Uniform-MA-Broker-Model-Rule.pdf

[4] Written Testimony of A. Heath Abshure, Arkansas Securities Commissioner and Past President of the North American Securities Administrators Association, Inc. House Financial Services Committee, Subcommittee on Capital Markets and Government Sponsored Enterprises. October 23, 2013. Washington, DC. http://financialservices.house.gov/uploadedfiles/hhrg-113-ba16-wstate-habshure-20131023.pdf

Services Committee on November 14, 2013, the Committee adopted an amendment that removed key investor protections, including the bill's statutory "bad actor" disqualification provision, prohibitions on "shell" transactions, and a requirement for electronic registration by notice filing with the SEC.[5] These changes prevented NASAA from supporting the legislation when it was considered by the full House on January 14, 2014.

The Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2015, H.R. 686, is identical to the amended version of H.R. 2274 that passed the House in the 113th Congress. Therefore, NASAA does not support the bill. In its current form, the legislation lacks the key investor protection features discussed above, including a basic and critical provision disqualifying "bad actors" from the registration exemption established by the bill.

Although state securities administrators are disappointed that we cannot support H.R. 686 as presently constituted, we continue to recognize a valid basis for a responsible statutory exemption from registration for persons acting as a broker in many M&A transactions. Moreover, we note that there appears to be consensus among many stakeholders that there could be bipartisan support in Congress for legislation that restores the investor protections noted above, and which NASAA could also support.[6] In the event that the House were to amend H.R. 686 to restore the bad-actor disqualification and prohibition on "shell transactions," consistent with the earlier House bill, and recently introduced Senate legislation, NASAA would be pleased to revisit its position.

2. *The Reforming Access for Investments in Startup Enterprises Act of 2015* (H.R. 1839)

H.R. 1839 would add a new transactional exemption in Section 4 of the Securities Act of 1933 ("Securities Act") for secondary market sales by any person other than an issuer, underwriter, or dealer. It would also require that if securities are "offered" through the use of any general solicitation or advertising under this new exemption, all such sales "are made through a platform available only to accredited investors." Finally, it would preempt state authority to review and/or exempt these secondary sales.

NASAA commented on a discussion draft in the 113th Congress—the Startup Capital Modernization Act of 2014, which contained one provision with language nearly identical to H.R. 1839. State securities regulators are very sensitive to the desire for increased liquidity for holders of unlisted securities and understand the interest in this type of an exemption, but after a close review of H.R. 1839, we continue to have concerns regarding important investor protections.

Exemptions are subject to the antifraud provisions of the Securities Act, which generally make it unlawful to offer or sell a security without fully disclosing all material facts. Exemptions are based on the principal that securities registration is not necessary because of available and effective alternative oversight to ensure quality control, a pre-existing relationship between the company and potential investors (i.e., employees or current securities holders), or the offering is made to investors that meet minimum financial thresholds and are thus presumably capable to evaluate a private securities offering and do not need the full protection of the securities registration.

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[5] See: H. Rept. 113-326.

[6] A bipartisan version of the Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2015, which includes a prohibition on reliance on the exemption by "bad actors" and a prohibition on the application of the exemptions to "shell" transactions, was introduced last week in the Senate by Senators David Vitter (R-LA) and Joe Manchin (D-WV). NASAA supports this legislation (S. 1010).

H.R. 1839 would create a new transactional exemption under the securities laws for certain secondary sales. With respect to nonpublic companies, it will be very difficult for a selling security holder (i.e., not the issuer) to obtain and provide to a subsequent purchaser the information necessary to fulfill the requirement that all material facts be disclosed, as sources of information such as the 10-K and 10-Q are unavailable. Further, the disclosures that the selling security holder received through a private placement memorandum or other disclosure document when he or she acquired the security may be significantly out-of-date. Moreover, an issuer may not have, or may not be willing to reveal, material information about the company to a purchaser with whom it is not familiar.

We note that this bill, unlike the discussion draft last year, proposes to allow securities holders to generally solicit and advertise to prospective purchasers, so long as the sale is made through a platform only available to accredited investors. We are concerned about allowing individual investors to resell their shares by generally soliciting the public when such selling security holders do not need to meet the protective standards for broker-dealers. We further note that the bill allows for general solicitation without any subsequent verification requirements that the persons being solicited also meet the income and net worth standards applicable to accredited investors. Issuers would be able to rely on self-made representations by purchasers concerning their status as accredited investors, which could be buried in user or subscription agreements, in contrast to the heightened verification standards under Rule 506(c).

We are concerned that the legislation lacks a definition or qualification standards for the "platform," as compared to a registered broker-dealer. Similarly, there is neither a filing requirement nor qualification standards for the individual holder of securities to sell their shares through the platform. This is particularly troublesome when an investor sells their investment without providing the new purchaser with current, material information. As currently drafted this legislation appears to be focused on facilitating a business model built around secondary sales of privately issued securities while omitting significant investor protection. To be successful, capital formation measures must include investor protection provisions as such provisions foster confidence in companies and the markets. Moreover, because the bill deems these transactions as a "covered security" and thus preempts state review or applicable state exemptions, NASAA is concerned about the potential repercussions for investors who may be defrauded or subject to other unethical conduct. As with Regulation D, Rule 506 offerings, state securities regulators will only be able to take action after the fraud or unethical conduct has occurred, and in almost all such instances the investors' funds will be unrecoverable.

We want to make the Subcommittee aware that under state law, there are at least 10 exemptions from securities registration for secondary transactions available to selling security holders. One popular exemption for selling securities holders is the "manual exemption."[7] This exemption has important investor protections that we strongly recommend as this Committee evaluates the bill. The manual exemption requires that (a) the transaction to be offered and sold through a broker-dealer; (b) the securities have been outstanding in the hands of the public for at least 90 days; (c) the issuer is in fact engaged in business (and is not in bankruptcy or receivership, and not a blank check, blind pool, or shell company with no specific business plan); (d) the security is sold at a price reasonably related to its current market price; (e) the security does not constitute whole or part of an unsold allotment; (f) a nationally recognized securities manual or a publicly available record filed with the SEC contain the following information: (i) description of business and operations, (ii) names of executive officers and directors, (iii) audited balance sheet dated within 18 months of the transaction, and (iv) audited income statements for two prior fiscal years (or shorter period since existence), and (g) the issuer must meet one of the

[7] *See* Section 202(2) of the Uniform Securities Act of 2002.

following: (i) it has a class of equity securities listed on a national securities exchange or designated for trading on the NASDAQ, (ii) it has been engaged in continuous business for at least 3 years, or (iii) it has total assets of at least $2,000,000 based on audited balance sheet dated within 18 months of transaction. There are no state filing requirements under this exemption.

We continue to have concerns about the lack of transparency (i.e., platform qualifications standards, purchaser verification requirements and information disclosures) contained in this new exemption, and look forward to discussing with the Subcommittee those investor protections that we consider paramount to a workable exemption, even where the sale is made to an accredited investor. We also urge the Subcommittee to remove any state preemption so that states can tailor their own exemptions, with appropriate investor protections, to any new exemption enacted under federal law.

3. *The Small Business Investment Company Advisers Relief Act of 2015* (H.R. 432)

The Small Business Investment Company Advisers Relief Act of 2015 would amend the Investment Advisers Act of 1940 to expand the registration exemption under §203(l)[8] so that it would exempt persons who are advisers to both venture capital funds and small business investment companies ("SBICs"). The bill would also exclude SBIC assets from the SEC registration threshold calculation for private funds under Section 203(m), and preempts state regulation of SBIC fund advisers.

As NASAA previously testified when the Subcommittee was considering similar legislation in the 113th Congress, state securities regulators appreciate that, on its face, H.R. 432 does not appear to directly impact retail investors. However, we are concerned that the contemplated preemption of state law would exempt advisers of SBICs from all state and federal registration focused on investor protection. Further, we remain concerned that removal of all forms of state and federal securities oversight of persons acting as the adviser of SBIC funds, as would be achieved under this bill, could have unforeseen downstream effects on the securities markets which might negatively impact retail investors. Therefore, should the Committee take action on H.R. 432, we recommend that the bill be amended to permit states the option of requiring the registration of any person acting solely as an adviser to an SBIC.

4. *The Disclosure Modernization and Simplification Act of 2015* (H.R. 1525)

The Disclosure Modernization and Simplification Act would direct that the SEC permit issuers to submit a summary page as part of a Form 10-K filing in order to make annual disclosures easier to understand for current and prospective investors. It would also direct the SEC to reform Regulation S-K and tailor its disclosure rules as they apply to smaller issuers and Emerging Growth Companies.

In reviewing the SEC website, it does appear that Form 10-K cross-referencing by hyperlink is already widely used on the Electronic Data-Gathering, Analysis, and Retrieval ("EDGAR") system. There has been bipartisan dialogue and scholarly debate about whether a one-size-fits-all reporting requirement makes sense for all issuers, especially for those reporting requirements that may be cost-prohibitive or inapplicable to issuers of smaller size (i.e. some environmental impact disclosures). We further note and appreciate that the sponsor has included provisions in H.R. 1525 that were recommended by NASAA last year, and adopted by the Committee during its consideration of similar legislation in the

[8] §203(l) exempts persons who are advisers solely to venture capital fund advisers from SEC registration requirements.

113th Congress, which ensure that any revisions made to Regulation S-K by the SEC as a result of legislation shall continue to provide "all material information" to investors.[9]

State securities regulators do not oppose the Disclosure Modernization and Simplification Act.

