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CAPITAL FORMATION AND REDUCING SMALL BUSINESS BURDENS

HEARING

BEFORE THE

SUBCOMMITTEE ON
SECURITIES, INSURANCE, AND INVESTMENT

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

ON

EXAMINING LEGISLATIVE PROPOSALS ON CAPITAL FORMATION THAT WERE CONSIDERED IN THE HOUSE LAST CONGRESS THAT WOULD HELP CAPITAL FORMATION AND REDUCE BURDENS FOR SMALLER BUSINESSES

MARCH 24, 2015

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C O N T E N T S

TUESDAY, MARCH 24, 2015

WITNESSES

Additional Material Supplied for the Record

CAPITAL FORMATION AND REDUCING SMALL BUSINESS BURDENS

TUESDAY, MARCH 24, 2015

U.S. SENATE,
SUBCOMMITTEE ON SECURITIES, INSURANCE, AND INVESTMENT,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Subcommittee convened at 2:33 p.m., in room 538, Dirksen Senate Office Building, Hon. Mike Crapo, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF CHAIRMAN MIKE CRAPO

Chairman CRAPO. Good afternoon. This hearing of the Subcommittee on Securities, Insurance, and Investments will come to order.

Today's hearing will focus on several legislative proposals that would help capital formation and reduce burdens for smaller businesses. My goal is to work with Senator Warner and with other Senators on the Banking Committee to identify legislative proposals that help small business grow and succeed and work to move a package of such proposals through the Senate.

The bills being discussed in today's hearing were considered in the House of Representatives last Congress, and most of them passed with a voice vote or with very strong bipartisan support. Some of these bills have also been introduced in the Senate.

Senator Warner and Senator Toomey introduced legislation to allow companies to expand employee ownership. Senator Kirk has introduced legislation that would end the double regulation of small business investment companies last Congress.

Others are aimed at aiding the SEC in its mission. The SEC is tasked with protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation. However, the SEC has a long list of "to do" items, and the Congress can help in prioritizing this list through oversight and legislation. This includes completing the Regulation A rules from the JOBS Act—I think you are probably in agreement with that, Senator Warner—modernizing disclosure requirements, and improving access to capital for small companies.

At this time, I will include for the record, if there is no objection, testimony and letters from the Biotechnology Industry Organization, the Coalition for Derivatives End-Users, and XBRL US on several of these legislative proposals. Without objection——

Senator WARNER. Without objection.

Chairman CRAPO. They are entered into the record.

At our previous hearing, we explored whether a venture exchange would help emerging companies get access to capital and what steps should be taken. Today's hearing continues this Subcommittee's work on how to improve America's capital markets, encourage job creation, and reduce regulatory burdens for business. I look forward to hearing from our witnesses on these legislative proposals.

Senator Warner.

STATEMENT OF SENATOR MARK R. WARNER

Senator WARNER. Thank you, Chairman Crapo, for holding this hearing. I think, because of our long affiliation, association, if anything can be done bipartisan together, this may be the pair to start it.

And, as somebody who still can claim that I have spent longer in the private sector and longer on the emerging growth company side of the fence than I have on the elected official side of the fence, this is a subject that is near and dear to my heart.

I want to echo what Senator Crapo has said. I want to thank him again for the hearing we held last week on venture exchanges. I think it is an interesting idea. I think there are some challenges around it, but I think it is a very interesting idea. And, I know that we are looking at a series of bills today that I am looking forward to the panel's comments on.

I will note that perhaps just holding this hearing may have spurred the SEC into action. If you are not going to take credit, we ought to jointly take credit. My understanding is that tomorrow, the SEC will be voting to go ahead and move the Reg A Plus regulations forward, something that I wish would have happened earlier. I hope that they will not only take that step, but go ahead and move forward on the crowdfunding, finalization of those regulations. Crowdfunding has both an upside and a downside, I know, but the sooner we can get it out into the marketplace and learn, I think, the better.

As also was mentioned, I have been one of the cosponsors of a bill with Senator Toomey to make sure that growing companies have an opportunity to share that growth with employees, raising the standard that had been set back more than a decade ago to, I think, a more modern standard. And, candidly, the notion of employee participation in companies, I think, is both good policy and good for our overall economy. Of course, I still welcome the panel's comments on this legislation.

Another bill under consideration today is meant to further assist the emerging growth companies during the IPO process, and I am anxious to hear some pros and cons and what happens in terms of the due diligence during that process.

I note that we will be discussing two bills today in the realm of derivatives regulation. Used appropriately, derivatives can be an important risk mitigation tool. But, if unregulated, derivatives can also, as Warren Buffett famously said, become financial weapons of mass destruction, and I still believe that there is a great deal of that sector 5 years after Dodd-Frank that still needs some further review.

I have got a number of questions for witnesses on the prudence of one of the particular bills, but I also hope the Subcommittee will look at derivatives regulation more generally at a future date. I think it would be something that the Subcommittee should take a fresh look at. We have really not, I do not believe, in the last 5 years since Dodd-Frank taken a look at that sector, and maybe, Mr. Chairman, it might be the subject of a hearing if you decide.

In particular, I am open, as you are, to finding ways that we can both cut down some of the bureaucracy, speed the ability to get capital to growth companies. I remember the Kauffman Foundation's statistics that say that more than 50 percent of all the net new jobs that have been created in the last 30 years in this country have come from startups. Those startups have got to have access to capital.

So, Mr. Chairman, thank you for holding this hearing, and I look forward to the panel's comments.

Chairman CRAPO. Thank you very much, Senator Warner.

Today's witnesses are Mr. Thomas Quaadman, Vice President of the U.S. Chamber's Center for Capital Markets Competitiveness; Mr. Bill Spell, President of Spell Capital Partners; Mr. Marcus Stanley, Policy Director of Americans for Financial Reform; and Mr. John Partigan, Partner and Securities Practice Group Leader at Nixon Peabody.

Your written testimony for each of you has been entered into the record and will be here entered into the record and we encourage you each to try to wrap up your initial comments in 5 minutes. There will be a clock going, so we encourage you to pay attention to it, so we will have plenty of time for our questions and your responses.

With that, Mr. Quaadman, why do you not begin.

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

Mr. QUAADMAN. Thank you, Chairman Crapo, Ranking Member Warner, Members of the Subcommittee. First off, I would like to thank you for this hearing and also for the continued bipartisan leadership of this Subcommittee on moving forward on bills important to capital formation.

What is true of any company is that there has to be the ability to grow from small to large and that companies need to have the tools to be able to access that growth and also to be able to engage in reasonable risk taking. Sometimes, Government policies get in the way of that, and there was a bipartisan recognition several years ago with the JOBS Act that some of those impediments needed to be pushed aside, and I want to commend the Senate and the House for doing just that.

Since we have seen a partial implementation of the JOBS Act—I want to stress partial—we have seen a very steady rise in IPOs, and for the first time in 14 years, we actually saw the number of public companies in the United States rise.

But, the long-term trends are not good. We have with entrepreneurs, particularly with young entrepreneurs, the public company model is no longer an attractive model. We also have a tremendous number of outflows of public companies, as well, so that when somebody like Michael Dell says that he no longer will operate a public company, that means that there is something wrong. We have to take a closer look at that.

So, legislation and setting priorities for the SEC is an important item on our agenda. And, what should be noted with all the bills that you have here, because these are bipartisan bills that we have supported, it is important to note that these are all issues that the SEC could modernize existing regulations, but they have not done so and have only moved in the past when Congress has forced them to move.

So, just sort of ticking down the list here, with the Reg A bill, Senator Warner, I agree with you. I think you should get a press release ready. You know, I think it is—we have a situation here where, with the open meeting tomorrow, we are going to have the Reg A update finalized, hopefully. And, while that is a victory, it is also an example why there is a need for Congressional prodding to get something done.

With the Disclosure Modernization and Simplification Act, we have a corporate disclosure system that is based in a 1930s foundation and it is paper-bound. We need to update both the corporate disclosures and the delivery systems to meet the needs of 21st century investors as well as a global capital market.

Now, I want to just state, too, that Chair White and Keith Higgins, who is the Director of Corporation Finance, have started the ball rolling on this with their Disclosure Effectiveness Project, and I think they should be commended for it. However, we want to make sure that that is a project that does not die through bureaucratic inertia. You only have to look at the concept release on proxy voting that has been 5 years old to see, you know, something with good intentions die on the vine.

With the Encouraging Employee Ownership Act, that will actually effectuate a JOBS Act reform. We had Rule 701, number of shareholders, that threshold rise through the JOBS Act. However, the actual dollar amount was not adjusted. So, the bill here would actually take that number from $5 to $10 million, which reflects inflation since Rule 701 was implemented in 1988. And that is, as you said, Senator Warner, that is an important way for a growing company to keep and reward its employees. For a growing company, employees are their strongest asset.

The Improving Access to Capital for Emerging Growth Companies, it is a needed change for emerging growth companies in the JOBS Act portal to go out and attract second-stage financing.

With the SBIC Advisers Relief Act and the Holding Company Registration Thresholds Equalization Act, both codify Congressional intent of Dodd-Frank and the JOBS Act.

With the Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act, you know, businesses are increasingly looking to be acquired. As I said, they are not looking to necessarily become public companies. This will provide certainty around that process and it is something that we support.

With the Treatment of Affiliates of Non-Financial Firms that Use a Centralized Treasury Unit, this is a narrowly tailored bill that codifies Congressional intent, allowing a nonfinancial company to use derivatives without clearing to mitigate risk and lock in prices. I think it should be noted that with the proposed legislation, a financial company cannot access that CTU exemption.

The Swaps Data Reporting and Clearinghouse Indemnification Corrections Act, that is a change that is needed to clarify international differences of law to facilitate better information sharing and coordination amongst national regulators. That is an important piece in terms of global market.

So, again, I want to thank the Subcommittee and Chairman Crapo for your leadership on this. We look forward to working with you to developing these into a core package of JOBS Act 2.0 bills, and I am happy to take your questions.

Chairman CRAPO. Thank you.

Mr. Spell.

STATEMENT OF WILLIAM H. SPELL, PRESIDENT, SPELL CAPITAL PARTNERS, ON BEHALF OF THE SMALL BUSINESS INVESTOR ALLIANCE

Mr. SPELL. Good afternoon, Chairman Crapo, Ranking Member Warner, and members of the Senate Banking Subcommittee on Securities, Insurance, and Investment. My name is Bill Spell and I am President of Spell Capital Partners, a private equity firm in Minneapolis, Minnesota. Our firm manages three funds, two of which are small funds that engage in equity investing, and one of which is a Small Business Investment Company, SBIC, that engages in mezzanine debt finance.

I am here today representing the Small Business Industrial Alliance, which is the trade association of lower and middle-market private equity funds, SBICs, and business development companies and their institutional investors. SBI members provide vital capital to small- and medium-sized businesses across the country.

I am a Minnesota native, attended college at the University of Minnesota and went on to receive an MBA from my alma mater a few years later. I continued my relationship with the University of Minnesota years later, serving as an adjunct lecturer at the Carlson School of Management.

I began my career at a regional investment bank in Minnesota and for over 7 years engaged in corporate finance investment banking work. In 1988, I formed my own investment firm with the goal of making control equity investments in small industrial manufacturing businesses in the Midwest. Since that time, we have had a strong record of growing businesses, increasing employment, and providing a return to our investors.

Recently, we decided to pursue an SBIC license and were approved by the Small Business Administration in March 2013. Today, we advise total assets under management of about $170 million, with approximately $85 million of those assets in our SBIC fund. We currently employ a staff of 16 people in Minneapolis. Our SBIC fund has been examined twice by the SBA since we were licensed in 2013.

Spell Capital is focused on helping small businesses grow and providing them the capital and management assistance with which to accomplish that goal. Unfortunately, some of the regulatory burdens we face, notably the cost and burden of registration with the

SEC, which duplicates many of the costs and time burdens of complying with the SBA regulations in the SBIC program, have diminished both the time and funds we can allocate to our core mission.

I believe balanced regulation oversight is a good thing. However, when regulatory oversight is duplicative and redundant, that regulatory balance between investor protection and capital formation is lost.

Compliance costs have a disproportionate impact on smaller funds like mine. Small business investors commonly have very few employees, sometimes as few as two. Small business investment funds, such as Spell Capital, generally do not have legal departments, compliance teams, or extra employees to adhere to a complicated regulatory routine. Adding additional overhead expenses for regulatory compliance damages the ability of small business funds, such as Spell Capital, 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 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.

Therefore, as a consequence of these regulatory burdens on Spell Capital's mission to help small business, I am here to strongly support a bipartisan bill called the SBIC Advisers Relief Act. An identical bipartisan bill, H.R. 432, was introduced in the House on January 21, 2015, by Representatives Blaine Luetkemeyer and Carolyn Maloney. In the 113th Congress, this bill passed the House Financial Services Committee 56 to zero and was approved by the House on a voice vote. Senators Mark Kirk and Joe Manchin introduced the Senate companion to the bill in the 113th Congress.

My testimony here today will explain the need for 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 redundant regulatory paperwork. I would like to thank the Subcommittee for examining this bill today, and I especially want to thank the sponsors of this legislation and to urge support for the bill's introduction in the Senate during the 114th Congress.

Thank you.

Chairman CRAPO. Thank you.

Dr. Stanley.

STATEMENT OF MARCUS M. STANLEY, POLICY DIRECTOR, AMERICANS FOR FINANCIAL REFORM

Mr. STANLEY. Chairman Crapo and Ranking Member Warner, thank you for the opportunity to testify before you today on behalf of Americans for Financial Reform.

Before turning to the specific bills under consideration today, I would like to make a general comment regarding capital formation. AFR does not believe that the SEC's capital formation mandate fundamentally conflicts with its mission of investor protection. Effective capital formation requires investor trust in the markets and also requires that markets channel investor capital to its best use. When investors put their money into a penny stock scheme or purchase securities on the basis of fraudulent accounting or on the basis of misleading descriptions of their true risk, capital is likely to be misallocated.

The numerous financial scandals of the last two decades have led to enormous amounts of capital being misallocated and have done grave damage to investor trust in the markets. A failure to place a high priority on the SEC's investor protection mission will also harm its mission of ensuring effective capital formation.

AFR supports legislation eliminating swaps data indemnification requirements, H.R. 742. Progress in derivatives data reporting has been slow. There are many reasons for this, but the indemnification requirements in Dodd-Frank are one factor involved. The replacement of indemnification requirements with a simpler confidentiality agreement would be beneficial in encouraging needed sharing of derivatives data between different jurisdictions and entities.

AFR opposes H.R. 2274, legislation exempting M&A brokers from broker-dealer registration. While a much narrower version of this legislation could be acceptable, this bill is flawed. It lacks provisions to prevent bad actors from taking advantage of exemptions from registration. It would exempt acquisitions of companies with gross revenues up to $250 million, which goes far beyond any reasonable definition of a small local business. There is no effective provision to prevent transfer to a shell company, so the exemption could be used in a private equity-type transaction. The bill could, thus, interfere with ongoing SEC investigations of potential abuses in private equity involving unregistered broker-dealer activities. The legislation is also unnecessary, as SEC has already taken administrative action to exempt true M&A brokers from broker-dealer registration.

We would also point out that numerous registered broker-dealers who comply fully with SEC conduct requirements are already active in arranging deals, and this legislation would expose them to competition from unregulated entities that would not have to comply with important investor protections, such as suitability standards.

AFR also opposes H.R. 5471, legislation that would expand exemptions from Dodd-Frank derivatives clearing requirements for financial affiliates of commercial entities. While commercial entities using derivatives to hedge legitimate commercial risk are already exempted from clearing requirements, 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. This legislation would remove these limitations and leave in place only a requirement that the financial entity is somehow mitigating the risks of a commercial affiliate.

