LEGISLATIVE PROPOSALS TO ENHANCE CAPITAL FORMATION AND REDUCE REGULATORY BURDENS, PART II

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

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U.S. HOUSE OF REPRESENTATIVES

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LEGISLATIVE PROPOSALS TO ENHANCE CAPITAL FORMATION AND REDUCE REGULATORY BURDENS, PART II

Wednesday, May 13, 2015

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

The subcommittee met, pursuant to notice, at 2:09 p.m., in room HVC–210, Capitol Visitor Center, Hon. Scott Garrett [chairman of the subcommittee] presiding.

Members present: Representatives Garrett, Hurt, Neugebauer, Huizenga, Duffy, Stivers, Hultgren, Ross, Wagner, Messer, Schweikert, Poliquin, Hill; Maloney, Scott, Ellison, Foster, Carney, and Murphy.

Ex officio present: Representative Hensarling.

Chairman GARRETT. Good afternoon, everyone.

The Subcommittee on Capital Markets and Government Sponsored Enterprises is hereby called to order. Today's hearing is entitled, "Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens, Part II."

I welcome the esteemed panel and my colleagues who are here today. We will begin with opening statements, and I will yield myself 3 minutes. And, again, I wish everyone good afternoon.

Today the subcommittee meets for, as I said, the second time in as many weeks to explore four pieces of legislation that would further reduce barriers to capital formation and help to make the U.S. capital markets even more attractive to both companies and to investors.

Now, the first of these bills is a discussion draft, which I have put forward. And what would it do? It would authorize the creation of and establish a regulatory framework, if you will, for what some have dubbed venture exchanges.

So what are these venture exchanges? What could they be? And why are they necessary? To put it simply, they would be security exchanges specifically tailored to foster the secondary trading of securities for not the large cap, but for small caps and pre-IPO companies.

As multiple witnesses have testified already to this committee over the years, our current equity market structures in many ways have disadvantages for small issuers who oftentimes find that their stocks are trading in illiquid markets with little to no research coverage. Now, this has the ultimate effect of raising the cost, therefore, of the capital for these companies and, of course, that impacts their ability to grow and to then hire new workers.

In many ways, the creation of these new formats or exchanges is a logical next step in the wake of the 2012 JOBS Act, which is now a law. And while the JOBS Act did a great deal to facilitate primary offerings by companies, it really did comparatively little to address some of the structural issues that exist in the secondary market for the smaller companies.

As SEC Commissioner Dan Gallagher put it in a speech last year, these exchanges "should bring market makers and analysts to these exchanges, thereby creating some of the ecosystem supportive of small companies that has been lost over the years."

Under the discussion draft, these venture exchanges would list securities such as those issued by emerging growth companies or reg A plus issuers and would be exempt from certain SEC rules that are more befitting of large cap markets.

Now, while this is the first time that this committee will consider legislation in this area, this idea is certainly not new and has gained a significant amount of support in recent years as these markets for small companies have become more pronounced.

And so, I look forward to exploring this draft, and these other bills as well, offered by Mr. Hurt, Mrs. Wagner, and Mr. Hill.

And, again, I want to thank all the members of the panel and, also, the members of the subcommittee and the sponsors of these bills.

And with that, I will yield to the gentlelady from New York for, 5 minutes?

Mrs. MALONEY. Four minutes.

Chairman GARRETT. Four minutes. Okay, we will go for 4 minutes. We will compromise right in the middle.

Mrs. MALONEY. Thank you, Mr. Chairman, for calling this hearing to review these important bills.

And I thank all of the panelists for being here.

Many of our colleagues are voting. They will be coming back soon.

While the system of securities laws in the United States is complex, the central tension underlying our securities law is simple: Investors want as much information as possible on the companies they are investing in as quickly and as accurately as possible.

The companies that issue the securities, on the other hand, want to spend as little time as possible preparing the disclosures that investors crave. It is a job of public policy to strike the right balance between these competing desires.

Most of the bills before us today would in one way or another alter the current balance between investor protection and lower cost for public companies. For example, the Accelerating Access to Capital Act would allow very small and thinly traded companies to sell securities faster using the self-registration process. This would no doubt reduce costs for these small companies, but it could also reduce key investor protections.