5. ***The Encouraging Employee Ownership Act of 2015* (H.R. 1317)**

The Encouraging Employee Ownership Act directs the SEC to amend Rule 701 to increase the amount of securities that may be sold from $5 million to $10 million in a 12-month period, before the additional disclosures must be made. Rule 701, adopted pursuant to Section 3(b) of the Securities Act of 1933, provides an exemption from the registration requirements of the Securities Act for securities offered to employees or consultants pursuant to a written compensatory employee benefit plan or a written contract by an issuer that is a non-reporting company (i.e., a non-public issuer) under the Exchange Act. The purpose of Rule 701 is to facilitate the use of securities as compensation to employees for private companies, including start-ups.

Because NASAA commented extensively on similar legislation in testimony to this Subcommittee last year, I will not address it at length today. I would, however, respectfully refer interested members of the Subcommittee to pages 22-24 of my Written Testimony from that hearing on May 1, 2014.

6. ***The Small Business Freedom and Growth Act of 2015* (H.R. 1723)**

The Small Business Freedom and Growth Act would require that the SEC revise Form S–1 to permit a smaller reporting company to incorporate by reference documents filed in a registration statement with the SEC. NASAA and state securities regulators participate in the SEC's Advisory Committee on Small and Emerging Companies and the SEC's Forum on Small Businesses Capital Formation. We understand that allowing incorporation by reference is a policy change that has been supported by many other participants. We also recall that last year Professor John C. Coffee advised the Subcommittee that such a reform, on its own, "could have real efficiency justifications and could help smaller issuers."[10] State securities regulators do not oppose H.R. 1723, although we strongly recommend that Congress consult the SEC prior to enacting legislation resulting in major changes to the use and application of Form S-1.

7. ***The Small Company Disclosure Simplification Act of 2015* (H.R. 1965)**

Extensible Business Reporting Language ("XBRL") is an electronic reporting language that assigns unique electronic identifiers to individual items in an issuer's financial reports, thereby making such data more interactive. This interactive financial data can allow investors, analysts and regulators to retrieve and use financial information in documents filed with the SEC. Any investor with a computer and an internet connection will have the ability to acquire and download interactive financial information that has generally been available only to large institutional users. In early 2009, the SEC published three final rules requiring XBRL tagging of certain disclosure information for operating companies, mutual

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[9] H. Rept. 113-642

[10] Statement of Professor John C. Coffee Jr., Adolf A. Berle Professor of Law, Director of the Center on Corporate Governance at Columbia Law School, Columbia Law School. House Financial Services Committee; Subcommittee on Capital Markets and Government Sponsored Enterprises. April 9, 2014. (P.10) http://financialservices.house.gov/uploadedfiles/hhrg-113-ba16-wstate-jcoffee-20140409.pdf

funds, and credit rating agencies.[11] The Small Company Disclosure Simplification Act would delay by five years from its enactment the date by which those rules would become effective, for companies with total annual revenues of less than $250 million. The bill would further require the SEC to analyze the costs and benefits of requiring companies of this size to file reports in XBRL format.

As a general matter, like the SEC's Investor Advocate and the SEC's Investor Advisory Committee, NASAA favors requirements regarding the use of XBRL and other protocols that maximize meaningful disclosure and improve its usefulness to investors. At the same time, as NASAA previously has testified,[12] state securities regulators agree that the cost of XBRL reporting requirements should be reasonable, and that these costs should yield a justifiable benefit.

NASAA supports and encourages the SEC to provide sufficient regulatory analysis of the costs and benefits associated with XRBL reporting. However, we do not believe that Congress should enact legislation to unnecessarily further delay implementation of XBRL reporting for many companies that would be covered by H.R. 1965, the effect of which would be to exclude the XBRL filing requirements for more than 60 percent of all public companies.[13] As SEC Investor Advocate Rick Fleming noted in discussing similar legislation considered in Congress earlier this year:

> We should not expect the next generation of American investors to scroll through hundreds pages of disclosure to find the information they need to make investment decisions. Private companies would not display critical information to their customers in this manner, and American investors have a right to expect their government to do better.[14]

8. *The Improving Access to Capital for Emerging Growth Companies Act* (Discussion Draft)

Finally, NASAA would like to comment on the discussion draft legislation affecting emerging growth companies ("EGCs"). We commented on a similar draft in the 113th Congress, and noted that it would further relax reporting requirements for EGCs. In the draft proposed in the 113th Congress, EGCs would have benefited from a dramatic shortening of the window of time between the completion of a confidential filing with the SEC and the beginning of the "road show" marking its initial public offering (IPO). We noted that the shortening of the required waiting period from 21 days to five days may be beneficial for issuers, as it reduces the likelihood of external events impacting the offering; however, the 21-day period is already a relatively short window of time. Moreover, non-EGC companies seeking to go public do not even enjoy an opportunity for confidential review. Although we do not believe a shorter window is necessary, we were pleased to see it increased from five to 15 days in this new draft.

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[11] U.S. Securities and Exchange Commission. Final Rule on Interactive Data to Improve Financial Reporting. 17 CFR Parts 229, 230, 232, 239, 240 and 249. [Release Nos. 33-9002; 34-59324; 39-2461; IC-28609; File No. S7-11-08]. April 13, 2009. https://www.sec.gov/rules/final/2009/33-9002.pdf

[12] Written Testimony of A. Heath Abshure, Arkansas Securities Commissioner and Past President of the North American Securities Administrators Association, Inc. House Financial Services Committee, Subcommittee on Capital Markets and Government Sponsored Enterprises. October 23, 2013. (P. 4). Washington, DC. http://financialservices.house.gov/uploadedfiles/hhrg-113-ba16-wstate-habshure-20131023.pdf

[13] Daniel Castro and Josh New, Congress Should Not Undo Progress on Financial Data Reform, The Hill Blog, http://itk.thehill.com/blogs/pundits-blog/finance/232417-congress-should-not-undo-progress-on-financial-data-reform

[14] See written Remarks Rick A. Fleming, Investor Advocate, U.S. Securities and Exchange Commission, in reference to Sec. 701 of H.R. 37, 114th Congress. "Effective Disclosure for the 21st Century Investor." Washington, DC. February 20, 2015. http://www.sec.gov/news/speech/022015-spchraf.html#_ftn7

The JOBS Act authorized EGCs to submit registration documents to the SEC for review on a confidential basis prior to an IPO. The proposed legislation, however, would permit EGCs to enjoy this same "confidential review" privilege for follow-on offerings of securities issued after the IPO. It would also lengthen the grace period for changing a company's status from an EGC to a non-EGC at the earlier of consummating an initial IPO or the end of the one-year period beginning on the date the company is no longer an EGC. When Congress established the mechanism for EGCs to obtain confidential SEC review of registration documents under the JOBS Act, its expressed purpose was to encourage companies to go public. It is not clear why the privilege should now be extended to companies that, by definition, have already successfully completed an IPO. Moreover, it is not clear why the privilege should be extended for a one-year period after disqualifying for EGC status and not completing an IPO. If a company no longer qualifies for EGC status (i.e., it has annual gross revenues of less than $1 billion in its most recent fiscal year and does not retain that status under four additional circumstances set forth in the JOBS Act), it should not be entitled to continued relief from important financial and risk disclosures applicable to public reporting companies.

The bill also requires that EGCs be permitted to file registration documents for confidential SEC review that "omit financial information for historical periods otherwise required by regulation S-X." Accounting scandals have shaken public confidence in the markets and demonstrated the critical importance of complete and accurate financial reporting. Such an omission of historic financial information runs counter to the interests of investors, the public, and or our capital markets. We would also note that this draft requires reporting of historical financial information prior to the public filing of a Form S-1 rather than, as in the prior draft, prior to delivery of a preliminary prospectus. At a minimum, such information should be provided to investors reviewing the details of the business and the transaction in the preliminary prospectus. The success of our capital markets is based on full, complete and transparent information that is readily available and accessible for investors to digest prior to investing.

Conclusion

Thank you again, Chairman Garrett, and Ranking Member Maloney, for the opportunity to provide a Statement to the Subcommittee today.

April 28, 2015

The Willard Office Building
1455 Pennsylvania Avenue, NW
10th Floor
Washington, DC 20004
Phone: (202) 434-9213

The Honorable Scott Garrett
Chairman
Subcommittee on Capital Markets & Government-Sponsored Enterprises
United States House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

The Honorable Carolyn Maloney
Ranking Member
Subcommittee on Capital Markets & Government-Sponsored Enterprises
United States House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

RE: April 29, 2015 Hearing on *Legislative Proposals to Enhance Capital Formation & Reduce Regulatory Burden*
H.R. 1965: *The Small Company Disclosure Simplification Act*

Dear Chairman Garrett and Ranking Member Maloney:

XBRL US is a not for profit that focuses on improving the availability, comparability and transparency of business information in the capital markets to all stakeholders. We respectfully submit the enclosed statement for the record of the hearing to be held on April 29, 2015 on "Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burden." This statement specifically addresses proposed legislation H.R. 1965, "The Small Company Disclosure Simplification Act" which will be discussed during the hearing.

We share the goals of the authors of the bill, H.R. 1965, to promote job creation, and to reduce the regulatory burden on smaller companies, however we disagree with the approach taken of exempting small companies from XBRL submissions. As currently written, this bill will do little to reduce costs for small companies in the short-term and will increase costs in the longer term, while impeding their ability to raise money in the capital markets.

We welcome the opportunity to discuss this statement and respond to any questions.

Regards,

Campbell Pryde
CEO, XBRL US, Inc.