But, many purely financial trades can be interpreted to somehow mitigate risks for a related commercial affiliate. This legislative change would, thus, greatly reduce the ability of the CFTC to ensure that derivatives clearing requirements are properly applied in all cases. As the nonpartisan 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 trading requirements as long as one of the banks had a nonfinancial affiliate.

There are some cases in which affiliates of commercial entities may genuinely be hedging commercial risks but may not, in the narrowest sense, be acting as an agent of the commercial affiliate. The CFTC has already provided extensive and robust administrative "no action" relief, allowing such affiliated central treasury units to make use of the clearing exemption.

AFR also opposes legislation to expand exemptions for adviser registration for SBIC funds. It is likely that this change would affect only a relatively small number of advisers whose funds are not large. For this reason, we do not place as high a priority on this bill as the previous two bills discussed. However, we object to carving more advisers out of new Dodd-Frank registration requirements as these requirements are already proving effective in creating needed investor protections. We are also concerned that the legislation would weaken State investor protection oversight of SBIC funds.

AFR does not at this time have positions on the other bills under consideration by the Subcommittee. However, my written testimony offers some additional comments on the Disclosure Modernization and Simplification Act of 2014. We question whether the mandate in this bill is an appropriate priority for agency resources and also express our view that greater investment in machine readable disclosures in order to change disclosure from disconnected documents into searchable open data would be a much greater benefit to investors than the regulation called for in that bill.

Thank you for the opportunity to testify.

Chairman CRAPO. Thank you.

Mr. Partigan.

STATEMENT OF JOHN C. PARTIGAN, PARTNER AND SECURITIES PRACTICE GROUP LEADER, NIXON PEABODY

Mr. PARTIGAN. Chairman Crapo, Ranking Member Warner, and Members of the Subcommittee, thank you for inviting me to testify today. I am a partner at Nixon Peabody and the Chair of the firm's Securities Practice Group. I have been practicing corporate and securities law for more than 25 years and have advised public and private companies, including Wegmans, for over 15 years, on a range of securities issues.

I am here to speak about Wegmans' support for S. 576, the Encouraging Employee Ownership Act, and how this bill updates SEC Rule 701. On behalf of Wegmans, I would like to thank Senators Toomey and Warner for introducing the Act.

Wegmans is a privately held, family owned company. It is an American success story. In 1916, John Wegman started the company with a produce pushcart. A year later, his brother, Walter, joined him. Today, Wegmans operates 85 stores in seven States and has almost 44,000 employees.

Wegmans is the recipient of numerous awards. My testimony lists a number of them, but I would like to highlight just one. Every year since its inception, Wegmans has been ranked among

Fortune Magazine's 100 "Best Companies To Work For". Wegmans is extremely proud of this recognition because it is a reflection of how the company treats its employees, and having broad employee stock ownership is a key to the success of the company. This is manifest in its philosophy that if Wegmans takes care of its employees, its employees will take care of the customers and the bottom line will take care of itself.

I would like to provide a brief description of Rule 701 and then discuss S. 576. Rule 701 was adopted in 1988. It provides an exemption from SEC registration requirements for private companies to offer their own securities to employees pursuant to a written compensation plan. The exemption is not available for capital raising purposes.

Rule 701 offerings are often an important component of companies planning to attract and retain talent, a key to the success of any business, but especially for smaller or newer companies that may offer stock or stock options as they are attracting early stage financing and need to preserve their cash.

Under Rule 701, a company must provide investors with a copy of the plan document. In addition, because the offering remains subject to the antifraud rules, a company must also disclose the information that a reasonable investor would expect to receive from the company about the investment before making an investment decision.

In 1999, when Congress provided new authority, the SEC amended Rule 701 and created a two-tier disclosure regime. For sales of $5 million and below during a 12-month period, the existing disclosures remained in place. For sales greater than $5 million during a 12-month period, the SEC created new enhanced disclosures. These enhanced disclosures, among other things, require the provision of audited financial statements, if available, no older than 180 days.

In its 1999 rulemaking, the SEC explained that because the compensated individual has some business relationship over a long period of time with the securities issuer, the amount and type of disclosure required for this person, the employee, is not the same as for a typical investor with no particular connection with the issuer. Even at the time of the enhanced disclosures, the American Bar Association warned about the risks of requiring privately held companies to disclose their confidential financial information.

Simply put, any assertion that the enhanced disclosures are not burdensome or problematic is wrong. The bottom line is that privately held companies are faced with a decision whether to limit compensatory grants and sales to employees to stay under the threshold or risk the dissemination of highly confidential information.

This is what the Encouraging Ownership Act would fix. It would raise the threshold for enhanced disclosure to $10 million, accounting for inflation. This is a sensible and balanced adjustment that continues to address the SEC's concerns by requiring two levels of disclosure.

Thank you.

Chairman CRAPO. Thank you, Mr. Partigan.

I would like to start out, first, with Mr. Quaadman and Mr. Stanley. It appears that there is a difference of opinion between the two of you with regard to H.R. 5471 and whether it is limited to nonfinancial end-users. It is my understanding that the exemption in the legislation is only intended to apply if the centralized treasury unit is hedging the commercial risk of a nonfinancial entity, an entity that otherwise could hedge its own risk directly without clearing. In such cases, the end-user would not be denied the end-user clearing exception.

Mr. Quaadman, is that your understanding of how H.R. 5471 works?

Mr. QUAADMAN. Yes, Mr. Chairman. We share the same reading of the bill and we think it works the same way.

Chairman CRAPO. All right. And, again, Mr. Quaadman, Mr. Stanley references a CRS report that suggests that the legislation may create a broader exemption. Are you familiar with that report?

Mr. QUAADMAN. Yes, I have read it.

Chairman CRAPO. And, apparently in the report, there is an example used to show how that could occur. Could you respond to that?

Mr. QUAADMAN. Yes. You know, the example that used there is a typical Rube Goldberg example, which is unrealistic in actual practice. If you are a financial company, you would not be able to avail yourself of that exemption. And, if you are a financial company—the nonfinancial company, as you said, you would be able to use the CTU process in that way. So, we did not think that the CRS report was accurate and it is not the way that a corporation will use derivatives to mitigate risk.

Chairman CRAPO. All right. Thank you.

And, Mr. Stanley, I would like you to have an opportunity to respond, and also, could you explain why it is that you believe the text of this legislation would create a broader exemption than what we were discussing.

Mr. STANLEY. Sure. I guess I would say, first, that if you have ever looked at the organization chart for one of the major bank holding companies, one of the systemically significant bank holding companies, it does have a Rube Goldberg look to it. So, I think we have got to watch out for the way Rube Goldberg things can happen here.

I think a critical difference between this legislation and the "no action" relief that the CFTC has already provided is that the CFTC's "no action" relief stated that the company at the top of the conglomerate, in other words, the company that owned the commercial affiliate and the central treasury unit, could not itself be a financial entity, such as a bank or a systemically significant bank. This legislation is not limited in that way.

So, what the CRS report, I think, was picking up on is that if you have a bank, and we know that these major global banks have thousands of different affiliates, if one of those legal entities under the bank is a commercial affiliate, then you could have a financial affiliate under the bank claiming to be mitigating risk for an affiliated commercial entity, another commercial entity that is under that same holding company. And, what we are concerned about is that that mitigating risk is just too vague in terms of the legal authority that it gives to the CFTC and that you could have examples, say, for example, if you had a bank with a commercial affiliate in Brazil, you could have another financial affiliate that was, for example, buying credit default swaps under Brazilian debt and there would be a claim that it was mitigating risk in some general sense for that commercial affiliate.

Chairman CRAPO. Well, thank you. I understand your point. Would you agree, though, that if the language could be crafted adequately, that it would be appropriate to provide that a nonfinancial entity—frankly, that a centralized treasury unit that is hedging the commercial risk of a nonfinancial entity should be allowed to do so?

Mr. STANLEY. Yes, if it is genuinely hedging that commercial risk, and we do believe that there are ways this legislation, the language in this legislation could be crafted to be reasonable. Frankly, we think that given that the CFTC has shown its willingness to accommodate, that perhaps just legislative language that clarifies and makes clear the CFTC's discretion to accommodate central treasury models would be a better alternative.

Chairman CRAPO. I would appreciate any suggested language you might have in that regard.

In the minute or so I have left, let me move to another issue. Mr. Spell, it also appears that there is a difference between you and Mr. Stanley with regard to the SBIC Adviser Relief Act, and probably we will only have time for you to respond, Mr. Spell, but I will come back, Mr. Stanley, when I get my next chance. Could you respond to Mr. Stanley's concern that he has raised with regard to the concern that the legislation does not adequately protect against the potential for investor abuse in private equity markets.

Mr. SPELL. Yes, sir, Mr. Crapo. You know, I am not familiar with any type of abuses in the private equity industry. The SBA regulation of SBICs is stringent and thorough and they have the ability to shut down any SBIC fund managers that do anything inappropriate or illegal. And, when I got into this business in 1988, there were just a handful of private equity managers. Now, there are thousands and they manage hundreds of billions of dollars. Money would not flow into that industry if this was plagued with abuse.

Chairman CRAPO. Well, thank you. My time has expired. I will come back in another round.

Senator Warner.

Senator WARNER. Thank you, Mr. Chairman, and I appreciate you asking on the H.R. 5471 because I was going to ask kind of the same question.

I guess I would—Mr. Quaadman, I am sympathetic to your argument, but I have to agree with Dr. Stanley that some of these large financial institutions, the level of complexity that they go to is pretty extraordinary, and I would love to see if there could be some way that we could come up with language that might meet both concerns. I guess I would ask you, should there be any limitations on clearing exemptions for nonfinancial institutions?

Mr. QUAADMAN. Well, Senator Warner, the Chamber's position is, if you are going to use a derivative or hedging for financial speculation, that should go through clearing. Our members and the Corporate End-User Coalition, we use derivatives to lock in prices and mitigate risk. That is what derivatives are intended for.

Senator WARNER. I understand.

Mr. QUAADMAN. So, that is where we believe that this should go. So, we agree that there should be, you know, with the CTU legislation, it should only apply to nonfinancials, which is how we ready that.

I would also just say, too, with the Volcker Rule, I think it would be extremely difficult for a bank to have a commercial unit be able to use derivatives in this manner.

Senator WARNER. Well, Dr. Stanley, quickly, because I want to get to a series of other questions.

Mr. STANLEY. I think it is important to note that although this legislation is about mitigating commercial risk, it permits a financial entity, not just a commercial entity, a financial entity, which is what a so-called central treasury unit is, to access the clearing exemption, and that is precisely why we are so concerned about it, because it permits a financial entity to access the clearing exemption based on a claim it makes, so——

Senator WARNER. You did say, I think, that somewhere between the legislation and the "no action" letter, there might be some—and I appreciate, Chairman Crapo, you getting them to that point.

Mr. Partigan, let me just—I, obviously, strongly support the legislation that you have discussed, and we have got about 5.7 million small private companies in the United States. If we move this number, and, frankly, just move it up with inflation from $5 million to $10 million, do you have any sense of how many more employees or companies might be able to participate?

Mr. PARTIGAN. Well, I think for companies like Wegmans, they run up against that limit. So, you could have twice the number of employees participating in stock grant programs as well as stock purchase programs, and then you can expand that by the number of privately held companies that share employee stock with their employees.

Senator WARNER. Let me move, and Mr. Spell, one of the things that I would agree with, and Dr. Stanley, I guess I would like to get your quick comment, because I would like to get a couple more in, I think the SBIC program 20 years ago had a lot of problems. I think there is a much higher level of scrutiny now on SBICs. I am not exactly sure where the line should be drawn. But, when you are thinking at that 150 number and the nonability to aggregate, there is a—do you have some suggestion on how private equity managers can—it is a lot of compliance cost. There has not been a history outside of what was long ago in the SBICs before the SBA cleaned up the process that you would be willing to accommodate.

Mr. SPELL. Yes, and we would be happy to talk to you about that. I think we were just very impressed, and it lined up with some of what our pension fund members have seen, with what the SEC found when it did these inspections of private equity companies and found that over half had either violations of law or material weaknesses in controls. So, that is our concern.

Senator WARNER. I would like to see that.

Let me get to the H.R. 3623, and Mr. Chairman, you have got quite a collection of legislation here, so they are all pretty complicated and——

Chairman CRAPO. All good stuff.

[Laughter.]

Senator WARNER. That is what we hope to get to. You know, it seems to me, somebody who has been through the registration process, that the idea that if you somehow pass through that billion dollar total gross revenue limit during the registration process, that you could still become an emerging growth company and that you should not have to disrupt the IPO process. Is there any concern across the panel on that?

[Witnesses shaking heads side to side.]

Senator WARNER. What about the change, the 6-day change on the period between the public filing and the start of the road show? I mean, I am not exactly sure—since most folks file and it is usually 30 or 40 days, conceptually, I get it, but why is this so high on the list?

Mr. QUAADMAN. I was with just a—I was with a group of CFOs from bio companies about a month ago and we were doing a round of visits. They did talk about this issue with road shows and being able to go out sooner as being very helpful, and there was some concern with the JOBS Act, that the JOBS Act gets them to a certain point, but there were concerns about how they can get to the next stage. So, I think this is a helpful way to make the JOBS Act better, more efficient, but also to get them to second stage financing.

Senator WARNER. Well, Mr. Chairman, I appreciate this, and I am going to ask Senator Donnelly to sit in now. I have got an intel meeting. But, I look forward to seeing—these are technical in nature, most of this legislation, and I would love to see if we can find some bipartisan collaboration, and I would, again, welcome all of us to—it would be nice to work on some things where we can actually get to yes. Thank you, Mr. Chairman, for holding this hearing.

Chairman CRAPO. Thank you, Senator Warner.

Senator Scott.

Senator SCOTT. Thank you, Mr. Chairman, and thank you also for holding this hearing today and talking about the number of bills that we have that could be very important to the investors and, frankly, to building a healthier economy long-term in our country.

I come from the great State of South Carolina, where our Governor and our legislature have worked very hard to create a business-friendly environment and it is really paying off dividends and growing more jobs in our economy, which is fantastic.

I would like to use this opportunity to highlight the success of the Greenville Chamber of Commerce and their work with UCAN, which is the Upstate Carolina Angel Network, a network that is accredited investors that has invested over $11 million in South Carolina startups since 2008. Private offerings are a useful tool to raise capital.

Still, I think we need to do more to permit South Carolina's small cap and emerging growth companies to access public markets. This is especially important as banks and credit unions face heavier regulatory burdens that reduce access to lending and increase cost.

Mr. Chairman, we heard this morning from some of the banks. I think Regions, in particular, talked about how their regulatory burden from a cost perspective is around $200 million, which means that the pricing and the availability of credit is going down, down, down. And, they talked about having over 150 employees dedicated only to the regulatory responsibilities, that they have hired more folks lately for the regulatory burden than they have for lending purposes, which I think is quite remarkable and truly unfortunate.

In the area of capital formation, our path forward should be a little easier. Reduce costs that present unnecessary burdens to access to capital.

Securities regulation should be sensible. The SEC should balance its investor protection and capital formation missions and not do one at the expense of the other. One way to achieve that balance is to improve disclosure effectiveness by scaling it based on the size or the complexity of the issuer.

I am pleased to see that the SEC is making overtures in this direction, and Mr. Quaadman, can you elaborate on disclosure overload and why scaling disclosure may make it a more useful tool to retail investors, especially to retail investors in my home State of South Carolina?

Mr. QUAADMAN. Sure. Thank you very much, Senator Scott, and that is a very thoughtful question. When you take a look at the proxy as it exists today, it currently has exploded to about 100 or more pages. So, what we have seen is as the proxy has increased tremendously, retail shareholder rates have dropped precipitously, to as low as 5 percent, in some cases. So, we have large institutional investors by law are required to vote and retail investors just do not vote. So, this means that the corporations themselves are not getting the adequate voice of their investors. So, being able to scale disclosures, being able to make sure that disclosures are readable and understandable is very important.