Traditionally, self-registration has been limited to larger, well-known issuing companies that are widely followed by the markets. In 2007, the SEC decided to expand the number of companies which are eligible to use self-registration. In doing so, however, the SEC was careful to balance this against the need to maintain investor protection.

The SEC was comfortable allowing certain very small companies to have a limited ability to use self-registration to offer securities to investors, but only on the condition that the company has at least one class of securities traded on the exchange.

This was because the exchanges have their own standards that companies must meet in order to get their securities listed on the exchange, and these listing standards provided investors with sufficient assurance that the company is legitimate, has a reasonably wide investor base, and will have enough trading interest to ensure a reasonable amount of liquidity in the stock.

But this bill would do away with these protections and would allow very small companies that trade in over-the-counter markets and not on a registered exchange to sell securities using self-registration. Allowing a small company whose stock is very thinly traded to quickly sell a large amount of securities under a self-registration raises serious concerns about potential market manipulation. And I would like to hear more from our witnesses about this issue.

Another bill, the Fair Access to Investment Research Act, would extend the SEC's research safe harbor to allow broker-dealers to publish research on exchange-traded funds and other investment companies. I think that this is an interesting and worthwhile idea.

And while I have some concerns with the way the bill is currently drafted, I hope that we can work together toward a solution that allows for more quality research on a fast-growing market while also minimizing the potential for abuse.

I look forward to hearing from the witnesses on all of these bills.

And I yield back. Thank you.

Chairman GARRETT. The gentlelady yields back. Thank you very much.

I now recognize Mrs. Wagner for 1 minute. Welcome.

Mrs. WAGNER. Thank you, Mr. Chairman, for recognizing me for 1 minute.

Today we will be considering some important legislative proposals that will help facilitate capital formation and reduce regulatory burdens for small companies.

My legislation, the Accelerating Access to Capital Act of 2015, will broaden eligibility for smaller companies to use Form S-3, a simplified registration document filed with the SEC that is currently available to larger companies. This will help get small companies off the sidelines and help them secure funding to grow their business and, more importantly, create jobs.

The benefit of Form S-3 is that it allows forward incorporation. By reference, it enables companies to provide offerings off the shelf, giving them greater flexibility to time their issuances with favorable market conditions. These benefits allow companies to avoid delays and interruptions in the offering process, which preserves their continued access to capital while reducing costs and eliminating uncertainty relating to funding.

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

Chairman GARRETT. The gentlelady now yields back.

And I believe that is all the opening statements we have. We will now turn to the witnesses.

Some of you have been here before, and others have not. For those who have not, your entire written statements will be made a part of the record, and we will yield you each 5 minutes for an oral summary of your testimony.

I believe in those machines in front of you there is a green light, a yellow light, and a red light. The yellow comes on, I believe, at the 1-minute warning sign.

So, with that, we are going to now begin with the representative from SIFMA.

But before we do that, we have an introduction to be made, and I will yield to Mrs. Wagner to make that introduction.

Mrs. WAGNER. Thank you.

I would like to introduce a new panelist, Mr. Chairman. Today, I would like to introduce one of my constituents, Ron Kruszewski, as one of our witnesses and welcome him before this subcommittee, sir.

Ron currently serves as chairman of the board of directors at Stifel Nicolaus, a brokerage and investment and banking firm in my hometown of St. Louis, Missouri, after first joining the firm as CEO in 1997.

In addition to his prominent involvement in the industry, such as currently serving on SIFMA's board of directors and being appointed by the St. Louis Federal Reserve Board to a term on the Federal Reserve Advisory Council, Mr. Kruszewski has also played an active, active, role in the St. Louis community.

I thank you, Ron, for joining us here today, for doing your civic duty in coming before Congress.

And, with that, I yield back the balance of my time.

Chairman GARRETT. The gentlelady yields back.

And, sir, you are now recognized for 5 minutes. And welcome.