CC: Members of the Subcommittee on Capital Markets & Government-Sponsored Enterprises

WRITTEN STATEMENT

OF XBRL US, INC.

FOR THE RECORD OF THE

APRIL 29, 2015

HEARING OF

THE UNITED STATES HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT-SPONSORED ENTERPRISES

ON

LEGISLATIVE PROPOSALS TO ENHANCE CAPITAL FORMATION & REDUCE REGULATORY BURDEN

XBRL US' Written Statement for the Record
U.S. House of Representatives
Subcommittee on Capital Markets and Government-Sponsored Enterprises
April 29, 2015 Hearing on Legislative Proposals to Enhance Capital Formation & Reduce Regulatory Burden
Page 1

Introduction

XBRL US commends Chairman Garrett and Ranking Member Maloney and members of the Subcommittee on Capital Markets and Government-Sponsored Enterprises for recognizing the unique needs of small companies and for seeking to reduce their regulatory burden. That said, we believe that the proposed legislation, H.R. 1965, as currently written, will have unintended consequences that will result in harming small companies ability to grow and expand their business.

XBRL US is the non-profit consortium for XBRL business reporting standards in the U.S. and it represents the business information supply chain. Its mission is to support the implementation of XBRL business reporting standards through the development of taxonomies for use by U.S. public and private sectors, with a goal of interoperability between sectors, and by promoting business reporting standards through marketplace collaboration. XBRL US has developed taxonomies for U.S. GAAP, credit rating and mutual fund reporting and has developed a taxonomy for corporate actions. XBRL US also focuses on improving the quality and usability of XBRL-formatted data by supporting creators and users of the data produced.

Legislation That Would Reduce Data Transparency & Provide Minimal Savings

Aiding small companies to grow their business requires: 1) improving access to funds, and 2) reducing regulatory costs where possible. XBRL (eXtensible Business Reporting Language) is a market-based open data standard. It is not software or a product. After XBRL was developed by industry participants in the financial reporting supply chain, the Securities and Exchange Commission (SEC) adopted the standard for public company reporting. XBRL-formatted financial data is less expensive, more timely and easier for investors and regulators to use because it makes financial data computer-readable.

Today, XBRL is required for financial statement reporting to the SEC but the legislation proposed (H.R. 1965) would exempt small companies from XBRL submission for a three to five year period. Contrary to the stated goal, an ***XBRL exemption for small companies will reduce their access to capital and will provide virtually no savings in regulatory costs***.

Explanation

The proposal as currently written would exempt companies with revenue under $250 million from XBRL formatting for a minimum period of between three to five years. A cutoff of $250 million effectively removes 60% of all public companies from electronic filing. Submitting data in HTML and not in XBRL, means corporate data for these filers must be manually rekeyed and validated by financial statement users before any analysis can begin. The proposed legislation would result in potentially hundreds of small companies that have already been filing in XBRL for years reverting back to earlier processes. This means they will lose the XBRL expertise they have gained and will have to "re-learn" it again once the three to five year period is over. Importantly, the larger issue is that small companies that do not file in an XBRL format, will be at a significant disadvantage versus large companies in terms of accessing public funds at a minimal savings in XBRL compliance costs.

Removing the XBRL requirement means that small company financial data will be more difficult to extract and less timely, making small companies more expensive to analyze than large companies. This would raise the cost of capital for small companies, impeding their ability to attract funds to grow and expand their business.

The cost of financial analysis for regulators and investors will increase.
The proposed legislation would result in small companies reverting back to filing in HTML alone; large company data would continue to be available in the enhanced (XBRL) format. Regulators and investors will be required to process two separate formats for financial data, resulting in unnecessary costs.

XBRL data in use today will no longer be available.
Investors, analysts, and the SEC themselves are users of XBRL-formatted financial data, benefitting from the greater timeliness and usability of computer-readable data that XBRL provides. Large data aggregators have begun to replace legacy systems that require rekeying and validating of data and numerous small providers have launched because they can leverage low-cost XBRL data. These market changes serve to drive down costs of corporate data, benefiting investors large and small. Examples of new providers and use cases can be found at http://www.xbrl.us/usedata.

The cost of XBRL formatting today averages $10,000 per year (median cost $8,000) for small companies which will do little to reduce the burden of being a public company. These statistics are from a comprehensive study conducted by the AICPA and XBRL US (see attachment below) that also found that 70% of small companies paid $10,000 or even less.

XBRL can reduce regulatory burden.
Today XBRL is used by public companies primarily for SEC reporting, but it can also be used in reporting to other regulatory agencies, e.g., DOE, Census, BLS, etc. The same corporate data is often reported to different government agencies, in different formats, at different times and by different individuals within the same organization. Massive redundancy means massive costs, which would be streamlined by reporting in a single format like XBRL. Streamlining, cost savings and increased accuracy would benefit both government regulators, investors and reporting companies.

Conclusion

The goals of the proposed legislation, H.R. 1965, are to reduce regulatory burden for small companies. This is an important goal but we ask members of Congress to consider the unintended consequences of rolling back a requirement that has already been in place for several years for large and small companies alike. Removing access to computer-readable corporate data for small companies would be a major step backward for the U.S. capital markets and would present significant problems for small companies seeking to expand and grow.

For more information or if you have any questions, please contact Campbell Pryde, CEO, XBRL US, at 917-582-6159, Campbell.Pryde@xbrl.us.

Attachment

Consequences of XBRL Exemption – Minimal Savings, Reduced Transparency and Access to Capital for Small Companies

(See study online at
http://www.aicpa.org/interestareas/frc/accountingfinancialreporting/xbrl/pages/xbrlcoststudy.aspx)

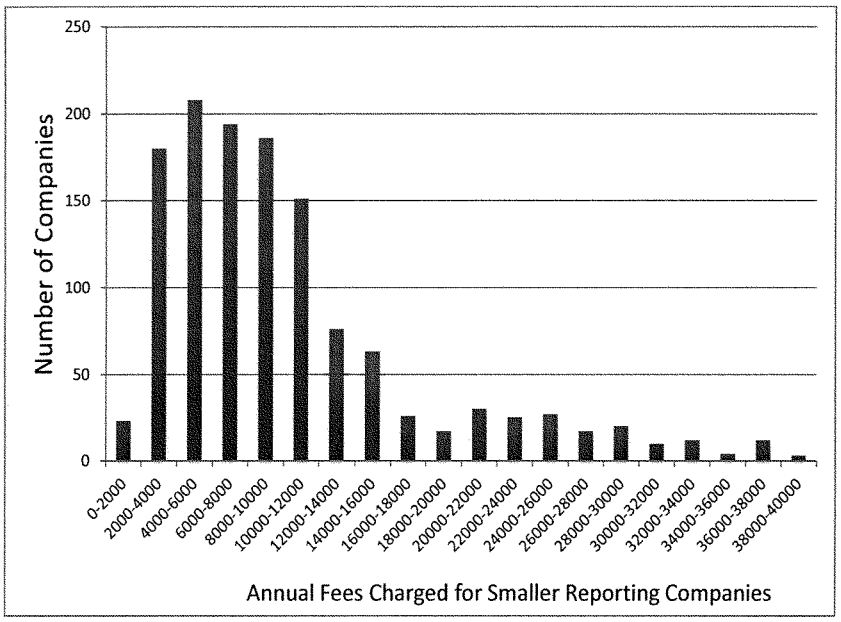
An XBRL exemption, such as that in the proposed legislation, H.R. 1965, will not reduce the burden on small companies.

The savings from an XBRL exemption averages $10,000 per year for small companies.
A December 2014 study conducted by the American Institute of CPAs (AICPA) and XBRL US found that the average annual cost of XBRL filing for companies defined as "small companies" per the U.S. Securities and Exchange (SEC) definition is $10,406; and 70% pay $10,000 or less. The median cost for the companies included in the study was $8,000. These figures demonstrate that the annual cost of XBRL creation is low relative to the benefits that XBRL formatting can provide. Financial data in XBRL format is significantly more functional and timely, and therefore less costly for investors and analysts, than traditional HTML data, which must be rekeyed and vetted before use.

The study was based on aggregating annual costs for 1,299 companies, working with 14 separate service providers, geographically dispersed around the country. The dataset captures 32% of all companies with the small company designation.

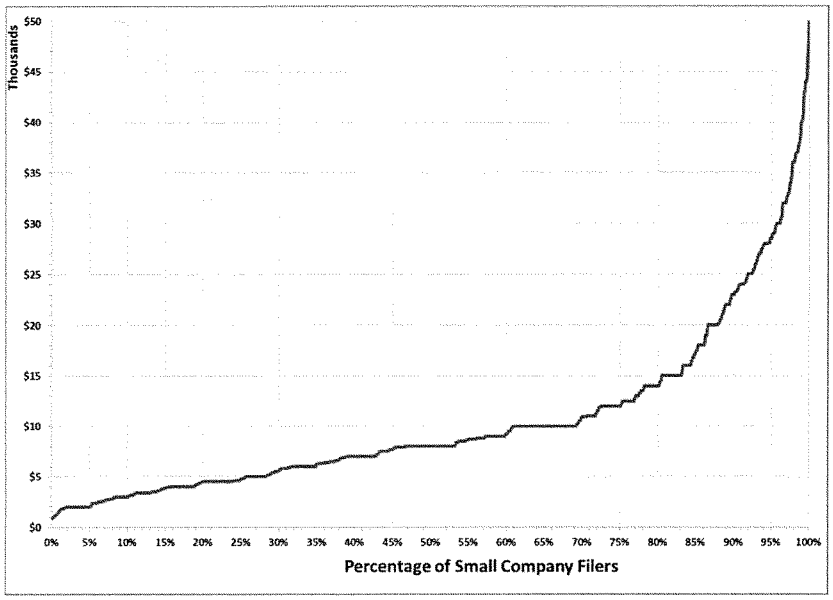
The chart below shows the distribution of the annual reported data with the lowest annual cost at $900/year and the highest cost at $50,000/year. Higher costs are typically associated with more complex financial statements and rush charges.