And, what is also interesting, as well, is that Professor Larcker from Stanford University also came out with a survey in the last few weeks that 55 percent of institutional investors are having the same problem. So, we are having a systemic problem, that the more that we are disclosing, the less it is understandable.

Senator SCOTT. I will say that the—and I oftentimes receive disclosures in the mail from a number of the companies that I have invested in, and I will tell you that the absolutely—and I am sure the paper companies are really happy—my ability to actually go through it all is difficult, and I have spent some time in business, and I will tell you that it just seems to be remarkable and perhaps counterproductive, frankly.

Mr. Partigan, many small businesses in South Carolina use stock to compensate employees. I think this is a good thing. Stock-based compensation eases the pressure on companies' cash and gives the employee a small stake in the future of the company, or as I would like to think of it, as a bigger motivating factor for the success of the company. Some people have argued that raising the Rule 701 threshold—I think Mr. Spell spoke about the fact that there has not been a change since 1988, when it went into place, $5 million. It is not necessary because employees can just sign confidentiality agreements to prevent the publication of sensitive information about the employer. In your estimation, is this a feasible approach from a business perspective?

Mr. PARTIGAN. No, I do not think so. The concern is if you do not raise the threshold and the company were to exceed it, they would have to give full financial statements to all the employees participating in the program, including former employees that are participants in the program. And, the concern is that that—even if you have an employee sign a confidentiality agreement, that information could find its way into the hands of a competitor, which would harm a company. And, remember, this is only for privately held companies.

Senator SCOTT. Yes.

Mr. PARTIGAN. So, that information is not otherwise available, and one of the reasons they have remained private is to keep that information confidential.

Senator SCOTT. Thank you.

Chairman CRAPO. Thank you, Senator Scott.

Senator Donnelly.

Senator DONNELLY. Thank you, Mr. Chairman, and thanks to all of you for being here.

Mr. Spell, the SBIC was created back in 1958. We wanted to facilitate the flow of capital to small businesses, and I was wondering if you could talk a little bit about the success of the SBIC program since it was created and how you see it benefiting small businesses.

Mr. SPELL. Senator Donnelly, I appreciate your question. The SBIC plays a critical role in providing capital to small- and medium-sized businesses, businesses that sometimes cannot get that capital from more traditional sources. We at Spell Capital have invested in approximately 105 transactions in the last 27 years and we have actually, in the last year and a half, have made 12 investments through our SBIC vehicle. We have actually realized 2 of those 12 just recently to everybody's success—our investors and the company's.

We at Spell Capital have utilized this program to provide needed funds to those businesses. We actually have made investments over the years in Indiana in a non-SBIC investment. Back in 1999 in your State of Indiana, we invested capital in a business doing about $18 million in sales, had about 50 employees. In 2007, after some nurturing and blood, sweat, and tears along the way, when we sold that business to a large corporation, it had almost 600 employees and was doing over half-a-billion dollars in sales. So, we are very proud of what we——

Senator DONNELLY. So, are you saying it pays to invest in Indiana, sir?

[Laughter.]

Mr. SPELL. Actually, I am.

Senator DONNELLY. Very good.

Mr. SPELL. Indiana is a great place to do business, sir.

Senator DONNELLY. The SBIC Advisers Relief Act, as you look at this, if it were enacted, what do you see as the most important benefits and what do you see as the risks on this?

Mr. SPELL. You know, twice the regulation just means twice the cost. It does not mean twice the protections. That is the key here.

And, all we are asking for is to remove the duplicative, redundant reporting requirements.

Senator DONNELLY. OK. Thank you.

And, Dr. Stanley, in regards to expanding exemptions from derivatives clearing requirements, and you indicated that that is opposed, as you look at this, you know, one of the things that has always struck me is how we want to make sure that for those who want to hedge for commercial purposes, that they have the ability to do it, that they are not hamstrung, and that those who do it for speculative purposes, that they obviously go down a different track in terms of regulation and such.

When you look at this, and you talk about your opposition, could you flesh that out a little bit for me.

Mr. STANLEY. Sure. Excuse me. I am testifying through a cold here.

Senator DONNELLY. Do you want me to ask someone else?

[Laughter.]

Mr. STANLEY. No, that is fine. So, as I said, our fundamental concern here is that this is—this legislation would permit financial entities, central treasury units, which are financial entities, potentially owned by a parent company that is a bank or a systemically significant financial entity, to access the clearing exemption just on the basis of a claim that they were mitigating risk for a commercial entity, and we saw in the London Whale case, for example, there were claims there made that JPMorgan's unit in London was hedging and mitigating risk based on commercial loans, but those turned out to be flawed, the internal controls that were just not there to tie the derivative to a specific risk that was being hedged.

And, we are concerned, especially with the under-funding of the CFTC, that if you reduce the CFTC's authority in this area and you open up the door to permitting financial entities, potentially financial entities owned by parent companies that are banks or other financial entities, to access the clearing exemption, that there are dangers there.

But, as I said, the CFTC has provided administrative accommodation here, and we are quite willing to work with people in this to make sure those safeguards are present in this statute.

Senator DONNELLY. I am just about out of time. I have one more question, and anyone who wants to take a swing at it can do so. In the IPO markets, and especially as you look toward smaller businesses and such, obviously, IPOs slowed down significantly during the most economically challenging times we had. As you look at it, do you think IPOs are back now, and if not, what do you think would be the main reason? But, overall, do you think they are playing as prominent a role as they were before?

Mr. QUAADMAN. Senator Donnelly, I do think we have seen an uptick, a significant uptick, in IPOs in the last couple years, and I want to say that part of that is that the JOBS Act is opening up some of that. We also had some pent-up demand, too, because from 2007 to 2011, we had a very sluggish IPO market. So, I think that is beginning to turn around some.

What is—and this is what I said in my opening statement, as well—we are concerned, however, that with a lot of the other rules, that as companies go from that emerging growth company into being a full-fledged public company, that as other regulations start to attach there, that you have an outflow problem. So, I think what we are doing is we are making tremendous progress on the inflow issues. We have to see if we can sort of cutoff the tap on the outflow, as well.

Senator DONNELLY. OK. Thank you very much. Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Most of the questions I was going to ask have been covered by the other Senators. I did want to talk briefly with a couple of you about mergers and acquisitions issues. As you know, the House of Representatives last Congress passed the Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act by a vote of 422 to zero. And, Mr. Stanley, you have raised concerns about the threshold in that Act and the need for bad actor language. Could you clarify.

Mr. STANLEY. Yes. I mean, I do not think anyone would be opposed to legislation that someone who put an advertisement in a paper seeking a buyer for a local restaurant or something like that should not be subject to broker-dealer regulation. That is just common sense. But, $250 million in revenues is a very large company, and when you combine that with the lack of shell company provisions, you could really get significant private equity business and some really complex broker deals falling under this registration exemption. And, we are concerned about the lack of oversight in those cases, and also, as you said, the lack of a bad actor provision.

Chairman CRAPO. Thank you.

Mr. Quaadman, would you like to comment on that issue.

Mr. QUAADMAN. Sure, on both issues, Senator. Number one, you know, I think the $250 million threshold is actually a reasonable threshold. Congress through Dodd-Frank actually exempted companies up to $700 million from SOX 404(b) internal controls. So, there has already been a public policy declaration as to what the line is there. So, we are actually somewhat well below that line.

With the bad actor language, in the original version of the bill that Congressman Heinzinger introduced in the House, there was bad actor language that prohibited anybody, you know, a broker who was suspended or under some sort of problem with the SEC. My understanding is, is that some of that language was inadvertently deleted by Legislative Counsel. So, I believe it was certainly the intent of the drafters of that legislation to have it in there and we would agree that it should be in there.

Chairman CRAPO. All right. Do either of the other two witnesses want to jump in on this issue?

[No response.]

Chairman CRAPO. Senator Donnelly, have you got another question, or should we wrap it up?

Senator DONNELLY. I am thinking, we have got great minds in front of us and could get great economic advice. I will just throw this out real quick. What do you think is—you know, we are talking about for small businesses and such, what do you think is one of the most—if you had one thing to tell us, the most important thing we can do here to help our small businesses continue and have success? If you could each give me your best idea.

Mr. QUAADMAN. Well, first off, I think it is part of what you are doing right now. What I think needs to happen is there needs to be pressure put on the SEC that they will periodically go in and review their rules and modernize them. The reason why we are here today, the reason why Congress passed the JOBS Act 3 years ago, is because the SEC does not do that. So, I think it is a matter of sort of, you know, kicking the cobwebs out there and getting them to do their job, and if there is Congressional pressure that is needed to do that, that is what I think should happen.

Senator DONNELLY. Mr. Spell, you have worked with an awful lot of family businesses, midsized small businesses. As you look here, what is the most important thing, for those owners, for you? And, on my end, it is somewhat selfish, because I see this as an opportunity to create more jobs in our State, more people put to work. So, what do you see as the most important thing we can do to continue safety and stability, but at the same time help out these business owners?

Mr. SPELL. Sure. Thank you, Senator. I would say it is the redundant and duplicative regulations that burden small businesses and then reforms in the tax code. You know, between the corporate rate and the pass through rate, most small businesses pay the pass through rate. And, if we can get some kind of relief and simplification of the code, that would be huge.

Senator DONNELLY. OK. Dr. Stanley.

Mr. STANLEY. Well, I would say attention to the financial stability mission of the committee, because small businesses are hit first and hit hardest when there is that kind of broader economic instability.

Senator DONNELLY. You know, just on that one point, when the—being from a working—I used to represent a Congressional district in Indiana, a blue collar district in many respects, and when the largest financial corporations in America ran into terrible trouble, all of a sudden, there was no floor plan in—there was no inventory financing. There was no floor plan financing for our local businesses, and that is how Main Street, basically, cut the back of the baseball bat when it swung around. So, I did not mean to interrupt you, but go ahead.

Mr. STANLEY. No, you just reinforced what I was saying. That was my point exactly.

Senator DONNELLY. OK.

Mr. PARTIGAN. I think the biggest issue is access to capital for small business, in particular, where there is a lot of job growth. It would be nice if our financial institutions were more willing to lend. I think that would be really helpful, if there is anything you can do to make even debt financing more available for small businesses to encourage that. Also, this crowdfunding rule proposal that the SEC has issued, I think that could be very helpful for some new businesses to get started if it is implemented in an effective way.

Senator DONNELLY. Thank you all very much.

Chairman CRAPO. Thank you. And, before wrapping up, Senator Donnelly's questions have prompted one, maybe an observation as opposed to a question from me. I really appreciated those answers, and it seems to me that reform of our tax code and regulatory reform are probably two of the most important things we could get done. I know those are big issues, but there are big rewards available, I think, if we can tackle those kinds of issues, and I appreciate that very much. And, the other observation is just, Mr. Quaadman, you indicated that one thing would be to have the SEC review its rules regularly. Interestingly, we are working on some legislation right now, which is not in the mix here because it has not been drafted yet, or dropped yet, to expand or at least clarify that the EGRPRA process, the Economic Growth—I have to look at the words for these acronyms—the Economic Growth and Regulatory Paperwork Reduction Act, which requires certain of our financial regulators to review their rules and regulations, does not apply to many, and actually, SEC is not in that group, and I am not sure we should put them in that group, but, at least, maybe the same kind of requirement should be imposed. Do you have any thoughts on that, Mr. Quaadman?

Mr. QUAADMAN. Yes, and Senator, you can have several hearings on this.

[Laughter.]

Mr. QUAADMAN. I agree with you. That is critical. And, the SEC has some very specific cost-benefit things that they are supposed to do when they write rules. However, I do want to just say, we are beginning to see with Basel III, with Dodd-Frank, we are beginning to actually see some very specific consequences that are starting to hit Main Street businesses, and the banking regulators under the Riegle Act are supposed to do an economic analysis whenever they write a rule. They have yet to do an economic analysis on any of the Dodd-Frank rulemakings they have done, including Basel III. So, when you start to see now that banks are turning away business deposits because those count against their liquidity coverage ratio, we could have caught some of those problems, as we had suggested, under Riegle Act analysis. So, I think legislation like that that puts more teeth into regulatory reform so we can stop these unforseen consequences is critical for future economic growth.

Chairman CRAPO. Well, I agree with that, and as a matter of fact, as I am sure you are aware, all Dodd-Frank rules and regulations were basically ignored by the EGRPRA process that is underway right now, which, by the way, is something we are addressing in the legislation that we are drafting right now. But, the point is that we should have economic analysis and we should have regular review of the rules and regulations that we are dealing with. I would like to thank all of our witnesses for coming here today and for spending the time that you have. Both your written testimony and your testimony here at the hearing is very carefully reviewed and is very helpful to us. In fact, you may even receive some questions after the hearing from some of us and we would appreciate you responding to those, if you would. This hearing is adjourned.

[Whereupon, at 3:32 p.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF THOMAS QUAADMAN

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

MARCH 24, 2015

Chairman Crapo, Ranking Member Warner, and Members of the Securities, Insurance, and Investments Subcommittee. My name is Tom Quaadman, vice president of the Center for Capital Markets Competitiveness (CCMC) at the U.S. Chamber of Commerce (Chamber). The Chamber is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector, and region. I appreciate the opportunity to testify before the Subcommittee today on behalf of the businesses that the Chamber represents.

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

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

1. A robust, efficient, and diverse financial system facilitates economic growth;
2. In terms of their financing choices individual entrepreneurs are largely limited to debt financing for raising capital;
3. As businesses grow they can access both debt and equity financing and the mix of these two, called the "capital structure" decision, is an important choice every business makes;
4. A rich diversity of financing sources is provided by the U.S. financial system; and
5. The U.S. financial system is highly connected and what happens to one financing source causes spillover effects in other parts of the system. So for example, if excessive regulation restricts access to, or the operation of, the IPO and secondary markets for publicly traded companies, the resulting loss of liquidity will act as a disincentive to private equity and venture capital activity as well.

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

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

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

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

II. Legislative Proposals

1. Regulation A Bill H.R. 701 Setting Rulemaking Deadline

The modernization of Regulation A (Reg. A) has the potential to be a real game changer for businesses that wish to seek public financing but may not be prepared to bear the full costs of an initial public offering. The current $5 million cap for Reg.

[1] The Thakor Study can be accessed at: *http://www.centerforcapitalmarkets.com/wpcontent/uploads/2013/08/sourcesofcapital__report1103.pdf.*

A offerings—originally set in 1992—has proven to be too low to elicit serious consideration from companies. In fact, as the Securities and Exchange Commission (SEC) pointed out in its proposal to implement Title IV of the JOBS Act, from 2009 through 2012, there were only 19 qualified Reg. A offerings, for a total offering amount of $73 million.[2]

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

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

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

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

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

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

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

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

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

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

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

Regrettably, despite the clear intent of Congress, the SEC did not interpret the law so as to allow savings and loan holding companies to take advantage of the new thresholds. Savings and loans perform nearly identical functions as do a bank and, since the passage of the Dodd-Frank Wall Street Reform and Consumer Protection

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

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

Act (Dodd-Frank), are overseen by the same regulators. While there may have been historical reasons for a lending institution to structure itself as a savings and loan as opposed to a bank, today there is essentially no difference between the operations or regulatory oversight between the two.

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

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

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

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

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

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

This legislation would build upon the success of the JOBS Act by providing emerging growth companies (EGCs) with expanded opportunities to raise capital. The bill would facilitate follow-on offerings made by EGCs 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 EGCs 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-1990s, last year saw the largest number of IPOs since 2000. This is a positive trend that was driven in no small part by the JOBS Act, and we urge Congress to continue focusing on ways to make the public markets more attractive for growing companies.

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

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

Congress exempted SBIC and venture capital fund advisers for good reason, and there is simply no valid argument for requiring someone to register simply because they advise both. SBICs 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 SBICs 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 oftentimes do not have vast resources to deal with legal complexities.

