M E M O R A N D U M

To: Members of the Committee on Financial Services

From: FSC Majority Committee Staff

Date: June 7, 2013

Subject: June 12 Subcommittee on Capital Markets hearing on "Reducing Barriers to Capital Formation"

The Subcommittee on Capital Markets and Government Sponsored Enterprises (GSEs) will hold a hearing on "Reducing Barriers to Capital Formation" at 2 p.m. on Wednesday June 12, 2013, in Room 2128 of the Rayburn House Office Building. This will be a one-panel hearing with the following witnesses:

- Mr. R. Cromwell Coulson, President, Chief Executive Officer and Director, OTC Markets Group
- Mr. Joseph Ferraro, Vice President, General Counsel, Prospect Capital Corporation
- Mr. Shane B. Hansen, Partner, Warner Norcross & Judd LLP
- Mr. David Weild, Senior Capital Markets Advisor, Grant Thornton, LLP
- Professor Donald Langevoort, Thomas Aquinas Reynolds Professor of Law, Georgetown University Law Center

Background

The Securities and Exchange Commission (SEC) has a three-part mission: to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. While the SEC's mission includes the promotion of capital formation, which it acknowledges "is necessary to sustain economic growth," the SEC's critics have charged that it has not given sufficient priority to improving the environment for capital formation. This criticism comes despite the several offices and committees the SEC has formed with the intention of promoting capital formation, some of which are described below.

SEC Office of Small Business Policy (OSBP)

The SEC's Office of Small Business Policy (OSBP) in its Division of Corporation Finance (the "Division") is responsible for answering questions on disclosure and other issues relating to smaller public companies, including those classified as "smaller reporting companies," and on limited, private, and intrastate offerings of securities. OSBP acts as the Division's liaison to the state securities regulators and the Small Business Administration. OSBP assists in and reviews rulemaking initiatives which may have small business implications and is charged with reaching out to smaller companies to facilitate capital formation, including (but not limited to) coordinating the annual SEC Government-Business Forum on Small Business Capital Formation.

SEC Forum on Small Business Capital Formation

As mandated by the Small Business Investment Incentive Act of 1980, the SEC conducts an annual forum that focuses on small business capital formation called the "SEC Government-Business Forum on Small Business Capital Formation" (the "Forum"). This gathering has been held annually since 1982. The stated purpose of this Forum is to "provide a platform to highlight perceived unnecessary impediments to small business capital formation and address whether they can be eliminated or reduced." Since its inception, however, the SEC has acted on only a small number of the recommendations offered during the annual Forum and documented in the annual report.[1]

SEC Advisory Committee on Small and Emerging Companies

In 2011, in response to a letter from then-Ranking Member Spencer Bachus and Congressman Kevin McCarthy requesting that the SEC use its existing regulatory authority to act on a number of recommendations received in multiple Forums, former SEC Chairman Mary Schapiro established the SEC Advisory Committee on Small and Emerging Companies (the "Advisory Committee"). The Advisory Committee is tasked with seeking advice on its rules, regulations and policies, as they relate to emerging companies or privately-held small businesses and publicly traded companies with less than $250 million in public market capitalization in the areas of: raising capital through securities offerings; trading in the securities of emerging and smaller public companies; and public reporting and corporate governance requirements of emerging and smaller public companies. The Advisory Committee issued a number of recommendations to the SEC in January 2012, February 2012, and most recently on February 1, 2013, on a variety of topics. As of June 7, 2013, however, the Commission has not acted on any of these recommendations.[2]

Capital Formation

Although small companies are at the forefront of technological innovation and job creation, they often face significant obstacles in obtaining funding in the capital markets. These obstacles are often attributable to the proportionately larger burden that securities regulations—written for large public companies—place on small companies when they seek to go public.

[1] http://www.sec.gov/info/smallbus/sbforum.shtml

[2] http://www.sec.gov/info/smallbus/acsec.shtml

Capital formation correlates—or at least corresponds—directly to job creation. A 2010 Keybridge Research study found that "every $1 billion in capital spending is responsible for approximately 19,643 jobs including both direct and indirect effects."[3] The link between capital formation and job creation is further demonstrated by a Pepperdine University survey of small business owners in which "fifty-nine percent (59%) of respondents believe the current business financing environment is restricting growth opportunities while 52% of respondents believe it restricting their ability to hire new employees."[4] Unfortunately, many small companies—which have created nearly 65 percent of all new jobs over the last 15 years —find it difficult to obtain the capital necessary to expand and hire new employees.

Companies obtain capital through borrowing or equity financing. Because banks have tightened their lending standards in the wake of the economic crisis, there is less credit available to fund growth. Equity financing, in which investors purchase ownership stakes in a company in exchange for a share of the company's future profits, allows companies to obtain funds without having to repay specific amounts at particular times. The tightening of credit has made equity financing all the more important as a means of providing small companies with the capital they need to grow and create jobs. This hearing will examine proposals that would make it easier for companies to obtain equity financing and the extent to which the SEC can be more effective in fulfilling its statutorily mandated mission.

Based on the success of the bipartisan Jumpstart Our Business Startups ("JOBS") Act (P.L. 112-106), which President Obama signed into law on April 5, 2012, the Subcommittee is continuing its survey to identify legal, regulatory and market impediments to capital formation, particularly for small and medium-capitalized companies. Issues that could be examined during the hearing include changing the minimum trading increment or "tick size" for smaller companies; authorizing the creation of new equity markets to register with the SEC and then list and trade the securities of smaller companies; improving market quality for smaller issuers; modernizing the regulatory structure of business development companies; improving capital formation for privately held small businesses and publicly traded companies with less than $250 million in public market capitalization; and examining disclosure and corporate governance requirements that may be burdensome for smaller companies. The witnesses have been asked to provide the Subcommittee with their suggestions to improve the ability of small companies to raise capital more efficiently.

[3] Keybridge Research, An Analysis of the Business Roundtable's Survey on Over-the-Counter Derivatives (April 2010)
[4] Pepperdine University, Private Capital Index Survey Responses Second Quarter 2013