Chart 1 – Represents number of companies in our study that pay annual costs in the ranges shown.



The cumulative distribution function chart (Chart 2) below shows that 83% of companies pay $15,000 or less to perform 4 filings a year. Only 4% of companies pay more than $30,000 per year.

Chart 2 – Represents percentage of companies in our study that pay annual costs of the amounts shown in thousands.



April 28, 2015

The Honorable Jeb Hensarling
Chairman, House Financial
Services Committee
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member, House Financial
Services Committee
Washington, DC 20515

The Honorable Scott Garrett
Chairman, House Capital
Markets Subcommittee
Washington, DC 20515

The Honorable Carolyn Maloney
Ranking Member, House Capital
Markets Subcommittee
Washington, DC 20515

RE: Support H.R. 686, The Small Business Mergers, Acquisitions, Sales and Brokerage Simplification Act of 2015

Dear Representatives Hensarling, Waters, Garrett, and Maloney,

This letter is submitted on behalf of the Association for Corporate Growth (ACG), in support of H.R. 686, the Small Business Mergers Acquisitions, Sales and Brokerage Simplification Act of 2015 under consideration in this week's House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises hearing, entitled "Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens."

Founded in 1954, ACG is an organization with 45 chapters in the United States representing 14,500 professionals from private equity firms, corporations and lenders that invest in middle-market companies, as well as from law, accounting, investment banking and other firms that provide advisory services.

Private capital plays a critical role in the health of the middle market. The ACG and its members have long been supportive of financial regulatory enhancements that will improve the deal making climate for the middle market without inhibiting or burdening the flow of capital. We believe that H.R. 686 accomplishes this objective.

As background, the ACG supported an identical bill in the 113th Congress as H.R. 2274, The Small Business, Mergers, Acquisitions, Sales and Brokerage Simplification Act of 2013, which was passed unanimously by the House of Representatives on January 14, 2014 by a vote of 422-0. A companion bill was introduced the same day in the U.S. Senate.

Subsequently, on January 28, 2014, the SEC issued an M&A Broker No Action Letter that effectively supported many of the legislative points in H.R. 2272. Finally, on January 15, 2015, the North American Security Administrators Association (NASAA), published its proposed Model Rule Exempting Certain M&A Brokers from State Registration, and requested public comment. NASAA's Model Rule harmonized state regulatory requirements with the recent changes in federal registration requirements per the aforementioned SEC No Action Letter.

Recently, Congressman Bill Huizenga (R MI-2), Congressman Brian Higgins (D NY-26) and Congressman Bill Posey (R FL-8) introduced H.R. 686. The ACG respectfully requests that you pass this bill in the 114th Congress by working with your Senate colleagues to provide clarity for the small and mid-size broker dealer community based on the following points:

- An estimated $10 trillion of privately owned businesses will be sold or closed as baby boomers retire.
- Jobs are preserved and created when new entrepreneurs acquire and grow existing businesses.
- Business brokers can play a key role in facilitating private business mergers, acquisitions, and sales.
- Simplified regulation of business brokerage services will facilitate the flow of capital to privately held businesses in the middle market, which are the driving force in growing the nation's economy and job growth.

When provided with efficient capital flow and a sensible regulatory framework, ACG members are able to invest in and grow small and mid-sized businesses and facilitate transactions that support jobs and support economic growth. In support of these sensible objectives, the ACG stands ready to assist and serve as a resource for you and the Members of the Committee to achieve sound financial policies and enhancements of the Dodd-Frank Act. If you have any questions or require any additional information, please do not hesitate to contact Amber Landis, senior director of public policy at (312) 957-4272.

Sincerely,

Gary LaBranche, FASAE, CAE
President and CEO
Association for Corporate Growth

April 28, 2015

Via Email to:

Hon. Jeb Hensarling, Chairman
U.S. House Financial Services Committee
2129 Rayburn House Office Building
Washington, D.C. 20515

Hon. Maxine Waters, Ranking Member
U.S. House Financial Services Committee
2129 Rayburn House Office Building
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Hon. Scott Garrett, Chairman
Capital Markets and Government Sponsored Enterprises Subcommittee
2129 Rayburn House Office Building
Washington, D.C. 20515

Hon. Carolyn Maloney, Ranking Member
Capital Markets and Government Sponsored Enterprises Subcommittee
2129 Rayburn House Office Building
Washington, D.C. 20515

Re: Hearing, "*Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens*"
Capital Markets and Government Sponsored Enterprises Subcommittee
April 29, 2015 at 2:00 p.m.

Letter Supporting H.R. 686 and S. 1010, *the Small Business Mergers, Acquisitions, and Sales Brokerage Simplification Act of 2015* (114th Congress)

Ladies and Gentlemen:

This letter is submitted for the record in strong support of the bipartisan legislation, H.R. 686, *the Small Business Mergers, Acquisitions, and Sales Brokerage Simplification Act of 2015*. H.R. 686 and its bipartisan Senate companion, S. 1010, would grant relief from broker-dealer registration for merger and acquisition (*M&A*) intermediaries and business brokers (*M&A brokers*) serving qualifying privately owned business sellers and buyers under specified conditions and limitations.

In the 113th Congress, an identical bill, H.R. 2274, was unanimously passed (422-0) by the full U.S. House of Representatives on January 14, 2014, but the bill and its Senate companion, S. 1923, were never taken up for consideration by the U.S. Senate Banking Committee before the end of the session. Also in the last session, H.R. 2274 was unanimously reported and recommended (57-0) by this Committee. During mark-up on November 14, 2013, Ranking Member Waters noted for the record that the staff of the Securities and Exchange Commission (*SEC*) had requested two changes to the original version of H.R. 2274. There were no objections to the SEC's changes and, as amended, H.R. 2274 was unanimously reported out of this Committee on a recorded vote.

Moreover, two weeks after H.R. 2274 passed the House, the Chief Counsel of the SEC's Division of Trading and Markets issued a staff no-action letter to six M&A lawyers dated January 31, 2014 (*SEC M&A Broker Letter*), granting broker-dealer registration relief upon substantially similar terms and conditions as H.R. 2274, now H.R. 686 in this session. The SEC's M&A Broker Letter evidences that the SEC staff's views are in alignment with the public policy supporting this legislation. No-action letters are, however, nothing more than that—an expression of the staff's views. A no-action letter is not legally binding on anyone, not even the SEC itself, and does not change the law. This legislation remains critically important to clarifying and simplifying federal securities laws regulating M&A brokers and the privately-owned business sellers and buyers whom they serve.

222 North LaSalle Avenue, Suite 300
Chicago, Illinois 60601
312-856-9590

We strongly encourage you to favorably report H.R. 686, just as this Committee favorably reported H.R. 2274 in the 113th Congress. Rarely does legislation enjoy such broad-based support ranging from no less than three national and 15 regional and state professional associations of M&A brokers with members in all 50 states, to nationally recognized business associations, and including the SEC staff and state securities regulators. The urgent need for clarification and simplification of broker-dealer registration of M&A brokers serving privately owned business sellers and buyers, as well as a summary of the public policy supporting this legislation, are summarized in the following pages.

Our Association and its Members

The Alliance of Merger & Acquisition Advisors (*AM&AA* or *The Alliance*) is an international professional association of M&A intermediaries and related professionals. The Alliance serves the educational and transactional support needs of middle market M&A professionals worldwide. The Alliance was formed in 1998 to connect M&A intermediaries, CPAs, attorneys, and other experienced corporate financial investors and advisors, and currently has more than 900 professionals that are among the most highly recognized leaders in the industry. The Alliance draws upon proven capital resources combined with a think-tank of transactional expertise to better serve the many business investment needs of middle market companies worldwide. Some of our members are registered broker-dealers and others are unregistered in reliance upon SEC no-action letters and a variety of state-level transactional exemptions.

Our members serve corporate and institutional sellers and buyers of privately held businesses with a wide range of transaction values. These essential corporate financial advisory and transaction services include investment banking, business brokerage, accounting, finance, valuation, tax law, and due diligence. More information about our association is available on our website at: http://www.amaaonline.com/.

The Urgent Need for Clarification and Simplification

As baby boomers prepare to retire, it is estimated that privately owned businesses valued at over $10 trillion will either be closed or, if possible, sold to a new generation of entrepreneurs. Jobs are protected and created by facilitating the transition of private business ownership. Today's one-size-fits-all system of broker-dealer regulation unnecessarily burdens business sellers and buyers with the pass-through of heavy regulatory compliance costs that do not provide significant incremental benefits in privately negotiated M&A transactions. Existing broker-dealer regulation of M&A brokers is inconsistent, complex, and confusing for all of the participants in M&A transactions.

The application of federal broker-dealer regulation to business brokerage services largely came about as an unintended consequence of the U.S. Supreme Court's 1985 opinion in *Landreth Timber Co. v. Landreth et al.* The Court rejected a lower court-constructed "sale of a business" doctrine that in some jurisdictions treated the sale of all of a company's stock as being outside of the scope of Congressional intent of the Securities Act of 1933. The Court ruled that the sale of one share or all the shares of a corporation's stock were securities and the sale was subject to the antifraud prohibitions in the Securities Act. With the Court's rejection of the "sale of a business" doctrine, an intermediary brokering the sale of a business's stock is deemed to be acting as a "broker" under the Securities Exchange Act of 1934, as amended (*Exchange Act*), invoking the full measure of federal investment banking regulation upon purchases and sales, mergers, acquisitions, and business combinations involving privately held companies.