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

In the eight decades since the securities laws were enacted, public company disclosure requirements have increasingly expanded and more complex, as evidenced by the voluminous annual and quarterly reports filed today. 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. [4]

This expansion and increased complexity of disclosure has contributed to the phenomenon of "disclosure overload," whereby investors are so inundated with information it becomes difficult for them to determine the most salient factors they need to make informed voting and investment decisions. Retail investors are particularly vulnerable, as they typically don't have an army of analysts or lawyers to pore through SEC filings of the companies they invest in. In fact, it is the number one reason why retail shareholder participation has dropped to levels as low as 5 percent. 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 percent of institutional investors surveyed [5] felt the proxy was too long and 48 percent believe the proxy is too difficult to read and understand.

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

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

8. Encouraging Employee Ownership Act (S. 576)

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

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

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

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

9. Treatment of Affiliates of Nonfinancial 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.

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

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

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

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

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

III. Need for Action

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

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

PREPARED STATEMENT OF WILLIAM H. SPELL

PRESIDENT, SPELL CAPITAL PARTNERS, ON BEHALF OF THE SMALL BUSINESS INVESTOR ALLIANCE

MARCH 24, 2015

Good afternoon Chairman Crapo, Ranking Member Warner, and Members of the Senate Banking Committee Subcommittee on Securities, Insurance, and Investment.

My name is William Spell and I am President of Spell Capital Partners, a private equity firm in Minneapolis, Minnesota. Our firm manages three funds, two of which are small funds that engage in equity investing and one of which is a small business investment company (SBIC) that engages in mezzanine debt finance. 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 am also here to express my support for the SBIC Advisers Relief Act.

Before I delve into the details of why I am here testifying today, it might make sense to share a little of my background, and the background of Spell Capital Partners. I am a Minnesota native, attended college at the University of Minnesota, and went on to receive an MBA from my alma mater a few years later. I continued my relationship with the University of Minnesota years later, serving as an adjunct lecturer at the Carlson School of Management. I began my career at a regional investment bank in Minnesota and for over 7 years engaged in corporate finance investment banking work. In 1988, I formed my investment firm with the goal of making control equity investments in small industrial manufacturing businesses in the Midwest. Since that time, Spell Capital has stayed true to its roots, continuing to provide financing to small, entrepreneurial companies while working with those companies to grow employment, revenues, and provide a return to our investors. We have had a strong record of success in that endeavor, and I estimate in the investments we have made, we have increased employment significantly during our tenure.

After 25 years of managing smaller funds that invest in small manufacturing companies, we decided to pursue an SBIC license, which was approved by the Small Business Administration (SBA) in March 2013. Today, we advise total "Assets Under Management" (AUM) of approximately $171 million, with approximately $85 million of those assets in our SBIC fund. We currently employ a staff of 16 people in Minneapolis, Minnesota, to run our operations. Our SBIC fund has been examined twice by the SBA since we were licensed in 2013.

At Spell Capital, a large percentage of our investments are directly made in conjunction with entrepreneurs and business owners, often with no other equity funds involved in the transaction. This allows us to work closely with the small businesses we invest in, providing management expertise to help them professionalize and grow their businesses, hiring employees and supporting their communities along the way. The type of financing we typically provide is used by these small companies for growth capital—hiring, building new facilities—and to accomplish ownership transitions—allowing the operators of these businesses to continue their success by passing them along to the next generation of owners. Spell Capital is focused on helping small businesses grow, and providing them the capital and management help with which to accomplish that goal. Unfortunately, some of the regulatory burdens we face, notably the cost and burden of registration with the Securities and Exchange Commission (SEC), which duplicates many of the costs and time burdens of complying with the SBA regulations in the SBIC program, have diminished both the time and funds we can spend engaged in providing capital and management expertise to small businesses.

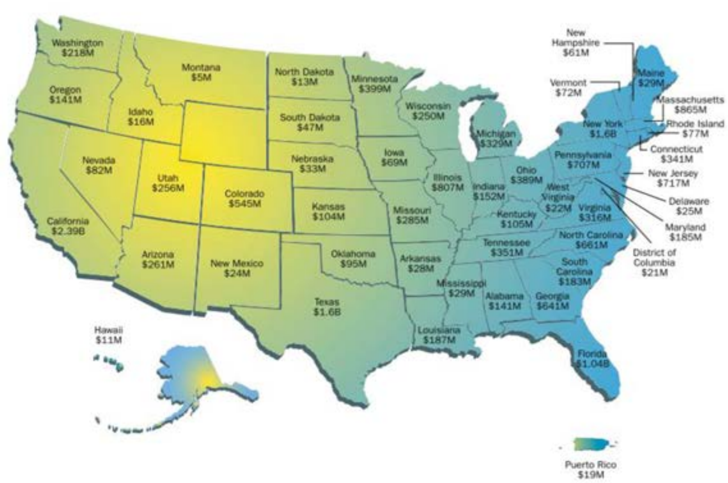
As a result of the burdens on Spell Capital's mission of small business investment, a mission in place since 1988, I am here to strongly support a bipartisan bill called the SBIC Advisers Relief Act. An identical bipartisan bill, H.R. 432, was introduced in the House on January 21, 2015, by Congressman Blaine Luetkemeyer (R-MO). In the 113th Congress, this bill 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 testimony here today will walk you through 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.

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 percent 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, Arkansas, Illinois, Nebraska, Kansas, Virginia, Rhode Island, New York, New Jersey, Massachusetts, and Indiana, among others. The full list of SBICs in States represented by the Committee is available in an addendum to my testimony.

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 and 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 nonpublic securities, which is common with small funds.

The initial cost to register with the Securities and Exchange Commission (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.*

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 pro-

[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/*.

vide 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 Spell Capital, 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 commonsense, 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 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 "exempt reporting adviser" (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 invest-

[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 percent 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.

ment 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, including Spell Capital, 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

My firm, Spell Capital Partners, would be directly helped by this provision in the SBIC Advisers Relief Act. Our focus, as I stated previously, is on staying small and investing in small, entrepreneurial companies primarily in the manufacturing space. We currently employ a staff of 16 people in Minneapolis, Minnesota. Our SBIC fund has been examined twice by the SBA since we were licensed in March 2013. Our funds have created thousands of jobs and invested in many companies since we formed over 25 years ago. Currently, we have 21 companies in our portfolio that we have invested debt, equity, or, in some cases, both. Some of these include Norshield Security Products, a maker of force protection doors, windows, guard booth products (used in U.S. Embassy sites) based in Montgomery, Alabama; Tech Cast, an industrial forging and casting company based in Myerstown, Pennsylvania; Animal Adventures, a maker of stuffed animal toys based in Minnesota, New York, and Washington State; American Card Services, a specialty printer of plastic gift cards with offices in Missouri and Illinois; and Las Vegas Color Graphics, which engages in commercial printing and data management based in Las Vegas, Nevada.

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, we are required to register with the Commission as we have over $171 million AUM with the SBIC capital included. All of our investors are accredited investors and include high net worth individuals, banks, insurance companies, family offices, and foundations. We received our SBIC license in March 2013, and have had an onsite examination by the SBA twice in that time period with no concerns raised. We have never had an SEC examination; despite, until recently, being an ERA. We will soon be filing a Form ADV to register with the Commission and expect our 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.

These increased compliance costs and time wasted take away the capital we could be using to source small business deals and impose an unnecessary duplicative regulatory burden on Spell Capital. The SBIC capital we are advising is thoroughly examined and regulated by the SBA, while the private capital in our 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 we oversee and our investment adviser will continue to be regulated in full by one sole regulator, rather than the enhanced oversight of SEC regulation. This legislation will save us immense compliance- and time-based costs that will allow our team to focus on what we do best—investing in innovative small companies in the manufacturing center, which often do not have much access to capital.

b. The Impact on SBIC Advisers With Either Private or SBIC Funds in Wind Down

In addition to the impact on Spell Capital and other funds like it, this legislation will resolve issues that other SBIA funds, including Merion Investment Partners in Radnor, Pennsylvania, and Patriot Capital in Baltimore, Maryland, have faced.

One of these issues is that, oftentimes, advisers to an SBIC will have a vestigial private fund that is winding down. This can result in having to take on the new regulatory compliance burdens as the fund is closing out and little to no money is coming in. If the SBIC fund has $150 million of capital in it and even one dollar in a fund that has run its course and is closing out, then full SEC registration is triggered. This is despite the fact that the bulk of the capital is in the SBIC and subject to SBA oversight. SEC registration is not adding investor protections in cases like these.

Another issue that will arise is when an adviser just to SBICs is winding down one of their SBIC funds. Once the SBIC has paid off their SBA debentures and is winding down, the license is generally terminated. There is still a small remaining pool of private capital it is returning to investors, but it is harvesting investments and not making new ones in that fund. This investment adviser, if they have a larger SBIC that they are also advising that is over $150 million AUM, then will be forced to register because without a current SBIC license the fund that is almost closed is classified as a private fund, despite being in wind down and returning the rest of its capital to its private investors. Often this wind down can take 1 to 2 years. These issues would both be resolved through the SBIC Advisers Relief Act by eliminating the SBIC capital from the AUM calculation and eliminating the registration burden for these funds, while preserving oversight as an ERA or State-registered adviser during that wind down period. Registration is not adding investor protections in cases like these.

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. We 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 percent), 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 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 3 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, record keeping, reporting, examinations, conflict of interest rules, and other significant requirements. For a more in-depth understanding of the

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[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/.*

[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.*

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.

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.

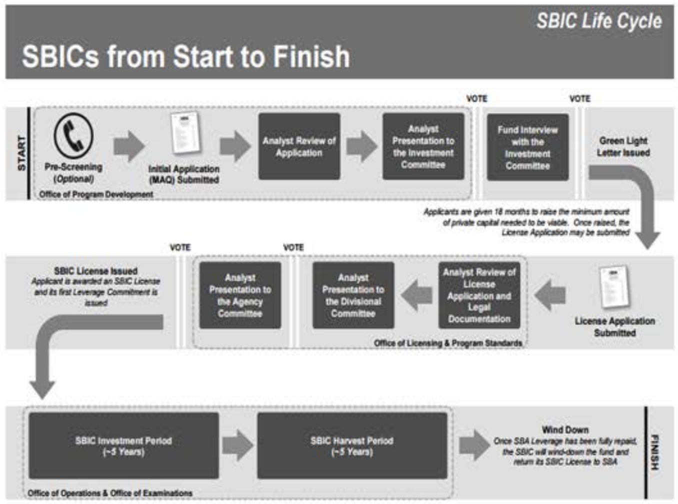
Rigorous Licensing Process

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.[5]

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.[6]
- 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.[7]
- 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).[8] 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.[9]
- 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[10], is charging a

[5] 13 CFR Section 107.600
[6] 13 CFR Section 107.630
[7] 13 CFR Section 107.640
[8] 13 CFR Section 107.650
[9] 13 CFR Section 107.660
[10] 13 CFR Sections 107.1830-1850

management fee within SBA guidelines[11], and investments in any one portfolio and its affiliates do not exceed the permitted limits.[12]

SBIC Examinations

SBA examinations are regulatory compliance audits. [13] 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.[14] 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.[15] 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.

[11] 13 CFR Section 107.510
[12] 13 CFR Section 107.740
[13] 13CFR Section 107.690
[14] 13 CFR Section 107.692
[15] 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. [16]
- 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.[17]
- 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.[18]
- 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.[19] The maximum rate of amortization on loans and debt securities cannot be amortized faster than straight line for the first year. The small

[16] CFR Section 107.610
[17] CFR Section 107.620
[18] CFR Section 107.740
[19] 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.[20] 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.[21]

- 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.[22]
- No new manager or officer of an SBIC may be appointed without prior SBA approval.[23]
- 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.[24]
- A change of control of an SBIC requires prior SBA approval.[25]
- There are restrictions on common ownership and control of two or more SBICs, absent SBA approval.[26]
- SBA must approve the management agreement and the management fee that an SBIC with Leverage can pay and sets a cap on that fee.[27]
- SBA restricts the categories of expenses that the SBIC can pay.[28]

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

[20] 13 CFR Section 107.850
[21] 13 CFR Section 107.855, Section 107.860, and Section 107.900
[22] 13 CFR Sections 107.1500-1590
[23] 13 CFR Section 107.160
[24] 13 CFR Sections 107.550-570
[25] 13 CFR Sections 107.400-430
[26] 13 CFR Section 107.460
[27] 13 CFR Section 107.510
[28] 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.

Addendum II to Testimony

List of SBICs in Senate Banking Committee Member States

Alabama:	Harbert Mezzanine Partners (Birmingham)
Arkansas:	Diamond State Ventures (Little Rock)
Illinois:	Aldine Capital (Chicago); Alpha Capital (Chicago); CapX Partners (Chicago); Channel Medical Partners (Evanston); Dunrath Capital (Oak Brook); Fidus Investment Corporation (Evanston); Freeport Financial (Chicago); Granite Creek Partners (Chicago); High Street Capital (Chicago); Invision Capital (Chicago); LaSalle Capital Group (Chicago); Midwest Mezzanine Funds (Chicago); MK Capital (Northbrook); Monroe Capital Corporation (Chicago); Prism Capital (Chicago); Victory Park Capital (Chicago).
Indiana:	1st Source Capital Corporation (1st Source Bank) (South Bend); Cambridge Ventures (Cambridge Capital Mgmt) (Indianapolis); Centerfield Capital Partners (Indianapolis).
Kansas:	Kansas Venture Capital (Leawood); Midstates Capital (Overland Park).
Louisiana:	Jefferson Capital Partners (Mandeville); LongueVue Capital Partners (Metairie).
Massachusetts:	Ascent Venture Partners (Boston); Citizens Ventures (Boston); Crescent Capital (Boston); Crystal Financial (Boston); New Atlantic Ventures (Cambridge); Gemini Investors (Wellesley); High Peaks Venture Partners (Williamstown); Lancet Capital (Cambridge); Long River Ventures (Amherst); Pine Street Capital Partners (Wellesley); Seacoast Capital (Danvers); SEED Ventures (Taunton); Ticonderoga Capital (Braintree).
Nebraska:	First Capital Partners (Omaha).
New Jersey:	Contemporary Healthcare Capital (Shrewsbury); Edison Partners (Lawrenceville); University Ventures Inc. (New Brunswick).
New York:	Accretive Investors (NYC); AEA Investors (NYC); Argentum Group (NYC); Bluehenge Capital (NYC); Bridges Ventures (NYC); Brightwood Capital (NYC); Brookside Pecks Capital Partners (NYC); CapitalSpring (NYC); Cephas Capital Partners (Pittsford); Deerpath Capital (NYC); DeltaPoint Capital (Rochester); East Coast Capital Holdings (NYC); Emigrant Capital Corporation (NYC); Empire State Capital Corporation (NYC); Enhanced Capital Partners (NYC); Eos Partners (NYC); Falcon Private Equity (NYC); Flushing Capital Corporation (NYC); Founders Equity (NYC); Freshstart Venture Capital Corporation (NYC); Golub Capital Corporation (NYC); Gefinor Capital (NYC); Graycliff Partners (NYC); Hudson Ferry Capital (NYC); Hudson Venture Partners (NYC); KBL Venture Capital (NYC); Kinderhook Capital (NYC); Medallion Funding (NYC); Medley Capital (NYC); Mercury Capital (NYC); Michigan Growth Capital Partners (NYC); Morgan Stanley Impact SBIC (NYC);

	Multiplier Capital (NYC); New Mountain Capital (NYC); OFS Capital (NYC); PennantPark (NYC); Pine Street Capital Partners (Albany); Praesidian Capital Investors (NYC); Rand Capital (Buffalo); Riverside Company (NYC); Saratoga Investment Corporation (NYC); Triad Investments (NYC).
North Dakota	North Dakota SBIC (Fargo)
Ohio:	Enterprise Ohio SSBIC (Dayton); Northcreek Mezzanine (Cincinnati); Peppertree Capital (Chagrin Falls); River Cities Capital Funds (Cincinnati); Stonehenge Partners (Columbus); Triathlon Medical Ventures (Cincinnati); The Riverside Company (Cleveland).
Oregon:	Endeavor Strategic Equity & Mezzanine (Fund in Formation) (Portland)
Pennsylvania:	Renovus Capital Partners (Wynnewood); Merion Investment Partners (Radnor); F.N.B. Partners (Wexford); NewSpring Capital (Radnor); Argosy Capital (Wayne); Boathouse Capital (Wayne); Meridian Venture Partners (Radnor).
Rhode Island:	Bay Capital Investment Partners (Providence).
Tennessee:	Tenth Street Capital (Nashville/Chattanooga); Petra Capital Partners (Nashville); Harbert Mezzanine Partners (Nashville); Claritas Capital (Nashville).
Virginia:	BIA Digital Partners (Chantilly); Gladstone Management Corporation (McLean); Leeds Novamark Capital (Reston).