Clarification and harmonization of broker-dealer registration requirements are urgently needed because of the vastly different and anomalous regulatory consequences arising from the legal ownership of each business and the legal structure of each business sale transaction. At one end of the regulatory spectrum, the sale of a company's assets for cash, no matter the size, is typically not a securities transaction and does not subject the parties or the M&A broker to any aspect of federal or state securities regulation. However, the sale of the same company's stock to convey those assets as a whole achieves the same business objective but triggers the full weight of federal and state securities laws to all aspects of the transaction, the parties, and the M&A broker.

In between an asset sale and a stock sale lies substantial uncertainty about whether and when securities laws apply to a particular business sale, leading to complexity, confusion, and uncertainty for all of the transaction's participants. For example, typically, general partnership interests are not securities and so do not trigger securities regulation when purchased or sold. Limited liability company (*LLC*) membership interests may or may not be securities depending upon the facts and circumstances, primarily turning upon whether the LLC owner is active or passive in the operation of the LLC's business. A promissory note issued by a business buyer to a business seller (i.e., seller financing that is commonly called a "seller's note") is presumed to be a security under the U.S. Supreme Court's analysis in *Reves, et al., v. Ernst & Young,* but, depending upon its characteristics and related facts and circumstances, may or may not come within one of several court-constructed exceptions to "securities" status. Hence, a business seller's form of legal entity and the legal structure of the transaction itself directly bear upon whether or not securities laws apply to the transaction, the parties, and the M&A broker's activities. Moreover, these details are often not finalized until the parties' pre-purchase due diligence and contract negotiations have reached a final, legally binding transaction agreement. This transaction-by-transaction facts and circumstances analysis creates wide-spread uncertainty and confusion about the securities regulatory treatment of M&A brokers. It also creates uncertainty for the parties over the validity of a business sale transaction arranged by an unregistered M&A broker.

The decision whether a business will be sold on an asset sale basis, a stock sale basis, a merger or ownership exchange, and other transactional terms and conditions is driven by a variety of competing business considerations wholly unrelated to securities laws (e.g., historical liability risk mitigation, income taxation, non-assignable contracts, and non-assignable licenses or charters). Typically, the choice of a transaction's legal structure is negotiated by the parties with advice from their lawyers and tax accountants. Rarely is significant consideration given to whether securities laws do or do not apply to the transaction. Rather than relying upon general antifraud prohibitions for protection, the parties negotiate transaction-specific representations, warranties, covenants, price adjustments, indemnities, and other remedies into their M&A agreements. Moreover, business sellers and buyers rarely turn to the SEC or state securities regulators to resolve disputes over their M&A transactions because they go to court to enforce their negotiated rights and remedies. Indeed, securities regulators are typically reticent about allocating their limited regulatory resources to investigating and resolving commercial disputes among business sellers, buyers, and M&A brokers.

Unlike passive investors, business sellers and buyers are, or will be, active in controlling and running their businesses. They negotiate the terms and conditions of their business transfers, often with the assistance of lawyers, accountants, and other business advisors. Typically, the sale of a business takes many months, and often more than a year, for the parties' own due diligence processes, negotia-

tions, drafting purchase or merger agreements, related disclosure schedules, and transaction's closing. Prospective buyers conduct their own pre-purchase investigations because they will control and run the acquired business, commonly with the assistance of knowledgeable senior managers, employees, lawyers, and accountants. A buyer's access to information about the business is direct, unfiltered, and unrestricted because, typically, the buyer needs the information to run the business after closing.

Today's "one-size-fits all" regime of broker-dealer regulation treats the activities of M&A brokers assisting sellers or buyers of private companies like "Wall Street" investment bankers selling passive ownership in public companies. This regime imposes regulatory burdens and related costs that are necessarily passed on to private business sellers and buyers who use these professional services, but who benefit little from the perceived "investor protections" associated with SEC and FINRA regulation in the context of these business brokerage activities. For example, the regulatory compliance costs of forming, registering, and operating a broker-dealer to engage in business brokerage activities is estimated to be $150,000 initially and $75,000 annually on-going forward regardless of the number of business sales handled by an M&A broker during any given year. Those fixed costs of doing business are necessarily passed on to business sellers and buyers. Moreover, these fixed regulatory costs are incurred regardless of the number of securities or non-securities M&A transactions handled by an M&A broker in any given year. Commonly, M&A brokers—themselves small businesses—only handle a few transactions at a time. The time necessary to become SEC-registered and a FINRA member typically exceeds nine months and sometimes more than a year, and there are on-going requirements and fees to maintain these registrations not just federally but also with all states having jurisdiction. Commonly, state-level real estate and broker business brokerage licensing are also required.

The Legislative Solution

H.R. 686 and its bipartisan companion, S. 1010, would create a limited, conditional exemption from broker-dealer registration for qualifying M&A brokers with respect to qualifying privately owned businesses without regard to the legal structure of the M&A transaction. The exemption is only available if the prospective business buyer will acquire control and actively run the business—that is, in effect, the buyer cannot be a passive investor and must have full access to all of the information and operations of the acquired business. The bill defines a presumption of control to accommodate a variety of business ownership scenarios. This clearly defined registration exemption would simplify and harmonize the interests of business sellers, buyers, and the M&A brokers who serve them. The registration exemption would lower the regulatory costs associated with providing business brokerage services. The bill carefully defines operative terms, conditions, and limitations. Important "investor protections" are unaffected by the bill.

The bill only creates an exemption from broker-dealer registration. It does not change the statutory definition of a "broker", and so it does not exclude M&A brokers from the SEC's jurisdiction to investigate and bring enforcement actions for violations of the antifraud prohibitions in federal securities laws, including prohibitions directly applicable to all "brokers" as defined in the Exchange Act regardless of being registered or exempt from registration. The bill does not exempt M&A brokers from generally applicable anti-terrorism and anti-money laundering requirements under the U.S. PATRIOT Act, Bank Secrecy Act, and related U.S. Department of Treasury regulations. The registration relief is not available if an M&A broker handles or has custody of the funds or securities to be exchanged by the parties in the transaction.

The broker-dealer registration exemption eliminates costly regulatory requirements that provide little incremental investor protection in the context of privately negotiated M&A transactions. For example, M&A brokers provide business brokerage services in an agency capacity, do not hold clients funds or securities, typically do not receive their compensation unless and until a successful transaction closing, and so do not become financially obligated to their seller or buyer clients. Consequently, annual audited financial statements by PCAOB-registered CPAs and on-going quarterly and annual financial reporting to the SEC and FINRA provide no meaningful benefit to business sellers or buyers but do impose substantial fixed regulatory costs.

Public Policy Support

The SEC has already reviewed and commented on the bill in the last Congressional session and its requested changes were unanimously adopted by this Committee when it favorably reported H.R. 2274 to the full U.S. House of Representatives. Moreover, the SEC staff issued its M&A Broker Letter two weeks after the bill (then H.R. 2274) unanimously passed the U.S. House of Representatives. The SEC M&A Broker Letter expressly says its Division of Trading and Markets would not recommend enforcement action by the Commission[1] if an M&A broker provided business brokerage services without registering as a broker-dealer in connection with the sale or transfer of ownership of privately-held companies to buyers who will have control and actively run the business.[2] The SEC's definitions and operative language are substantially similar to the definitions and operative language in H.R. 686 and S. 1010. We believe the no-action letter clearly articulates the staff's view that there is sound public policy supporting this bill. There have been few reported regulatory enforcement actions involving M&A brokers. Accordingly we also believe the no-action letter reflects the staff's view that the SEC's (and FINRA's) limited regulatory resources are more cost-effectively deployed in other areas of its jurisdiction where there have been a plethora of investor protection issues.

Notably, the SEC M&A Broker Letter contains no limitation on the size of a privately held company that may be offered and sold in reliance upon the relief from broker-dealer registration. We believe the absence of a size limitation reflects the SEC staff's understanding that the larger the transaction the more sophisticated the parties, the greater the involvement of each party's legal teams, the more highly negotiated the contractual terms, conditions, rights, and remedies in the M&A agreements, and the more exhaustive the pre-closing due diligence performed by the parties' executives, senior managers, employees, and accountants. Like the SEC, we believe no limitation on the size of the target company is necessary because these "investor protections" are inherently greater in larger M&A transactions. The public policy objective of the bill is to balance regulatory costs and benefits in the context of M&A transactions. In short, the larger the transaction, the more financial resources the parties have at their disposal to protect their own interests through employing professional staff, lawyers, accountants, and other business advisors. This cost/benefit analysis cannot be limited to arbitrarily defined "small businesses", but rather is fundamentally important to the profitability and transfer of ownership of all companies regardless of their size.

[1] The Commission is not bound by the no-action letter; the limited, non-binding legal effect of a no-action letter is described on the SEC's website at: http://sec.gov/answers/noaction.htm.
[2] Available at: https://www.sec.gov/divisions/marketreg/mr-noaction/2014/ma-brokers-013114.pdf.

That being said, the bill does include a size limitation on qualifying privately-held companies that we believe represents a reasonable compromise between the SEC's staff's position that no size limit is necessary and a handful of opponents who seek to severely limit the target company's size in order to preserve their complex and costly regulatory barriers to pro-competitive entry by lower-cost professional service providers. These opponents' self-interest is self-evident in view of the SEC M&A Broker Letter, as well as the support of state securities regulators as summarized below.

The bill uses two size limitations because different types of businesses have different economics. Some businesses have high gross revenues but low profit margins (e.g., grocery stores and car dealerships) and some businesses have lower gross revenues but high profit margins (e.g., jewelry stores). Recognizing these differences, H.R. 686 defines an "eligible privately held company" with reference to dual size limitations. To qualify for the exemptive relief in the bill, the private company must meet either or both of two conditions determined in accordance with the company's historical financial accounting records: (i) the earnings of the company before interest, taxes, depreciation, and amortization (a basic accounting concept known as EBITDA) must be less than $25 million; (ii) the gross revenues of the company must be less than $250 million.

To avoid the potential for manipulation, these figures must be based upon the target company's own financial records, such as would be reflected in its financial statements and tax returns. Gross revenues and EBITDA are easily identified in a company's existing books and records. Smaller businesses typically do not have reviewed, compiled, or audited financial statements, so no such requirement is imposed by the bill. Recognizing that M&A transactions may take many months to complete after an M&A broker has been engaged, including a substantial investment of the M&A broker's time and resources, the latest year-end financial records available at the time of engagement are used as the reference point. While the SEC M&A Broker Letter contains no size limitation, we believe the bill's size limitations are reasonable and their method of calculation difficult to manipulate, and so provide an appropriate level of "investor protection".

We do note that the SEC M&A Broker Letter includes two disqualifying conditions preventing reliance upon the broker-dealer registration relief by so-called "bad actors" and in M&A transactions involving so-called "public shell companies". These two disqualifications were actually in the original version of H.R. 2274 and concept drafts of the bill, but were inadvertently lost during the 2013-2014 session's legislative drafting process. These disqualifications are included in a Senate companion bill, S. 1010, and we do not oppose their inclusion in H.R. 686 or a conference committee report.

Proposals to appropriately scale federal regulation of business brokers have been among the top recommendations in the 2006, 2007, 2008, 2009, 2010, and 2011 Government-Industry Forum on Small Business Capital Formation hosted by the SEC (http://sec.gov/info/smallbus/sbforum.shtml). The Final Report of the Advisory Committee [to the SEC] on Smaller Public Companies (2006) made the same recommendation (www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf), as did the Report and Recommendations of the Private Placement Broker-Dealer Task Force of the Business Law Section of the American Bar Association, 60 Business Lawyer 959-1028 (2005) (www.sec.gov/info/smallbus/2009gbforum/abareport062005.pdf).

State securities regulators have also recognized the need for regulatory clarification and simplification. As introduced, H.R. 2274 was supported in testimony by the North American Securities

Administrators Association (*NASAA*) at this Committee's hearing on October 23, 2013. Later, the above-referenced revisions to the bill accommodating the SEC's changes caused NASAA to withhold its further support for the amended bill last session. This session, the bipartisan Senate companion bill, S. 1010, addresses NASAA's concerns by adding back the "bad actor" and "public shell merger" disqualifiers. Moreover, in January 2015, NASAA's Broker-Dealer Section proposed a model M&A broker rule for adoption by NASAA's member states. NASAA's proposed model state rule is similar in all substantive respects to the Senate version of this bill, S. 1010. The proposed model rule is available at: http://www.nasaa.org/wp-content/uploads/2011/08/Proposed-Uniform-MA-Broker-Model-Rule1.pdf. If adopted by a state, the model rule would create an exemption from state-level broker-dealer registration for M&A brokers under the circumstances conditions, and limitations tracking with the federal legislation, resulting in unparalleled harmonization between federal and state securities regulation.

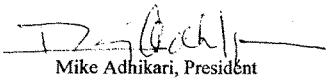
Conclusions

H.R. 686 and its Senate companion, S. 1010, provide a common sense solution to the unintended effects of today's "one-size fits all" system of broker-dealer regulation. Business sellers and buyers have one economic objective, to transfer ownership of the business from the seller to the buyer. However, federal and state securities laws may or may not apply to the M&A transaction depending upon: (1) seller's form of legal entity and ownership (e.g., corporation, limited liability company, or general partnership); and (2) the legal structure of the M&A transaction itself (sale of assets vs. sale or exchange of stock). Accordingly, the sale of a corporation virtually always involves a securities transaction. The sale of a limited liability company may or may not involve a securities transaction depending on the facts and circumstances. The sale of business assets for cash rarely involves a securities transaction. The sale of a general partnership rarely involves a securities transaction.

These common but varying business sale scenarios create uncertainty for business sellers, buyers, and the M&A brokers who serve them. H.R. 686 and its Senate companion, S. 1010, resolve these uncertainties by exempting M&A brokers from SEC broker-dealer registration regardless of the form of ownership or legal structure of the M&A transaction, subject to the conditions and limitations in the bill and the investor protections inherent in the context of privately negotiated M&A agreements.

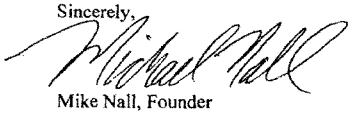
We appreciate the opportunity to provide the Committee with this background and public policy support for H.R. 686. Please do not hesitate to contact us or our securities counsel, Shane Hansen, if you have any questions or need additional information.

Sincerely,



Mike Adhikari, President
(847) 438-1657

Sincerely,



Mike Nall, Founder
(312) 856-9590

c: Mr. Shane B. Hansen, Partner
Warner Norcross & Judd LLP
111 Lyon Street, N.W.
Grand Rapids, Michigan 49503-2487
(616) 752-2145 or shansen@wnj.com

BUSINESS BROKERS OF FLORIDA

April 23, 2015

The Honorable Jeb Hensarling
Chairman, House Financial
Services Committee
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member, House Financial
Services Committee
Washington, DC 20515

The Honorable Scott Garrett
Chairman, House Capital
Markets Subcommittee
Washington, DC 20515

The Honorable Carolyn Maloney
Ranking Member, House Capital
Markets Subcommittee
Washington, DC 20515

REF: HR 686, The Small Business Mergers, Acquisitions, Sales and Brokerage Simplification Act of 2015

Dear Representatives Hensarling, Waters, Garrett, and Maloney,

The Business Brokers of Florida is the largest association of business brokers in United States with approximately 3,300 active business listings, over 1,000 active agents & 300 active brokers/offices throughout the state. Florida law requires a Florida real estate license to operate as a business broker in the state.

Business sellers have typically spent most of their working life building the value of their business, and seek professional representation in order to realize the best possible return for their life's work. In many cases, the sale of their business will be the largest financial transaction of their lives.

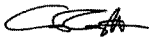
In the twelve months ending 12-31-14, BBF members closed more than 1,000 business sales totaling over $300 million. In the vast majority of transactions, these were handled from start to finish as an asset sale. In all cases these businesses were too small to contemplate a public offering of the company's stock, or to be of interest to a fully licensed broker/dealer or investment banker. A relatively small percentage of the total transactions started as an asset sale and converted at some point to a stock sale in one form or fashion.

For this reason, we have followed closely the development of HR 686 from HR 2274 & S 1923, The Small Business Mergers, Acquisitions, Sales and Brokerage Simplification Act of 2015, which would right-size federal regulation of small business brokers and M&A advisors who do not hold funds or securities and do not raise capital, and we strongly support the earliest possible passage of this bill.

We believe this is essential that we continue to provide an affordable, efficient market for thousands upon thousands of small business owners to cash out their investment upon their retirement, failing health, death, etc. and provide a like opportunity for the next generation of small business owners to invest in owning their own business and realize their dream of growing it into a much larger enterprise.

Thanks in advance for your support of this important legislation for small businesses.

Respectfully submitted,



Andrew Cagnetta
Transworld Business Advisors
State Chair, Business Brokers of Florida

cc. The Honorable Bill Huizenga, 1217 Longworth House Office Building, Washington, DC 20515
The Honorable Brian Higgins, 2459 Rayburn House Office Building, Washington, DC 20515
The Honorable Bill Posey, 120 Cannon House Office Building, Washington, DC 20515
The Honorable Carlos Curbelo, 1429 Longworth House Office Building, Washington, DC 20515

5101 NW 21st Ave Suite 300 Fort Lauderdale, Florida 33021 888-925-5055

April 25, 2015

The Honorable Jeb Hensarling
Chairman, House Financial Services Committee
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member, House Financial Services Committee
Washington, DC 20515

The Honorable Scott Garrett
Chairman, House Capital Markets Subcommittee
Washington, DC 20515

The Honorable Carolyn Maloney
Ranking Member, House Capital Markets Subcommittee
Washington, DC 20515

RE: **Support HR 686**
The Small Business Mergers, Acquisitions, Sales and Brokerage Simplification Act of 2015

Dear Chairman Hensarling,
Ranking Member Waters,
Chairman Garrett, and
Ranking Member Maloney:

We respectfully request you to join in co-sponsoring HR 686, The Small Business Mergers, Acquisitions, Sales and Brokerage Simplification Act of 2015, and to add your strong and active support to promptly passing this needed and overdue legislation. This bipartisan bill and its counterpart S.1010 appropriately revise regulatory burdens on small business owners and their advisors. What will the impact be? HR 686 will help squeeze out obstacles created by counterproductive regulations; ones that add risks

and costs without demonstrating commensurate benefits to any party. It will enhance private business commerce, protect and create jobs, and improve the efficient flow of capital for small to medium businesses.