PREPARED STATEMENT OF MARCUS M. STANLEY

POLICY DIRECTOR, AMERICANS FOR FINANCIAL REFORM

MARCH 24, 2015

Mr. Chairman and Members of the Committee, thank you for the opportunity to testify before you today on behalf of Americans for Financial Reform. AFR is a coalition of more than 200 national, State, and local groups who have come together to advocate for strong and effective financial regulation. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups.

Before turning to the specific bills under consideration today, I would like to make some general points regarding the topic of the hearing. Today's hearing addresses "capital formation," which is of course a central part of the SEC's mission. However, AFR does not believe that the agency's capital formation mandate conflicts with its mission of investor protection. Effective capital formation requires that investors entrust their capital to the market without demanding prohibitive risk premiums. Perhaps even more critically, it requires that markets channel investor capital to its highest and best use. When investors put their money into a pump-and-dump penny stock scheme, that money was not effectively used in capital formation. When investors purchased securities on the basis of fraudulent accounting, or on the basis of misleading descriptions of the true risks of the "toxic" mortgage assets at the heart of the financial crisis, their capital was misallocated and economic harm was done. Furthermore, after these scandals came to light, they contributed to loss of faith in our financial markets and to a potential rise in the future risk premium demanded by investors in order to supply capital, or even an unwillingness to supply capital for risky projects at all. In sum, then, a failure to place a high priority on the SEC's investor protection mission will also harm its mission of ensuring effective capital formation.

This perspective shapes our views on the bills under consideration today. I will now turn to discussing those bills in detail. I will discuss five of the nine bills under consideration. AFR supports the legislation eliminating swaps data indemnification requirements (H.R. 742 from the 113th Congress). We oppose three bills:

- Legislation exempting mergers and acquisition brokers from broker-dealer registration (H.R. 2274 from the 113th Congress).
- Legislation that would expand exemptions from Dodd-Frank derivatives clearing requirements for financial affiliates of commercial entities (H.R. 5471 from the 113th Congress).
- Legislation that would expand exemptions from adviser registration for advisers to certain funds that combine monies from small business investment companies (SBICs) and private equity or venture capital. (H.R. 4200 from the 113th Congress).

Although we do not have a formal position on legislation requiring the SEC to modify Reg SK disclosures (H.R. 4569 in the 113th Congress), I will briefly speak on that bill as well.

Eliminating Swaps Data Indemnification Requirements: AFR SUPPORTS

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 much 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 H.R. 742, would be beneficial in encouraging needed sharing of derivatives data between different jurisdictions and entities. We thus favor this legislation.

Exemption of Merger and Acquisition Brokers From Dealer Registration: AFR OPPOSES

This legislation (H.R. 2274 from the 113th Congress) would eliminate SEC broker-dealer registration requirements for merger and acquisition brokers. While a much narrower version of this legislation could be acceptable, AFR opposes this bill, since it 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. [1]
- 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. [2]

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. [3]

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.

Expanding Exemptions From Derivatives Clearing Requirements: AFR OPPOSES

The requirement that standardized derivatives transactions be cleared through a central counterparty is a fundamental financial system safeguard established by the Dodd-Frank Act.

While commercial entities using derivatives to hedge legitimate commercial risk are already exempted from clearing requirements, 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. This legislation (H.R. 5471 from the 113th Congress) 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 nonspecific.

This seemingly technical change could have far-reaching implications. 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." [4] This legislative change would significantly reduce the ability of the CFTC to police risk management for this kind of comingling of commercial and financial activities, both at major banks and at commercial companies

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[1] North American Securities Administrators Association, "NASAA Letter to Senators Manchin and Vitter Re S 1923", September 8, 2014.

[2] 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.

[3] Securities and Exchange Commission, "No-Action Letter Re M&A Brokers", January 31, 2014 [Revised February 4, 2014].

[4] 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.

like General Electric that have large financial subsidiaries such as GE Capital. As the nonpartisan 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-trading requirements as long as one of the banks had a nonfinancial affiliate." [5]

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. [6] 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. There should be no general reduction in CFTC authority to manage this complex area of derivatives regulation.

Expand Exemptions From Advisor Registration for SBIC Funds: AFR OPPOSES

An important change made by the Dodd-Frank Act was the new requirement that most advisors to private funds such as hedge and private equity (PE) funds must register with the Commission under the '40 Act. We are strong supporters of this provision, both for its investor protection benefits and its systemic risk benefits in creating greater financial system transparency. This new requirement has already begun to create improvements in investor protection, as initial SEC inspections of newly registered PE fund managers found violations of law or material weaknesses in controls at over half of advisors examined. [7]

Currently, fund advisors who manage less than $150 million in combined assets are exempted from this registration provision. Combined assets are defined as private equity or hedge fund assets plus assets from Small Business Investment Companies (SBICs) and venture capital (VC). However, advisors who manage solely SBIC or VC money are completely exempted.

This legislation (H.R. 4200) alters these provisions so that only private equity or hedge fund assets would be counted toward the $150 million line. Advisors combining SBIC with PE money would be exempted even if their total funds exceeded $150 million, so long as total PE assets were under $150 million. It is likely that this change would affect only a relatively small number of advisors. However, we object on principle to carving more advisors out of these new registration requirements, especially given what we have learned over the last year about the potential for widespread investor abuses in private equity markets. We are also concerned that the legislation would weaken State investor protection oversight of SBIC funds.

AFR does not at this time have positions on the other bills under consideration by the Committee. But I would like to briefly comment on "The Disclosure Modernization and Simplification Act of 2014", legislation that requires the SEC to modify Reg SK disclosures. There is no issue in principle with updating or simplifying investor disclosures as long as no material information is lost. The SEC has ample authority to do this, and was last required to examine the issue in 2013 under the JOBS Act. It has a current task force working on this issue, marking the fifth time a task force or initiative has studied this issue over the past two decades.

Given the large amount of SEC work on this issue that has already taken place and continues to take place, as well as the numerous other critical priorities for the agency, including the completion of the roughly 40 percent of Dodd-Frank rules that

[5] Congressional Research Service, "CRS In Focus: H.R. 37 Derivatives Provision May Create Broader Exemption", January 26, 2015.

[6] 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.

[7] Bowden, Andrew, "Spreading Sunshine in Private Equity", SEC Office of Compliance Inspections and Examinations, Speech at Private Equity International (PEI), Private Fund Compliance Forum 2014 New York, NY, May 6, 2014.

remain incomplete, we question whether this is an appropriate priority for agency resources. We are also concerned that the legislation instructs the agency to "eliminate" disclosure requirements under Reg SK when important parts of Reg SK—notably the disclosures for asset-backed securities—were recently shown to be inadequate during the financial crisis and are being strengthened under the Dodd-Frank Act. A sensible review of disclosures should ask what needs to be improved, not simply what needs to be eliminated.

This is not the only issue with the bill. As currently written, this bill requires rulemaking after 6 months, although the study to determine what if any rule changes are necessary or appropriate takes place over 12 months. This seems inappropriate.

Finally, on the issue of disclosures, we believe that greater investment in implementing machine-readable disclosures would be of much greater benefit to investors and possibly issuers than any reasonable "simplification" or "scaling" of disclosures could possibly be. There is significant private sector interest in assisting investors in analyzing machine-readable data, and likely also assisting issuers to generate and file such data. But the potential benefits here cannot be fully realized until the SEC has transformed its disclosure system from disconnected documents into searchable open data.

Thank you for the opportunity to testify. I am happy to answer further questions.

PREPARED STATEMENT OF JOHN C. PARTIGAN

PARTNER AND SECURITIES PRACTICE GROUP LEADER, NIXON PEABODY

MARCH 24, 2015

I. Introduction

Chairman Crapo, Ranking Member Warner, and distinguished Members of the Subcommittee, thank you for inviting me to testify.

I am a partner in the Washington, DC, office of Nixon Peabody LLP and the chair of the firm's national securities practice group. Prior to moving to Washington, I practiced securities law in Rochester, New York.

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 am a graduate of Albany Law School, J.D., and Willamette University, B.S.

I understand the Committee will examine a number of bills, and I of course, applaud your efforts to find bipartisan legislation addressing particular regulatory issues. I am here to speak on two related issues: (1) Wegmans Food Market, Inc.'s (Wegmans) support for S. 576, Encouraging Employee Ownership Act; and (2) how S. 576 updates the Securities and Exchange Commission's (SEC) Rule 701.

On behalf of Wegmans, I would like to thank Senators Toomey and Warner for introducing the Encouraging Employee Ownership Act. This bipartisan legislation will allow privately held companies, like Wegmans, to continue to provide and expand ownership opportunities without having to risk the public release of competitively sensitive company information.

I have worked with Wegmans for more than 15 years, among other things assisting the company in its employee investment plan and the program design.

Wegmans is proud that a key component of its recruitment and retention efforts is designing programs that allow employees to share in the success of the company. The employee investment plan is one example of this shared success. In addition to sharing in the success, the program allows participants to build wealth. Finally, as is the case with many employee ownership programs, the Wegmans' program helps create an environment of innovation and loyalty.

II. About Wegmans

History

Wegmans is a privately held, family owned company. It is an American story. In 1916, John Wegman started his company with a produce pushcart. A year later his brother Walter joined him in the operations. In 1921, John and Walter Wegman purchased the Seel Grocery Co. and expanded operations to include general groceries and bakery operations. Since its beginnings, Wegmans has remained, and will remain, a privately held company.

Currently, Danny Wegman is CEO, and Colleen Wegman, his daughter, is president. Robert Wegman, Danny's father, was chairman until his death in April 2006.

Wegmans operates 85 stores: 46 in New York, 16 in Pennsylvania, 7 in New Jersey, 6 in Virginia (with the newest Wegmans set to open in Alexandria, Virginia, in June of this year), 7 in Maryland, and 3 in Massachusetts. Wegmans employs almost 44,000 people.

Wegmans' Points of Pride

In February 2015, Wegmans was ranked number one for Corporate Reputation among the 100 most visible companies according to the Harris Poll Reputation Quotient (RQ®).[1] Wegmans is the only company to be ranked in the top five on all six reputation dimensions of social responsibility, emotional appeal, products and services, vision and leadership, financial performance, and workplace environment. Wegmans believes that its inclusion in each of these categories is a direct result of the dedication of its employees.

Every year since its inception 18 years ago, Wegmans has been ranked among *FORTUNE* magazine's 100 "Best Companies To Work For", and has ranked among the top five for 9 consecutive years—Wegmans is the only company in America that has accomplished this—and among the top 10 best companies to work for, for 11 consecutive years. As a result, Wegmans is in *FORTUNE*'s Hall of Fame. In the recently released rankings, Wegmans was seventh on the 2015 *FORTUNE* list, and the number one retailer.[2]

Wegmans is extremely proud of this continued recognition and inclusion on the "Best Companies To Work For", because it is a reflection of how the company treats its employees. Two-thirds of the scoring for the *FORTUNE* score comes from a survey that is both anonymous and random. The *FORTUNE* survey participants include Wegmans' full- and part-time employees, and employees from all of its facilities, including stores, warehouses, farms, offices, and manufacturing plants.[3]

Finally, and while I could go on, I will stop here with one final award note; a national consumer magazine recently ranked Wegmans as the best supermarket chain in the United States.

These accolades are the result of the dedication and efforts of Wegmans' employees, including many that Wegmans is trying to reward with ownership opportunities.

Wegmans, like other privately held companies, has made the strategic decision to remain private. Wegmans has found this structure to be a competitive advantage as the company competes against our country's largest grocery chains, companies like Wal-Mart/Sam's Club, Target, Giant, Kroger, Costco, Albertsons, SuperValu, and Whole Foods.

By remaining privately held, Wegmans can focus on long-term results and customer service. This belief in the long-term nature of the company is manifest in its philosophy that if Wegmans takes care of its employees, its employees will take care of the customers, and the bottom line will take care of itself.

One example of this philosophy is the fact that Wegmans has never had a layoff.

Wegmans does not pay periodic bonuses. Rather Wegmans, like many privately held companies, stresses the long-term decision making that leads to a stronger company, not just next quarter, or even next year, but in the next decade and beyond.

Allowing privately held companies to provide ownership opportunities helps increase this long-term focus, which, in turn, creates a more engaged group of employees since they benefit directly from the company's long-term success. Even more important, programs like SEC Rule 701 allow privately held companies to share the increased wealth from the success of the company rather than just keeping it in the hands of the company founders and families.

III. SEC Rule 701

Before I describe what S. 576 does, and why I believe it is a modest and sensible update to an already popular SEC rule, I want to provide a brief description of Rule 701 and its history.

Introduction to 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 inter-

[1] See, *http://www.harrisinteractive.com/Insights/2015RQ100MostVisibleCompanies.aspx.*
[2] See, *http://fortune.com/best-companies/.*
[3] Id.

ests—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, many privately held companies offering such securities would be required to register the sale of these securities with the SEC regardless of the fact that they are 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 Exchange Act, 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 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.[4] 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 generally 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.[5]

A company must provide investors a copy of the compensatory benefit plan or the contract, as applicable. In addition, because the offering remains subject to SEC Rule 10b-5, the SEC's antifraud rules, a company must provide Rule 701 employee-investors with disclosure adequate to satisfy the antifraud provisions of the Federal securities laws. Generally, this means that a company offering Rule 701 securities must adhere to a reasonable investor standard when determining the information provided to investors. In a nutshell, the reasonable investor standard is what disclosure information a reasonable investor would expect to receive from the company about the investment before making an investment in the company.

The Enhanced Disclosures

In 1996, the National Securities Markets Improvement Act (NSMIA) was signed into law.[6] NSMIA included provisions that provide the SEC with 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.

In 1999, when the SEC issued amended rules for Rule 701 under its new NSMIA authority, 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."[7]

Nevertheless, because the SEC was expanding the program and had concerns that it was eliminating the $5 million cap, it created a regime of enhanced disclosure for yearly sales in excess of $5 million. These enhanced disclosures include: (1) a summary plan description if the plan is an ERISA plan or a summary of the material terms if it is not; (2) risk factors associated with the investment; and (3) financial statements, no older than 180 days, required under Regulation A.[8]

Why Is S. 576 Necessary?

S. 576 is a simple and balanced approach to raising this outdated threshold for the enhanced disclosures. Specifically, S. 576 instructs the SEC to increase the level, from $5 million to $10 million, at which the Rule 701 enhanced disclosures are required.

Simply put, any assertion that the enhanced disclosures are not burdensome or problematic is wrong. There are significant concerns about confidential information

[4] See, *https://www.sec.gov/rules/final/33-7645.htm.*
[5] See, 17 C.F.R. §230.701(d)(2).
[6] See, Pub. L. 104-290, 110 Stat. 3416 (October 11, 1996).
[7] See, *https://www.sec.gov/rules/final/33-7645.htm.*
[8] See, 17 C.F.R. §230.701(e).

getting outside a privately held company, while these disclosures provide little additional insight to employees.