The House of Representatives introduced, considered, and then unanimously passed an identical bill, HR 2274, early in 2014 by a vote of 422-0. A corresponding bill was then introduced in the U.S. Senate, but it was not acted upon before the session concluded.

After HR 2274 passed the House, the Securities and Exchange Commission released its "M&A Brokers" No Action Letter reflecting a staff view supporting an even less restrictive application of current law than would be created under HR 686. While the No Action Letter alone is somewhat helpful, it lacks the sufficiency of law and, absent provisions codified in HR 686, it is simply inadequate to clarify the issues to provide a fair, balanced, and reliable platform for small to medium sized business buyers and sellers, or their advisers.

Further evidencing validity of the public policy concept embodied in HR 686, is the recently published Model Rule Exempting Certain M&A Brokers from State Registration, as released for public comment by the North American Securities Administrators Association (NASAA). Once adopted, this rule promulgates a recommended rule into the states' regulatory schemes comporting well to the SEC's M&A Brokers No Action Letter and to the provisions under HR 686.

As business brokers and M&A brokers, we have a unique knowledge and understanding of the importance of HR 686 and S 1010 to buyers and sellers of businesses and of the broader economic benefits to employees, communities, and the effective flow of capital for entrepreneurs and privately held businesses.

- Vague and inappropriate requirements regarding an unclear potential need for generalized securities registration are not valuable in the specific context of selling operating businesses to a buyer who thereby takes active control of the decisions, management, the assets and operations, and control, on their own behalf. They are just burdensome.

- Jobs are preserved and created when new entrepreneurs acquire and grow existing businesses. This enhances and protects the lives and livelihoods of countless middle class wage earners, while avoiding employee layoffs and further straining the social safety net.

- Fresh ideas, capital infusions, and vigor associated with businesses sold rather than shuttered are major contributors to the economic vitality of communities and the country.

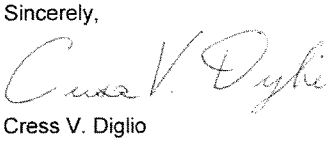
- M&A and business brokers are valuable assets and service providers in assisting buyers and sellers in negotiated transactions for the sale of businesses.

- Eliminating the specter caused when M&A brokers are required to register and comport with a burdensome, expensive and inapplicable scheme will facilitate the flow of capital to small businesses; the driving force to improving our nation's economy, tax revenues, and continued job growth.

As you will have seen by correspondence from others on this subject, your passing HR 686 and S 1010 is supported by a vast preponderance of groups comprising the M&A and business broker professionals who uniquely know, understand, and professionally serve the privately held business segment addressed by HR 686.

This request for your support of HR 686 is submitted by the International Business Brokers Association and the M&A Source. We are two leading non-profit associations of professionals who specialize in business ownership transitions, acquisitions and sales of private businesses through negotiated transactions.

Sincerely,



Cress V. Diglio
Chair, International Business brokers Association

3315 East Russell Road A-4 # 209, Las Vegas, NV 89120-3477

April 24, 2015

The Honorable Jeb Hensarling
Chairman, House Financial
Services Committee
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member, House Financial
Services Committee
Washington, DC 20515

The Honorable Scott Garrett
Chairman, House Capital
Markets Subcommittee
Washington, DC 20515

The Honorable Carolyn Maloney
Ranking Member, House Capital
Markets Subcommittee
Washington, DC 20515

RE: **Support HR 686 and S 1010, The Small Business Mergers, Acquisitions, Sales and Brokerage Simplification Act of 2015**

Dear Chairman Hensarling, Ranking Member Waters, Chairman Garrett, and Ranking Member Maloney:

On behalf of the Nevada Business Brokers and all of its members, we ask for your co-sponsorship and support of HR 686, The Small Business Mergers, Acquisitions, Sales and Brokerage Simplification Act of 2015, a bipartisan bill to reduce regulatory burdens on small business owners and their advisors.

An identical bill was first introduced in the 113th Congress as HR 2274, The Small Business, Mergers, Acquisitions, Sales and Brokerage Simplification Act of 2013, and was passed UNANIMOUSLY by the House of Representatives on January 14, 2014 by a vote of 422-0. A companion bill was introduced the same day in the US Senate, but no action was ever taken.

Subsequent to the passage of HR 2274, on January 28, 2014, the SEC issued its sweeping M&A Broker No Action Letter, and continues to be supportive of having this relief codified by Congressional action.

On January 15, 2015, the North American Security Administrators Association (NASAA), published its proposed Model Rule Exempting Certain M&A Brokers from State Registration, and requested public comment. NASAA's Model Rule harmonizes state regulatory requirements with the recent changes in federal registration requirements per the SEC MAB NAL.

Now that Congressman Bill Huizenga (R MI-2), Congressman Brian Higgins (D NY-26) and Congressman Bill Posey (R FL-8) have reintroduced this bill in the US House of Representatives, and Senator Joe Manchin (D WV) and Senator David Vitter (R LA) have introduced the companion bill in the Senate, we respectfully request that you join as a co-sponsor and urge your colleagues to pass these bills as soon as possible.

As professional business brokers/M&A advisors, we know that:

- An estimated $10 trillion of privately owned businesses will be sold or closed as baby boomers retire.
- Jobs are preserved and created when new entrepreneurs acquire and grow existing businesses.
- Business brokers can play a key role in facilitating private business mergers, acquisitions, and sales.
- Simplified regulation of business brokerage services will facilitate the flow of capital to privately held businesses, which are the driving force in growing the nation's economy and job growth.

Passage of HR 686 and S 1010 is strongly supported by the Alliance of Merger and Acquisition Advisors (AM&AA), the Small Business Investor Alliance (SBIA), the US Chamber of Commerce, the Association for Corporate Growth (ACG), the M&A Source (MAS), the International Business Brokers Association (IBBA), and every regional, national, and international professional association engaged in providing professional merger and acquisition services to business owners.

For more information on this legislation, please view the AM&AA's Fact Sheet by paste this link to your browser window: *Summary – The Small Business Mergers, Acquisitions, Sales, and Brokerage Simplifications Act.pdf*

Thank you, in advance, for your support.

Jack Novak, Chairman

Len Krick, Co-Chairman

Jeff Nyman, President

Bob Burley, Secretary/Treasurer

Linda Nyman, Member

Brad Bottoset, Member

Richard Lybbert, Member

February 12, 2015

The Honorable Bill Huizenga
1217 Longworth Building
Washington, DC 20515

Dear Representative Huizenga:

On behalf of the 100,000 members of the Small Business & Entrepreneurship Council (SBE Council), thank you for introducing H.R. 686, the "Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2015."

This important piece of legislation would clarify, simplify, and reduce regulatory costs associated with the sale and purchase of smaller privately held companies. Current law forces broker dealers to register with the Security and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), and one or more states at substantial costs, which are then passed on as transaction costs when small and family-owned businesses are sold from one entrepreneur to another. These high costs are an impediment for many entrepreneurs who want or need to sell their businesses.

Your bill would remove a costly regulatory burden faced by many small business owners and entrepreneurs by exempting brokers from registration who perform services associated with the sale of these small, private firms.

SBE Council was pleased H.R. 686 passed the U.S. House with massive bipartisan support (422-0) in the last Congress, and we are hopeful the U.S. Senate will quickly act on this measure. We look forward to working with your office to ensure H.R. 686 quickly moves through both chambers and to President Obama's desk for signature into law.

Sincerely,

Karen Kerrigan
President & Chief Executive Officer

301 Maple Avenue West • Vienna, VA 22180 •(703)-242-5840 • sbecouncil.org • @SBECouncil
Protecting Small Business, Promoting Entrepreneurship

Testimony of John C. Partigan
Before the U.S. House Committee on Financial Services, Subcommittee Capital Markets and Government Sponsored Enterprises

April 29, 2015

I. Introduction

Chairman Garrett, Ranking Member Maloney, and distinguished members of this subcommittee, thank you for allowing me to submit this testimony to the House Committee on Financial Services, Subcommittee Capital Markets and Government Sponsored Enterprises.

I am a partner in the Washington, DC, office of Nixon Peabody LLP and the chair of the firm's National Securities Practice Group.

I have been practicing corporate and securities law for more than 25 years. I am a member of the District of Columbia Bar Association and the New York State Bar Association. I have served as a member of the NASDAQ Listings Qualifications Panel (2004–2014), and have advised public and private companies on a range of securities issues.

I understand this committee will examine a number of bills, and I of course applaud your efforts to find bipartisan legislation addressing particular regulatory issues. I think this committee played a key role in passing the JOBS Act in 2012, which has helped increase initial public offerings and provided additional benefits to our nation's capital markets. I believe your continued review of additional legislative solutions can help improve our markets even more.

My testimony will address H.R. 1675, Encouraging Employee Ownership Act of 2015. I was a witness during a U.S. Senate Committee on Banking, Housing, & Urban Affairs subcommittee hearing on March 24, 2015, and provided testimony regarding similar legislation, S. 576.

II. SEC Rule 701

Before I describe what H.R. 1675 does, and why I believe it is a sensible update to an already popular SEC rule, I want to provide a brief description and history of Rule 701.

Why Was Rule 701 Created? How Does It Operate?

Rule 701, which was introduced in 1988, provides an exemption from SEC registration requirements, under the Securities Act of 1933, for private companies, private subsidiaries of public companies, and foreign private issuers to offer their own securities—including stock options, restricted stock, and stock purchase plan interests—as part of written compensation plans or agreements to employees, directors, officers, general partners, and certain consultants and advisors.

In the absence of Rule 701, most privately-held companies offering employer stock under a broad based employee compensation plan would be required to register the offer and sale of these securities with the SEC regardless of the fact that they are being offered for compensatory purposes and not capital raising.

Rule 701 may be used only by an issuer that is not subject to the reporting requirements of Section 13 or Section 15(d) of the Securities Exchange Act of 1934, and is not an investment company registered or required to be registered under the Investment Company Act of 1940.

The offer and sale of securities under Rule 701 must be for compensatory purposes, that is, the offer and sale must be made pursuant to either a written compensatory benefit plan or a written contract relating to compensation established by the company or its parent or majority-owned subsidiaries.[1]

Rule 701 offerings are not used for capital raising purposes, but are, nevertheless, often an important component of companies' planning to attract and retain talent—a key to the success of any business. This is particularly true of newer companies that may offer stock and stock options as they are attracting early-stage financing and need to preserve cash and demonstrate the commitment to the company of key employees.

Under Rule 701, the aggregate sales price or amount of securities sold or options granted in reliance on the rule during any consecutive 12-month period cannot exceed the greater of the following: (1) $1,000,000; (2) 15 percent of the total assets of the issuer, measured at the issuer's most recent balance sheet date; or (3) 15 percent of the outstanding amount of the class of securities being offered and sold in reliance on this section, measured at the issuer's most recent balance sheet date.[2]

A company offering securities pursuant to Rule 701 must provide investors a copy of the compensatory benefit plan or the contract, as applicable.

While it is true that privately-held companies do not file periodic reports with the SEC, it is also important to note that it is incorrect to say that the employee-investor is not entitled to any information under the Securities Exchange Act of 1934, as has been asserted. Because the offering remains subject to SEC Rule 10b-5—the SEC's antifraud rules—a company must provide Rule 701 employee-investors with disclosures adequate to satisfy the antifraud provisions of the federal securities laws. State securities or "blue sky" laws also continue to apply to these transactions. Rule 701 provides an exemption only from registration requirements under the Securities Act of 1933.

Generally, this means that a company offering Rule 701 securities to employees must, in all instances, provide to the employee a copy of the written employee compensation plan and the type of additional information that a reasonable investor would expect to receive from the company about the proposed investment before making an investment in the company.

The Enhanced Disclosures

In 1996, the National Securities Markets Improvement Act ("NSMIA") was signed into law.[3] NSMIA included provisions that provided the SEC with new and unlimited Rule 701 exemptive authority. Prior to the enactment of NSMIA, the SEC was restricted to allow no more than $5 million per year for exempt transactions like Rule 701 because that was the extent of the then-existing exemptive authority.

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[1] See, https://www.sec.gov/rules/final/33-7645.htm.

[2] See, 17 C.F.R. § 230.701(d)(2).

[3] See, Pub. L. 104-290, 110 Stat. 3416 (October 11, 1996).

In 1999, when the SEC issued amended rules for Rule 701 pursuant to NSMIA, it created a new two-tier disclosure regime. For sales of $5 million and below, the existing 1988 disclosures requirements remained in place, with the SEC noting it "***had not found instances of abuse of Rule 701, nor [had it] become aware of investor complaints***. Rather, investors have enjoyed the benefits of being compensated with the securities of the company for which they are employed or provide services. Therefore, we have found that Rule 701 has been consistent with investor protection in the past."[4]

The SEC went on to state, in recognition of the benefits of Rule 701, "[o]ver the years, our staff has monitored the use of the rule. The staff concluded that the rule has been popular for both small businesses and larger private companies. However, the $5 million limit appears to have become unnecessarily restrictive in light of inflation, the increased popularity of equity ownership as a retention and incentive device for employees, and the growth of deferred compensation plans."[5]

Nevertheless, because the SEC was expanding the program and had concerns that it was eliminating the $5 million cap for such offerings, it created a regime of enhanced disclosure for companies making yearly sales under the rule in excess of $5 million. These enhanced disclosures include delivery of: (1) a summary plan description if the plan is an ERISA plan; (2) risk factors associated with the investment; and (3) financial statements, which must be audited if available, no older than 180 days, required under SEC Regulation A.[6]

Why Is H.R. 1675 Necessary?

H.R. 1675 is simple; it raises the outdated threshold for the enhanced disclosures. Specifically, H.R. 1675 instructs the SEC to increase the level, from $5 million to $10 million, at which level the Rule 701 enhanced disclosures are required, and would adjust this level every five years. Otherwise, Rule 701 remains the same.

Some commentators, who do not appear to have ever approved of Rule 701's creation, do not see a need for updating it. Specifically, I have read suggestions that providing these disclosures are not burdensome or should not matter for a privately-held company. It seems to me that the real issue these commentators have is with Rule 701's existence, not with raising the threshold for enhanced disclosures.

I believe, as do others who have commented about Rule 701, that providing these disclosures is a significant issue for many privately-held companies. In my view, any assertion that the enhanced disclosures are not burdensome or problematic is wrong. Many of those asserting that releasing such information is not a problem have never spent significant time in the business world and may not appreciate how damaging the release of highly confidential financial information to competitors by an employee or former employee could be for the company. Moreover, these exempt offerings

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[4] See, https://www.sec.gov/rules/final/33-7645.htm. (emphasis added)

[5] *Id.* It is important to note that while the $5 million exemptive threshold was lifted, the $1 million, 15 percent assets or stock cap remains today.

[6] See, 17 C.F.R. § 230.701(e).

under Rule 701 differ from a company's attempt to raise capital under SEC Regulation D or other private placement exemptions. This distinction is critical and suggests different approaches for exempt offerings under Rule 701 and capital-raising transactions, which is exactly what the SEC has recognized for years under Rule 701.

The SEC noted in its NSMIA Rule 701 rulemaking, "[b]ecause the compensated individual has some business relationship, perhaps extending over a long period of time, with the securities issuer, that person will have acquired some, and in many cases, a substantial amount of knowledge about the enterprise. The amount and type of disclosure required for this person is not the same as for the typical investor with no particular connection with the issuer."[7]

In the same rule-making, the American Bar Association; members of the Task Force on Small Business Issuers; and the Subcommittee on Employee Benefits, Executive Compensation and Section 16 ("ABA Subcommittee") submitted comments expressing concern about the new enhanced disclosure requirements. The ABA Subcommittee stated that, "[m]ost private issuers keep confidential their financial conditions and results. Having to provide this information to employees (and often former employees) as a condition to the exemption risks having this information come into the possession of a company's competitors." The comments went on to note that, "[r]equiring that these employees be provided with financial information could result in serious injury to the company, ***one that it would be naïve to think could be avoided with a confidentiality agreement***."[8]

Since 1999, when the ABA Subcommittee's comments were submitted, the potential for leaks and the public release of highly confidential information has only grown. From private businesses being hacked by rogue players to secret government information being placed on the internet, protecting information has become exponentially more challenging. In this environment, privately-held companies are faced with the decision whether to limit compensatory grants and sales to employees to stay under the $5 million enhanced disclosure threshold or risk the dissemination of highly confidential financial information.

Why Raise the Enhanced Disclosure Threshold to $10 Million?

If the disclosure threshold had been adjusted for inflation since 1988, it would be roughly $10 million today.[9] As the SEC noted in the NSMIA Rule 701 rulemaking, the legislative history of the legislation supported a prompt increase of the Rule 701 threshold to not less than $10 million.[10] In fact, both the Senate Committee on Banking, Housing and Urban Affairs Report and the House of Representatives Committee on Commerce Report suggested that Congress wanted the Rule 701

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[7] See, https://www.sec.gov/rules/final/33-7645.htm.

[8] See, "Comments of Task Force on Small Business Issuers and the Subcommittee on Employee Benefits, Executive Compensation and Section 16 of the Committee on Federal Regulation of Securities of the Section of Business Law of the American Bar Association," available at, http://www.sec.gov/rules/proposed/s7598/liftin8.htm; see also, "Comments of David Greenlee," available at, http://www.sec.gov/rules/proposed/s7598/greenle1.txt. (emphasis added)

[9] See, Bureau of Labor Statistics CPI inflation calculator, available at, http://www.bls.gov/data/inflation_calculator.htm, the purchasing power of $5 million in 1988 dollars is $10,005,748 in 2014 dollars.

[10] See, H. R. Rep. No. 104-622 at 38; S. Rep. No. 104-293 at 16.

threshold raised to not less than $10 million, and neither report makes mention of additional disclosures being a part of that increase. Finally, the SEC Government-Business Forum on Small Business Capital Formation included, among its recommendations, that the SEC "raise the dollar threshold for triggering the required disclosures pursuant to a Rule 701 offering from $5 million to no less than $10 million."[11]

This is what the Encouraging Employee Ownership Act of 2015 would do. The legislation continues to address the SEC's original concerns by requiring disclosures for stock grants and sales above $10 million, while recognizing that employees know their companies and the companies are using such stock grants and sales solely for compensatory purposes.

IV. Conclusion

There are an estimated 5.7 million[12] privately-held companies. These companies operate under the conviction that being privately held is the best model for them. It would be unfortunate to punish their employees by restricting their ownership opportunities because of a failure to update this old threshold.

Thank you again for the opportunity to offer this testimony.

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[11] See, "SEC Government-Business Forum on Small Business Capital Formation," Nov. 21, 2013, report available at, http://www.sec.gov/info/smallbus/gbfor32.pdf, pp. 14–15.

[12] See, http://www.forbes.com/sites/sageworks/2013/05/26/4-things-you-dont-know-about-private-companies/.