The SEC noted in its 1999 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."[9]

In the same rulemaking, the American Bar Association, Subcommittee on Employee Benefits, Executive Compensation and Section 16 (ABA Subcommittee) submitted comments expressing concern about the new 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 naive to think could be avoided with a confidentiality agreement."[10]

Since 1999, when the ABA Subcommittee comments were submitted, the potential for leaks and the public release of highly confidential information has only grown. One need only to read the news to understand that organizations, including the U.S. Government, struggle to keep sensitive data protected from hackers and dissemination.

Wegmans and other 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.[11] As the SEC noted in its 1999 rulemaking, the legislative history of NSMIA supported a prompt increase of the Rule 701 threshold to not less than $10 million.[12] 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 threshold raised to not less than $10 million, and neither report makes mention of additional disclosures being a part of that increase. Finally, the most recently published 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."[13]

This is what the Encouraging Employee Ownership Act would do. It is a sensible and balanced inflation adjustment that continues to address the SEC's original concerns by requiring disclosures for stock grants and sales above a certain level, while recognizing that employees know their companies.

IV. Conclusion

Wegmans and many of the Nation's estimated 5.7 million[14] privately held 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 an outdated threshold. Privately held businesses that want to offer additional ownership opportunities are stuck with a no-win decision: Do we risk losing good employees or do we risk the public release of our confidential business information? If Congress passes S. 576, the employee-

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[9] See, *https://www.sec.gov/rules/final/33-7645.htm.*

[10] 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.*

[11] 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.

[12] See, H.R. Rep. No. 104-622 at 38; S. Rep. No. 104-293 at 16.

[13] 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.

[14] See, *http://www.forbes.com/sites/sageworks/2013/05/26/4-things-you-dont-know-about-private-companies/.*

investors of privately held companies will benefit because their employers will no longer face this no-win decision.

Thank you again for the opportunity to testify today. I look forward to answering any questions that the Committee Members may have.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR VITTER FROM THOMAS QUAADMAN

Q.1. Mr. Quaadman, as Chairman of the Small Business Committee, I have the responsibility to investigate Government actions that are harmful to small business, including regulations that affect SBICs and venture capital funds.

What are some of the reasons the Chamber of Commerce recommends exempting advisers to SBIC and venture capital funds from the Investment Advisers Act of 1940?

A.1. Small business investment companies (SBICs) and venture capital funds both play a vital in our economy, providing billions of dollars' worth of capital to small businesses that are looking to expand their operations and hire new workers.

SBICs are privately owned equity funds that are licensed with the Small Business Administration (SBA) and currently hold over $20 billion worth of investments in U.S.-based companies. SBICs are closely regulated by the SBA and are limited in terms of what they can borrow. SBICs undergo regular examinations from the SBA, and are an important source of capital for American businesses. Venture capital (VC) funds also play a critical role in our economy, particularly when it comes to providing "early stage" funding to nascent businesses. Many advisers to venture capital funds also advise SBICs, which benefit from the expertise that VC professionals can offer.

The Dodd-Frank Act did away with the so-called "private fund" exemption under the Investment Advisers Act and instead granted explicit exemptions to SBIC advisers, VC advisers, as well as private equity fund advisers under a certain threshold. Regrettably, the way the law has been interpreted, an individual that happens to advise both an SBIC and a VC fund would have to register with the SEC. This is not what Congress intended, and there is simply no valid reason for advisers to register (a costly and burdensome process) simply because they happen to advise both. The SBIC Advisers Relief Act would carry out Congressional intent and ensure that advisers to SBICs and VC funds do not have to deal with unnecessary and burdensome red tape.

Q.2. Given the complexity and volume of disclosure and reporting requirements, it appears to create the phenomenon you described in your testimony as "disclosure overload." What criteria would you recommend is used to simplify these requirements while still maintaining discernable transparency to investors?

A.2. The Chamber believes that "disclosure overload" has become a real concern for investors, as the length and complexity of quarterly and annual reports has increased over the years. We believe that the SEC can act swiftly in order to address some outdated or duplicative disclosure requirements in SEC filings (e.g., historical stock prices, which can now be searched easily on a computer or smartphone), while also focusing on long-term reforms that will bring the disclosure regime into the 21st Century.

As the SEC goes about the disclosure reform project, we believe that the guiding principle for determining what should (or shouldn't) be disclosed in SEC filings is materiality. As the Supreme Court explained nearly 40 years ago in *TSC Industries vs.*

Northway, a fact is material if "there is a substantial likelihood that a reasonable shareholder would consider it important before deciding how to vote. In other words, a fact is not material if an investor might find it important; rather it should depend on whether a reasonable person would find it important to their decision making.

Focusing on materiality will ensure that investors do not become increasingly overloaded with information that may or may not be material to their decision making. It will also help ensure that our disclosure regime does not become a tool for special interests to use when trying to drive an idiosyncratic agenda (e.g., "shaming" disclosures such as conflict minerals) that are unrelated to enhancing investor decision making.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR VITTER FROM MARCUS M. STANLEY

Q.1. Given the lack of cumulative, industrywide derivative data reporting as you mentioned in your testimony, can you provide specific reasons why this data reporting has been slow? Can you clarify what a clear, consistent, and usable derivatives data system would consist of?

A.1. There appear to be many reasons for slow progress in derivatives data reporting. These include the presence of multiple competing private entities in the derivatives data space which did not have consistent data formats, a failure by regulators to specify clear and standardized data formats and data items and require their use in reporting, the inherent complexity of derivatives contracts, and privacy laws in some Nations that restrict or limit the sharing of data. Americans for Financial Reform has submitted two comments to regulators in this area, which are attached to this response.

A full response to the question of what a clear, consistent, and usable derivatives data system would consist would be involved and technically complex. However, important goals for such a system would include the following:

- It should permit regulators to aggregate the derivatives exposures of counterparties throughout the financial system, using a consistent and universal counterparty identifier such as the LEI.
- Regulators should be able to examine how such exposures might change under stressed conditions. This requires that detailed information on individual derivatives contracts be reported, including how payment commitments change upon counterparty default. Reporting of only aggregated or netted exposures, with the aggregation modeling performed by reporting entities, would not be adequate.
- Data should be available to private parties to assist in proper risk aggregation and modeling within the financial system, including risk analysis and aggregation by banks and financial market utilities. AFR also supports the development of a public use license for the analysis of swaps data by academics and

others studying systemic risk, subject to proper confidentiality protections.

Q.2. You mention that the indemnification requirements in Dodd-Frank are slowing the process for information sharing and could be replaced with a simpler confidentiality agreement. How specifically does a confidentiality agreement help to improve the pace of information sharing and how does a confidentiality agreement solve the problem of derivatives currently being in a form that can't be aggregated? Can you elaborate on what changes to the indemnification requirements in Dodd-Frank that would help improve this process?

A.2. It is our understanding that the requirement that foreign financial regulators indemnify U.S. regulators against any litigation resulting from information sharing, as well as the requirement that other U.S. agencies provide indemnification to the SEC or CFTC before gaining access to data, is creating barriers to sharing of derivatives data. The replacement of the indemnification requirement by a simple confidentiality requirement is likely to make it simpler for regulators to pool their derivatives data and arrive at an information sharing arrangement that permits the global aggregation of derivatives risks. We do not believe that this change alone will address most of the barriers to effective derivatives reporting discussed in the response to the first question. It would be a small but helpful change.

Please feel free to contact me for any further discussion of these issues.

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FOR FINANCIAL REFORM
ACCOUNTABILITY • FAIRNESS • SECURITY

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AFSG Comment From Americans for Financial Reform

Americans for Financial Reform ("AFR") appreciates this opportunity to respond to the Financial Stability Board's request for comments on its "Feasibility Study on Approaches to Aggregate OTC Derivatives Trade Repository Data". AFR is a coalition of more than 200 American civil society organizations that have come together to advocate for reform of the financial industry. Members of AFR include major labor, consumer, civil rights, investor, retiree, community, and faith based groups. A list of AFR members is attached and further information on AFR is available at www.ourfinancialsecurity.org.

Improving the transparency of financial risk exposures for both regulators of the system and the broader public is a critical priority for financial reform. The failure of regulators to properly monitor and understand risk exposures, particularly in the derivatives markets, was a major contributor to the global financial crisis. Without developing the capacity to track and monitor financial risk exposures in the global markets, including the possible migration of risk exposures to less regulated 'shadow banks', it is difficult to see how financial oversight can possibly be reliable. The aggregation of derivatives data to produce clear and comprehensible metrics of counterparty exposure is central to improved transparency.

Unfortunately, progress on improving this basic element of regulatory capacity has been distressingly slow. Within the United States, regulators have stated that they cannot properly aggregate derivatives exposure data even within the various U.S. dealers and the four U.S. trade repositories.[1] Globally, there are eighteen repositories located in ten different jurisdictions, as well as numerous swap dealers – a challenge far greater than aggregating within a single jurisdiction. As this FSB report admits frankly, "global and comprehensive data aggregation is not possible under current arrangements". The recent senior supervisor's report showing that many major global banks are unable to aggregate even their own major counterparty exposures makes it clear that the inability to produce accurate, reliable, aggregated exposure data creates fundamental risk management problems across the financial system that must be addressed.[2]

It is remarkable that in August, 2008 representatives of the major banks laid out best practices goals that included the capacity to track and aggregate the prior day's risk exposures 'within a matter of hours', yet more than five years later we remain so far from that goal.[3] In light of the importance of this issue and the extraordinarily slow progress achieved to date, AFR believes that the status quo is unacceptable. This implies that Option 3 in this document – which relies on

[1] Osipovich, Alexander, "CFTC Has 'Turned the Corner' On Swaps Data Mess, Says O'Malia", Energy Risk, February 7, 2014.
[2] Senior Supervisors Group, "Progress Report on Counterparty Data", January 15, 2014.
[3] Counterparty Risk Management Group, "Containing Systemic Risk: The Road to Reform", Report of the CRMPG III, August 6, 2008.

the current status quo of individual national regulatory authorities working with trade repositories and then sharing the results on a regulator-to-regulator basis – must be rejected by the FSB. Continuing with the system described in Option 3 promises only to perpetuate the unacceptably slow pace of progress observed since the financial crisis.

If the FSB rejects Option 3, as it should, this leaves the choice between proceeding with further examination of Option 1 or Option 2. Option 1 involves a data center where all global derivatives data is physically stored for aggregation and reporting. Option 2 would be similar to Option 1, except that the data center would be 'virtual' – rather than physically storing the data, it would be accessed through requests to trade repositories all over the globe. The issues involving aggregation of the data once accessed appear to be similar between the two options, but the options differ in terms of data availability.

The report does not contain sufficient information for us to fully assess the strengths and weaknesses of the two options. Much depends on the reliability of access to remote data that is not physically stored at the data center location. If the availability of such data can be made truly reliable at a low investment in time and effort, then Option 2 is feasible. Otherwise, Option 1 appears superior. This seems to be an involved technological question that will require substantial engagement with information technology experts to determine. We suggest that the FSB continue to explore both options until a definitive assessment can be made.

However, we would suggest that the FSB be guided by two broad priorities in making its decision:

1) First, the lines of authority and responsibility should be clear. A governance structure should be set up that creates a single entity responsible for implementing an aggregation mechanism that can produce derivatives exposure data on demand and reliably. Obviously such an entity will need input and oversight by an international group. But a single entity involving a limited group of participants should be given clear authority and responsibility for success in this important effort.

2) Second, the FSB should be guided by the need to implement a genuinely reliable aggregation mechanism as rapidly as possible. The aggregation capacities of the mechanism should be completely tested within a reasonable timeline, and the ability to aggregate should be reliable and not vulnerable to technical differences between local trade repositories.

A single public entity appears to be a better governance structure for establishing clear lines of authority and responsibility described above. For this reason, AFR would favor a governance structure similar to the 'international data hub' (described in Box 3 on p. 27 of the report) rather than a public/private partnership with multiple tiers such as the governance mechanism for the global LEI project. It should be remembered that the global LEI project involved promulgating a data standard rather than the actual gathering and analysis of large amounts of data. This is quite different than the challenge involved in derivatives data aggregation.

Finally, putting a high priority on reliability and speed of implementation may call for centralizing actual data storage, along the lines of Option 1. If remote access such as Option 2 is chosen, an extensive testing regime will be required to ensure that all significant aggregation scenarios are adequately tested and the mechanism can properly access and analyze data from all global trade repositories. Such tests would have to be repeated periodically to determine if technical changes at the trade repository level had made it more difficult to access or aggregate data. If the full universe of derivatives data is routinely transferred to a single location, as in Option 1, it may prove to be easier to see any issues arising from technical differences between repositories or national data infrastructures. However, as noted above, the technical issues involved in the choice here are complex and it would be appropriate for the FSB to continue to explore both options with information technology experts.

Thank you for the opportunity to comment on this consultative paper. Should you have additional questions, please contact Marcus Stanley, AFR's Policy Director, at marcus@ourfinancialsecurity.org or (202) 466-3672.

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All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

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- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Center for Effective Government
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Green America

- Greenlining Institute
- Good Business International
- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Home Defender's League
- Information Press
- Institute for Agriculture and Trade Policy
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lawyers' Committee for Civil Rights Under Law
- Main Street Alliance
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
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- Public Citizen

- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
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- The Seminal
- TICAS
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- UNET

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FOR FINANCIAL REFORM
ACCOUNTABILITY • FAIRNESS • SECURITY

Americans for Financial Reform
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202.466.1885

May 27, 2014

Melissa D. Jurgens
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

To Whom It May Concern:

Americans for Financial Reform ("AFR") appreciates this opportunity to respond to the Commodity Futures Trading Commission ("CFTC" or "Commission") request for comments on its "Review of Swap Data Recordkeeping and Reporting Requirements". AFR is a coalition of more than 200 civil society organizations that have come together to advocate for reform of the financial industry. Members of AFR include major labor, consumer, civil rights, investor, retiree, community, and faith based groups. A list of AFR members is attached.

This request for comments comes more than two years after swaps data recordkeeping and reporting requirements were finalized in January 2012. In the years since the completion of this rule, the reality of swaps reporting has lagged far behind the goal of creating true regulatory transparency for this market. Initial analysis of swaps data produced errors of up to $55 trillion in simply assessing the size of the market.[1] CFTC commissioner Scott O'Malia has pointed to numerous errors and data quality problems that plague regulatory efforts to aggregate the data from different reporting entities and use it to understand swaps markets on a real-time or close to real-time basis.[2]

This Request gives a sense of the practical problem facing the Commission (CFR 16690):

> "At present there are over 150 potential swap data reporting entities registered with the Commission, each of which will have its own business and data standards for listing, executing, or clearing swaps in one or or more of the five asset classes recognized for purposes of the swap data reporting rules….In addition, swaps data may currently be reported to any registered SDR, each of which will also have its own data standards."

The data quality and data aggregation issues in CFTC-regulated swaps markets are only one part of the larger issue concerning risk exposure measurement and transparency that is faced by the

[1] Ackerman, Andrew, "CFTC Misreporting Size of Swaps Market, Agency Says", Wall Street Journal, December 18, 2013.
[2] Osipovich, Alexander, "CFTC Has Turned the Corner on Swaps Data Mess", Energy Risk, February 7, 2014.

entire global financial regulatory community. In the U.S. there are only four swaps data repositories, but globally, there are eighteen repositories over ten different jurisdictions – a challenge much greater than aggregating within a single jurisdiction. A recent consultation paper by the Financial Stability Board admits frankly, "global and comprehensive [swaps] data aggregation is not possible under current arrangements".[3] AFR commends the CFTC for its leadership in the Aggregation Feasibility Study Group and has supported the AFSG policy option for a centralized global data aggregation mechanism.[4]

The lack of data standardization and the accompanying capacity for aggregation is also a problem for bank regulators, as well as for banks themselves. A recent report by the prudential Senior Supervisor's Group shows that most major global banks are unable to aggregate even their own major counterparty exposures, even on a T+3 basis. This report makes it even clearer that the lack of ability to produce accurate, reliable, aggregated exposure data creates fundamental risk management problems across the financial system that must be addressed.[5] It is remarkable that almost six years ago, in August, 2008, representatives of the major banks laid out best practices goals that included the capacity to track and aggregate the prior day's risk exposures 'within a matter of hours', yet today we remain so far from that goal.[6] The failure of the major banks to meet their own best practice goals, to say nothing of more detailed and rigorous swaps reporting and record keeping rules, is unacceptable.

AFR's bottom line position on swaps recording and record keeping is simple: no one involved in swaps regulation should countenance the possibility of another crisis situation in which regulators do not know the details of market participants' positions. The CFTC must require swaps reporting and record keeping practices that achieve regulatory market transparency. These rules must come with a firm deadline for compliance and stipulated consequences for failure to comply. If a swaps dealer is capable of structuring and marketing a complex swap instrument, it must be capable of also reporting and recording that swap according to data standards and aggregation as agreed by the Commission.

Improving the transparency of financial risk exposures for both regulators of the system and the broader public is a critical priority for financial reform. The failure of regulators to properly monitor and understand risk exposures, particularly in the derivatives markets, was a major contributor to the global financial crisis. Without developing the capacity to track and monitor financial risk exposures in the global markets, including the possible migration of risk exposures to less regulated 'shadow banks', financial oversight cannot be comprehensive or reliable. The aggregation and tracking of derivatives data to produce clear and comprehensible metrics of counterparty exposure is central to improved transparency and risk management.

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3 Financial Stability Board, "Feasibility Study On Approaches to Aggregate OTC Derivatives Data", February 4, 2014.

4 Americans for Financial Reform, "Comment to FSB Re Feasibility of Aggregating OTC Derivatives Data", March, 2014.

5 http://www.financialstabilityboard.org/publications/r_140116.pdf

6 http://www.crmpolicygroup.org/docs/CRMPG-III.pdf

There is no technical reason why the swaps data reporting and recording standards and practices cannot be harmonized to enable near real time position, risk and financial surveillance. In its 2011 study on algorithmic derivatives, CFTC and SEC staff concluded that[7]:

> "…current technology is capable of representing derivatives using a common set of computer-readable descriptions. These descriptions are precise enough to use both for the calculation of net exposures and to serve as part or all of a binding legal contract."

The staff further concluded that the barriers to this type of standardized representation were:

1) A consistent and universal entity identifier for counterparties;
2) further analysis of the costs and benefits of electronic representation of derivatives, and
3) a uniform way to represent financial terms not covered by existing definitions.

With respect to the first barrier, U.S. and international regulators, led by the Office of Financial Research, are making significant progress on deploying a universal Legal Entity Identifier (LEI) for financial transactions.

As for the analysis of costs and benefits, this is an essentially bureaucratic barrier and no reasonable assessment of costs and benefits should hamper progress in achieving market transparency. Data standardization is classically an area in which private markets may not coordinate due to significant externalities – shared data standards are a public good.[8] Furthermore, they are a public good that lays the groundwork for all effective risk management and oversight, by both regulators and private entities. Uniform data standards for derivatives reporting, even if imposed on private parties, should easily be able to pass an objective cost-benefit test.

The final issue, the uniform representation of novel financial terms not captured in existing definitions, requires the Commission to stipulate that traders file standardized representations of new contract terms before trading new derivatives structures over-the-counter. While this requirement would add an additional step to the process of trading a novel derivative, this necessary addition would have major benefits both for regulatory oversight and for market participant transparency and private risk management. The distinguished risk manager David Rowe – hardly a radical in the area of financial regulation – has championed the mandatory coding of detailed transaction level data in a standardized format:[9]

> "..comprehensive and detailed electronic reporting of derivatives and structured security transactions is a win-win proposition, despite the inevitable industry resistance and complaints. Such detailed reporting is also essential if we are to have any chance of detecting and mitigating the impact of future forms of systemic risk"

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[7] Staff of the Commodity Futures Trading Commission and the Securities and Exchange Commission, "Joint Study on the Feasibility of Mandating Algorithmic Descriptions for Derivatives", April 7, 2011.
[8] See e.g. p. 21 of the presentation discussion by University of Maryland economist Pete Kyle at Americans for Financial Reform event on the economics of cost benefit analysis, May 8, 2012, available at http://ourfinancialsecurity.org/blogs/wp-content/ourfinancialsecurity.org/uploads/2012/05/PETE-KYLE-PPT.pdf
[9] Rowe, David, "Whither the Office of Financial Research?", Risk Magazine, November 1, 2010.

With regard to the issue of required standardization of new contract terms, Rowe states:

> "insisting on transaction level details would slow the process of quants creating a new structure in a spreadsheet in the morning and dealers actually booking such trades in the afternoon…Nevertheless, demanding that firms be able to represent the structure of any new trades in a standardized electronic form before booking them hardly seems like an outrageous requirement or an unacceptable burden on financial innovation".

Thus, AFR does not believe that any of the three barriers identified in the algorithmic derivatives study constitute a reason why the Commission should not move ahead with forceful action on the standardized electronic representation of derivatives transactions.

With respect to the almost 200 detailed technical questions asked in this request for information, AFR does not have detailed input on these questions at this time. However, given the importance of this issue we will consider industry responses to these questions, as well as Commission plans for action, and may offer input in the future.

At this time, guided by the considerations laid out above as well as other recent events, we do have several broad recommendations for the Commission in considering the responses to these questions and next steps in the crucial area of derivatives data requirements. These recommendations are:

1) The Commission must be willing to take proactive steps to ***require*** data standardization. The multi-year record of failure to achieve reliable aggregation and analysis of derivatives data is an ongoing embarrassment to financial regulators, and calls for strong action. As discussed above, this failure can be seen not simply at the CFTC, but also in the prudential regulatory space and at the international level. Data transparency and the proper measurement of counterparty risk exposures are the minimum requirements for both effective regulatory surveillance and private sector risk management. The information gathered through this request must not be used to accommodate existing divergence in private sector practices, but as a guide for areas where mandatory standardization is required.

2) The Commission should require detailed information related to regulatory exemptions, such as parental guarantees and affiliate structures. Commission rules contain significant regulatory exemptions in cases where e.g. swaps transactions undertaken by a foreign subsidiary are not guaranteed by a U.S. parent entity, or where swaps are conducted between affiliates. Several of the questions in this request for information ask whether information connected to such exemptions should be a required reporting element (see Questions 24 and Question 29(d)). AFR believes that such data should be reported to a Swaps Data Repository (SDR), and that such reporting must contain sufficient detail to allow the Commission to properly audit the use of these exemptions. For example, information on guarantees should include information on the full range of possible types of guarantees, including guarantees that exist at the entity (subsidiary) level rather than

just the swap level. Information on affiliate status should include documentation of shared ownership and the level of such ownership.

3) Similarly, the Commission must require sufficient reporting detail to determine whether clearing and execution mandates are being satisfied, and if not, why not. The execution and especially the clearing mandates are at the heart of the U.S. derivatives reforms in Title VII of the Dodd-Frank Act. The clearing mandate is likewise at the heart of the global commitment to derivatives reform agreed to at the 2009 Pittsburgh G-20 summit. Data reported to regulators must make clear whether a swap is subject to the clearing or execution requirement, and also whether such clearing and execution has taken place (Questions 2 and 3). Information related to swaps clearing is particularly important and in general all life cycle information relevant to tracking a swap from initial conception through clearing should be included in swaps reporting (including the reporting of the initial 'alpha' swap prior to novation into clearing). Such life cycle information will be particularly useful in tracking trends in clearing use in swaps markets, including both enforcement of the clearing mandate and also the optional use of clearing.

4) The Commission should develop a standardized Data Use License for swaps data that supports proper risk analysis throughout the system. Several questions (e.g. Question 64) asks about ownership and commercialization of data. AFR supports many of the general restrictions the Commission has placed on SDR commercialization of data, particularly in cases where such commercialization may lead to incentives for excessive fragmentation and competition in the public utility services provided by SDRs. However, it is crucial that each entity in the system that needs to process swaps data for risk management and analysis – especially DCOs and other types of CCPs – have direct access to whatever data is needed for proper stress testing and risk management. Further, we support the development of a standardized license for data use that would permit the external analysis of swaps data by academics and other regulators attempting to analyze systemic risk in U.S. and global finance.

Thank you for the opportunity to comment on this information request. Should you have additional questions, please contact Marcus Stanley, AFR's Policy Director, at marcus@ourfinancialsecurity.org or (202) 466-3672.

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- Mid City Animal Hospital, Pheonix AZ
- UNET

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

WRITTEN STATEMENT OF THE BIOTECHNOLOGY INDUSTRY ORGANIZATION, SUBMITTED BY CHAIRMAN CRAPO

Biotechnology Industry Organization

Written testimony of the

Biotechnology Industry Organization

Submitted to the United States Senate Committee on Banking, Housing, and Urban Affairs
Subcommittee on Securities, Insurance, and Investment

Capital Formation and Reducing Small Business Burdens

March 24, 2015

Executive Summary

- The Biotechnology Industry Organization (BIO) represents more than 1,100 innovative biotechnology companies, along with academic institutions, state biotechnology centers, and related organizations in all 50 states. The vast majority of BIO members are pre-revenue small businesses.

- More than 140 biotech companies have undertaken a public offering 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 next-generation medicines. 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 Fostering Innovation Act, which would add a revenue test to the SEC's filing status classifications under Rule 12b-2 and provide important regulatory relief for emerging biotechs.

- BIO supports the Small Company Disclosure Simplification Act, which would exempt EGCs and certain low-revenue issuers from the costly XBRL reporting requirement.

- BIO supports legislation to require the SEC to finalize its proposed rule implementing the new Regulation A+ pathway created by the JOBS Act. BIO also supports the SEC's proposed qualified purchaser definition, which would set a single national standard of review for Regulation A+ offerings.

- BIO supports the Disclosure Modernization and Simplification Act, which would direct the SEC to review and revise Regulation S-K to reduce the regulatory burden on smaller issuers and eliminate duplicative, outdated, and unnecessary compliance requirements.

- BIO supports the Encouraging Employee Ownership Act, 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, which would broaden the impact of the JOBS Act's IPO On-Ramp.

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

Testimony of the Biotechnology Industry Organization

Chairman Crapo, Ranking Member Warner, and Members of the Subcommittee, the Biotechnology Industry Organization (BIO) applauds you for convening today's hearing and for continuing your efforts to support capital formation and minimize regulatory burdens for America's small businesses.

BIO represents more than 1,100 innovative biotechnology companies, the vast majority of which are of growth-stage innovators. A typical biotech company has fewer than 50 employees (most of whom are scientists) and is dedicating vast sums of investment capital to the decades-long, billion-dollar R&D pathway intrinsic to groundbreaking medical advancement. These small businesses operate without the benefit of product revenue to fund their work, so 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.

The Jumpstart Our Business Startups (JOBS) Act, for which BIO was a strong advocate, was a perfect balance of capital formation incentives and right-sized 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.

In the three years since the JOBS Act was signed into law, there have been more than 140 IPOs in the biotech industry. For comparison, 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 24 IPOs by biotechs in the earliest stages of research (pre-clinical R&D and Phase I clinical trials), compared to just one pre-clinical IPO in the five years before the JOBS Act. Biotech investment is riskiest at the earlier stages of development – only 1 in 10,000 compounds discovered will lead to an FDA-approved drug – 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 unlock the secrets of Alzheimer's, HIV/AIDS, cancer, and other devastating diseases. It is clear that smart policymaking can have an impact on the capital formation ecosystem for innovative companies, and BIO thanks the Subcommittee for once again taking steps to support the growth of America's small businesses.

Reducing Small Business Burdens

The Disclosure Modernization and Simplification Act

One bill being considered by the Subcommittee, the Disclosure Modernization and Simplification Act, 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 pervasive 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, 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.

The Fostering Innovation Act

Take, for example, SEC Rule 12b-2, which divides companies by size to determine many of their compliance obligations. The Rule splits issuers into three buckets by public float: (1) companies with a public float below $75 million (non-accelerated filers), (2) those with a public float between $75 million and $700 million (accelerated filers), and (3) companies whose public float exceeds $700 million (large accelerated filers). If we apply the spirit of the Disclosure Modification and Simplification Act to Rule 12b-2, we must ask ourselves what a pre-revenue biotech company with a public float of $400 million truly has 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 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, right-sized regulatory environment. Specific to Rule 12b-2, BIO supports adding a revenue component to the non-accelerated filer definition. 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 out of date and should be increased to $250 million. These important reforms were included in the Fostering Innovation Act, which was approved by the House Financial Services Committee in the 113th Congress.

Reforming the non-accelerated filer definition could have a dramatic impact on emerging biotechs. Rule 12b-2 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 provide much protection to investors. Congress has already recognized that compliance with Section 404(b) is overly burdensome for small businesses by providing an exemption for EGCs in the JOBS Act. BIO urges Congress to take additional steps away from the one-size-fits-all compliance regime – to which EGCs will revert at the end of the five-year on-ramp – and instill permanent, commonsense filing status classifications that take revenue into account. Such a change would further open the public market to biotech capital formation, allowing companies to grow and attract investors without fear of subjecting themselves to a costly compliance burden.

The Encouraging Employee Ownership Act & the Improving Access to Capital for Emerging Growth Companies Act

BIO applauds the Subcommittee for considering additional legislation that applies the framework of the Disclosure Modernization and Simplification Act to other rules and regulations. For example, the Encouraging Employee Ownership Act 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 supports an effective disclosure regime that preserves the ability of innovative biotechs to attract talented workers and compensate them competitively without incurring additional compliance burdens.

Similarly, the Subcommittee is considering the Improving Access to Capital for Emerging Growth Companies Act, which 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. BIO commends the Subcommittee for taking these initial steps toward disclosure effectiveness, and urges it to continue its important work.

Support for an effective disclosure regime is widespread and bipartisan. The Disclosure Modernization and Simplification Act passed the House Financial Services Committee in the 113th Congress by a vote of 59-0. The Improving Access to Capital for Emerging Growth Companies Act was approved 56-0. Both bills were included, along with the Encouraging Employee Ownership Act, in the Promoting Job Creation and Reducing Small Business Burdens Act – which passed the full House of Representatives last September by a bipartisan vote of 320-102.

The Small Company Disclosure Simplification Act

Also included in this bipartisan package was the Small Company Disclosure Simplification Act, which had passed out of the House Financial Services Committee by a 51-5 vote. This important bill would broaden the IPO On-Ramp created by the JOBS Act by exempting EGCs from the requirement to provide financial statements in the eXtensible Business Reporting Language (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. 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 small issuers turn to external contractors to complete their 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.

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. Here again we see the importance of reviewing and reforming one-size-fits-all regulatory requirements. BIO urges the Subcommittee to continue down the path it has laid for itself and include a reexamination of the XBRL regime alongside the other cost-cutting proposals it is considering.

BIO is proud to support the Disclosure Modernization and Simplification Act, the Encouraging Employee Ownership Act, and the Improving Access to Capital for Emerging Growth Companies Act. We appreciate the steps the Subcommittee is taking toward an effective disclosure regime, and we are hopeful that Members on both sides of the aisle will continue to support right-sized regulations that provide important information to investors without creating a costly capital diversion that could slow the growth of small business innovators.

Capital Formation

Regulation A+

In addition to the important disclosure effectiveness legislation the Subcommittee is considering, it also has before it a bill that would give the SEC a deadline to finalize the reforms to Regulation A mandated by the JOBS Act. BIO was a strong supporter of Title IV of the JOBS Act, which directed the SEC to create a Regulation A pathway for offerings of up to $50 million. However, emerging biotechs have been prevented from utilizing this new avenue to capital because the SEC has not yet finalized its rule implementing the required changes.

The SEC proposed a rule authorizing Regulation A+ offerings of up to $50 million in December of 2013. BIO believes that the increased offering limit of $50 million – a significant change from the $5 million limit under the existing 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.

BIO provided comment on the proposed rule, applauding the SEC for taking steps to implement the new Regulation A+ pathway and largely praising its proposal. In particular, BIO's comment letter provided strong support for the SEC's proposed qualified purchaser definition, which would effectively set a national standard of review for Regulation A+ offerings and avoid costly state-specific roadblocks for emerging biotechs considering such an offering.

BIO strongly believes that Regulation A+ cannot function without a national review standard. The SEC's proposing release notes that "the cost of state securities law compliance…would discourage market participants from using the new exemption" – and BIO emphatically agrees. Given that the goal of the JOBS Act was to *increase* capital availability, requiring issuers to spend dollars to "analyze and comply with separate registration or qualification requirements, or to identify and comply with applicable exemptions, in each state in which they intend to offer or sell securities" would undercut the very intent of the law.

Instead, BIO supports a single national standard of review for Regulation A+ offerings. Though some stakeholders have proposed a coordinated review program that purports to streamline the review process, BIO still believes that a national standard is the only way for issuers to avoid the barrage of conflicting, state-specific requirements that would accompany an obligation to comply with divergent securities law in all 50 states.

BIO thanks the Subcommittee for considering legislation that would give the SEC a deadline to act on Congress's Regulation A+ mandate. We share the Subcommittee's sense of urgency, and join our voice to what is now a very loud chorus urging the SEC to finalize its rule. Further, we implore the SEC to maintain the qualified purchaser definition that it itself proposed, providing certainty to issuers and opening up an avenue to capital formation for a wide swath of early-stage companies.

Additional Reforms

BIO is encouraged that the Subcommittee is taking a proactive stance in encouraging the SEC to finalize its Regulation A+ rulemaking. We welcome efforts to support capital formation at growing companies, and hope to work with the Subcommittee to enact additional reforms that will bolster the fundraising potential of emerging biotechs.

For example, BIO 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 is wasting its potential by having 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.

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 also supports specific regulatory changes that the Subcommittee should consider as it continues to seek ways to sustain small business capital formation. In addition to the reforms to SEC Rule 12b-2 and the XBRL compliance regime mentioned above, we believe that emerging growth companies should be able to use forward incorporation by reference on Form S-1. We believe that Form S-3 should be available to issuers after 6 months on the public market rather than the full year currently required. We believe that the Well-Known Seasoned Issuer (WKSI) definition should be expanded so that more companies can take advantage of shelf offerings. The universe of policy options is broad, 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, BIO strongly supports 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*, BIO's member companies 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 believes 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.

WRITTEN STATEMENT OF THE COALITION FOR DERIVATIVES END-USERS, SUBMITTED BY CHAIRMAN CRAPO

Coalition for Derivatives **End-Users**

March 24, 2015

The Honorable Mike Crapo	The Honorable Mark R. Warner
Chairman	Ranking Member
Subcommittee on Securities, Insurance and Investment	Subcommittee on Securities, Insurance and Investment
Committee on Banking, Housing & Urban Affairs	Committee on Banking, Housing & Urban Affairs
United States Senate	United States Senate
239 Dirksen Senate Office Building	475 Russell Senate Office Building
Washington, DC 20510	Washington, DC 20510

Re: Subcommittee Hearing on Capital Formation and Reducing Small Business Burdens; Support for Derivatives End-Users Clarification Act

Dear Chairman Crapo and Ranking Member Warner:

The Coalition for Derivatives End-Users thanks you for holding this important hearing to explore ways to encourage capital formation and to avoid costly regulation of business activities where it is not needed. We also appreciate your focus on the *Derivatives End-Users Clarification Act* (H.R. 1317), which the Coalition strongly supports. The bill, H.R. 1317 in the House, contains the same language as the measure introduced in the Senate last year by Senators Collins and Klobuchar (S. 2976). This narrowly-tailored, bipartisan bill will provide much-needed clarification that certain swap transactions with centralized treasury units ("CTUs") of non-financial end-users are exempt from clearing requirements and fix a language glitch in the Dodd-Frank Act that denies some end-users the clearing exception that Congress passed specifically for them.

The Coalition is encouraged that the House of Representatives last year passed the bill (H.R. 5471/S. 2976) by voice vote, reflecting the fact that CTUs are a best practice among corporate treasurers and their use should be encouraged, not penalized.

While the Commodity Futures Trading Commission ("CFTC") has issued no-action relief allowing some end-users to use the clearing exemption, the relief does not fix the problematic language in the Dodd-Frank Act. This language, which also is referenced in regulatory proposals on margin, places corporate boards in the difficult position of approving decisions not to clear trades despite the unintended inapplicability of the exemption.

It also is important to note that international regulators often look to U.S. rules when developing their regulations. Unless we fix the underlying problem in the Dodd-Frank Act, our denial of clearing relief to end-users with CTUs may be propagated overseas.

We urge you to support this crucial legislation to address the concerns of derivatives end-users. Throughout the legislative process, the Coalition has supported efforts to increase

Coalition for Derivatives End-Users

transparency in the derivatives markets and enhance financial stability for the U.S. economy through thoughtful new regulation while avoiding needless costs. The language in this bill would provide certainty and help end-users focus their efforts on innovation, growth and job creation.

Sincerely,

Coalition for Derivatives End-Users

WRITTEN STATEMENT OF XBRL US, SUBMITTED BY CHAIRMAN CRAPO

xbrl.us

March 2015

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XBRL US on Legislation That Would Reduce Data Transparency & Provide Minimal Savings

Aiding small companies 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 legislation has been proposed[1] to 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 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. This data is 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.

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 will 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 sets of financial data, resulting in unnecessary costs.

XBRL can reduce regulatory burden.
Today XBRL is only used by public companies 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 govt agencies, in different formats, at different times and by different individuals within the same corporation. 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 and reporting companies.

XBRL US is a not for profit consortium that focuses on improving the availability, comparability and transparency of business information in the capital markets to all stakeholders. We share the goals of the authors of the bill to promote job creation, and to reduce the regulatory burden on smaller companies. This statement helps to explain the role of XBRL (structured data) in helping small companies, and even more importantly, their shareholders and potential investors. http://xbrl.us

For more information, please contact Campbell Pryde, CEO, XBRL US, at 917-582-6159, Campbell.Pryde@xbrl.us.

[1] H.R. 37 was passed by the House of Representatives on January 13.

XBRL eXtensible Business Reporting Language

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/xbrlcostsstudy.aspx)

The goal of Title VII in H.R. 37 is to reduce the burden on small public companies by delaying the XBRL (eXtensible Business Reporting Language) formatting requirement for companies with revenue under $250 million for a minimum of three years[2]. An XBRL exemption, such as the one proposed in this bill, will not reduce the burden on small companies.

The savings from an XBRL exemption averages $10,000 per year for small companies.

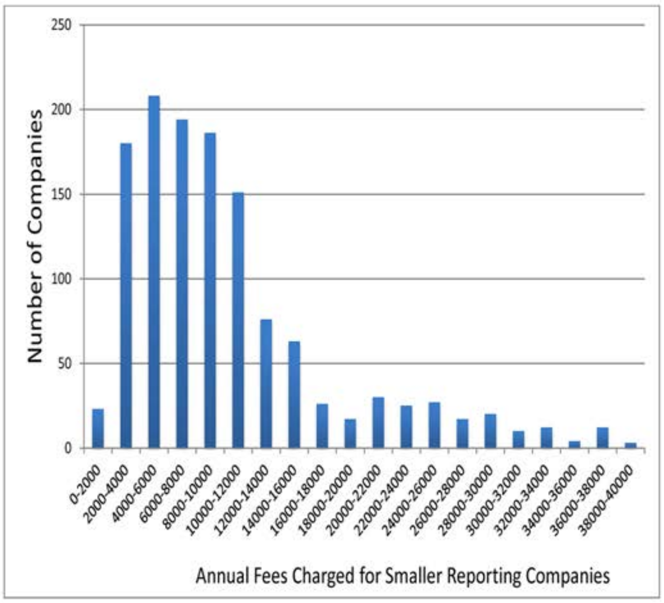
A December 2014 study conducted by the American Institute of CPAs (AICPA) and XBRL US found that the average annual cost of XBRL filing for companies defined as "small companies" per the U.S. Securities and Exchange (SEC) definition is $10,406; and 70% pay $10,000 or less. The median cost for the companies 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.

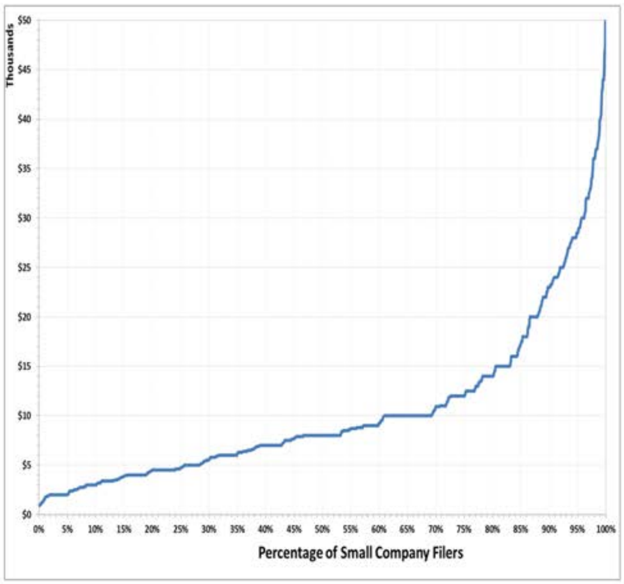
[2] Act requires exemption to stay in place for 5 years or 1 year after the SEC conducts a cost/benefit analysis proving that benefits outweigh the costs, with the exemption to stay in place a minimum of 3 years.

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.



WRITTEN STATEMENT SUBMITTED BY JESSICA B. PASTORINO, PRESIDENT, M&A SECURITIES GROUP, INC.

M&A securities group

March 31, 2015

Chairman Crapo and Ranking Member Warner
Senate Subcommittee on Securities, Insurance and Investment
534 Dirksen Senate Office Building
Washington, DC 20510

RE: Broker-Dealers' Opposition to Title IV of H.R. 37, the "Promoting Job Creation and Reducing Small Business Burdens Act"

Dear Senators Crapo and Warner:

Thank you for holding a hearing on portions of H.R. 37, the "Promoting Job Creation and Reducing Small Business Burdens Act." We have specific concerns with Title IV of H.R. 37, the "Small Business Mergers, Acquisitions, Sales and Brokerage Simplification Act." This portion of the legislation deals with the mergers and acquisitions space and the regulation of broker-dealers. We are opposed to Title IV of this legislation since it actually harms those business owners it intends to help. We would like to be constructive in this process and ultimately support this legislation if a few critical changes are made to help small businesses.

The supports of this bill would like members of this committee to believe that there is no opposition to Title IV of H.R. 37, since H.R. 2274[1] passed the House in the 113th Congress with a vote of 422-0. In fact, the opposite is true. In the 114th Congress, H.R. 37, which included Title IV failed to pass the House under the Suspension Calendar on January 7, 2015, by a vote of 276-146. H.R. 37 then passed 271-154 under regular order with additional "no" votes. This is a direct result of members of Congress having more time to review and understand this legislation. As they have received more input from their constituents, they are seeing that both businesses in their communities and consumers are opposed to these changes in the law. In addition, both consumer groups and industry groups have expressed opposition to this legislation. This is one of those rare instances in which industry and consumer groups actually agree.

The substance of this legislation has two major flaws.

- First, **the $25 million "earnings before interest, taxes, depreciation and amortization" (EBITDA) provision** would allow, for example, an unregistered party to run a merger and acquisition deal for a billion dollar company with zero EBITDA. If this

[1] Senators Manchin and Vitter introduced companion legislation, the "Small Business Mergers, Acquisitions, Sales and Brokerage Simplification Act of 2014," S. 1923, last Congress. The Senate did not have a vote on this legislation.

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bill is intended to help small companies this is a large loophole that can be exploited. A real world example of a company with zero EBITDA is TESLA. In 2012, TESLA had *negative* EBITDA of $367 million, while its equity market capitalization was close to $4 billion (today its $23.31 billion). This is not an uncommon scenario especially given the strong valuations that certain high tech companies can demand with little or no actual earnings (which can often translate into low to negative EBITDA). A prime example of these valuations is Facebook's purchase of WhatsApp Inc. in 2014 for $22 billion. At the time WhatsApp Inc. had $10.2 million of gross revenue for the preceding year and a *net loss* of $138.1 million for 2013. Since the particulars are not publicly available the exact EBITDA can't be determined but we can safely assume it was less than its revenue at $10.2 million.

- Second, **the $250 million gross revenue threshold goes far beyond a "mom and pop" corner store, and causes this legislation to *not* be a main street, small business bill.** For example, Planet Fitness has $211 million of gross revenue with 700 employees; Good Technology has $160 million of gross revenue with 838 employees; Allen Edmonds has $145 million of gross revenue with 987 employees; and Express Locations has $42 million of gross revenue with 701 employees.[2]

It should also be noted that U.S. Chamber's oral testimony mentioned a $750 million gross revenue number. Chamber's definition of a small company would include companies like The Cellular Connection with $671 million gross revenue and 1,476 employees and Nexus with $471 million gross revenue and 626 employees.[3] Clearly, these are not small companies and the supporters of this legislation would pretty much want any transaction to qualify for exemption under this legislation. This would provide for fewer protections to small businesses and less transparency to the market.

Recommendations: Our first recommendation is to strike the EBITDA provision based on the huge loophole created by such a provision. Our second recommendation is to change the gross revenue number from $250 million to $10 million gross revenue, which is consistent with what the Small Business Administration (SBA) defines as a small business. Under the SBA definition a small business is defined as $2.5-$21.5 million gross revenue for a "services" company; $5-$21 million gross revenue for a "retail" company; $13.5-$17 million gross revenue for "general and heavy construction" company; and $0.5-$9 million gross revenue for "agricultural product" companies.[4] Based on the SBA definition of a small business, we believe that $10 million gross revenue is an appropriate number.[5]

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[2] See, *Inc. Magazine's Fastest Growing 5000 Private Companies of 2014*, http://www.inc.com/inc5000/list/2014/revenue/250/500/

[3] Id.

[4] See, Small Business Administration's definition of a "small business," https://www.sba.gov/content/what-sbas-definition-small-business-concern.

[5] Even the Alliance of Merger and Acquisition Advisors (AM&AA), the trade association pushing for the enactment of this legislation, offers a certification program that defines a small business as one with less than $5 million in annual sales and goes on to explain that "there are more than 5 million small businesses in the United States and together this group generates approximately 15 percent of the U.S. gross domestic product." See, Kenneth H. Marks, Robert T. Slee, Christian W. Blees, Michael R. Nall. *Middle-Market M&A: A Handbook for Investment Banking and Business Consulting*. 1st ed. Hoboken, NJ: John Wiley & Sons, Inc. 2012, at page 4.

We wish to remind the committee that "The Securities Exchange Act of 1934" grew out of a Senate investigation after the crash of 1929, one that wiped out many investors. In a M&A transaction, the seller actually very often ends up being an investor, who is offered securities as part of the consideration for the business. The limited rules that apply to this business protect all parties involved in the transaction and the existing regulatory structure is functioning exceedingly well. There is simply no good policy reason to strip away existing protections and self-policing will not protect business owners. Being registered may be inconvenient to some, but certainly Congress believed that such inconvenience was worth protecting those who hire professionals that will ultimately advise on complex securities transactions.

In conclusion, we respectfully request that members of this Committee to either oppose this legislation or make the appropriate changes so that business owners are truly protected.

Sincerely,

Jessica B. Pastorino, President
M&A Securities Group, Inc.