STATEMENT OF RONALD J. KRUSZEWSKI, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, STIFEL FINANCIAL CORPORATION, ON BEHALF OF THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION (SIFMA)

Mr. KRUSZEWSKI. Thank you, Congresswoman Wagner.

Chairman Garrett, Ranking Member Maloney, and distinguished members of the subcommittee, thank you for providing me the opportunity to testify today on behalf of SIFMA and share our views on such a critically important topic. As introduced, my name is Ron Kruszewski, and I am chairman of Stifel, a 125-year-old investment banking firm based in St. Louis, which I have had the privilege of leading for 19 years.

To put any discussion of capital formation in context, I would note that the securities industry sits at the fulcrum between investors and those in search of capital. On the one hand, the U.S. securities industry employs nearly 900,000 people and 4,000 registered broker-dealers, serving clients with $16 trillion in assets. On the other hand, the industry in the aggregate has raised $2.4 trillion for businesses and municipalities in the United States in the last year alone.

For those reasons, the work this committee is doing to fine-tune and improve our securities loss is important and appropriate. We applaud your focus on promoting capital formation and decreasing burdensome friction in the securities laws while upholding necessary customer protections.

Market reforms like decimalization, Sarbanes-Oxley, and various SEC rulemaking and disclosure requirements have produced benefits for investors, but have also resulted in unintended obstacles standing in the way of capital formation, creating a one-size-fits-all market structure that often fails to provide adequate flexibility for small cap issuers. Because of the leadership of this committee, we have the JOBS Act, the Tick Size Pilot, and the public debate with respect to capital formation, which I know is alive and well.

Turning to the specific subject of today's hearing, I would like to discuss two proposals that are illustrative of how Congress can and should influence the SEC's capital formation agenda. SIFMA strongly supports Congressman Hill's legislation to provide access to research. Anomalies and conflicts in current regulation result in disparate treatment for research on different types of securities.

Legislation appears to be necessary to spur action at the SEC because they have failed to create a safe harbor for research on ETFs or other open-end funds, even though the need to provide clarity has been on their radar for decades. The impacted product has exploded in popularity, growing tenfold over the past decade, to reach $1.6 trillion in 2013.

Similarly, we understand Congressman Huizenga's legislation to deregulate the M&A broker industry was influential in spurring the SEC to action. Back in January 2014, just weeks after this committee passed Congressman Huizenga's legislation, the SEC issued a no-action letter regarding M&A brokers.

This no-action letter stemmed from more than a decade of SEC discussion and consideration of this issue; therefore, we believe it is premature to legislate an overriding and permanent form of relief on an issue where the SEC has already acted.

SIFMA has also been asked to comment on the discussion draft to establish venture changes put forward by Chairman Garrett. We appreciate the focus on market liquidity for smaller companies and support all efforts to rebuild the ecosystem for small companies.

SIFMA supports the SEC moving forward with a study of innovative ideas, to improve liquidity in small and mid-cap stocks, but any prescriptive solutions that risk damaging the competition in our equity markets that has fueled innovation needs to be carefully considered.

It is critical that any changes to market structure for less liquid securities be considered to avoid the unintended consequence of impeding competition in the name of possible increasing liquidity. SIFMA and its member firms are committed to working with Chairman Garrett to ensure that the legislation establishes a regulatory regime for venture exchanges that is both workable and efficient for all market participants.

Additionally, SIFMA is supportive of Congressman Hurt's effort to ensure that reviews of the SEC rule book are conducted on a regular basis. We strongly believe that regulators need to review the interplay between the rules and their aggregate effects rather than each rule in isolation. SIFMA has joined in this view by the Administration, as demonstrated by the recent Executive Orders.

The members of this committee are to be commended for working together in a bipartisan manner to identify problems and develop solutions to improve capital formation and job creation in America. Our robust capital markets distinguish our economy from every other on Earth, but without consistent attention and improvement, will not be as efficient as possible.

Thank you for the privilege of testifying, and I look forward to your questions.

[The prepared statement of Mr. Kruszewski can be found on page 76 of the appendix.]

Chairman GARRETT. Thank you very much.

Mr. Burton from the Heritage Foundation, welcome to the panel, and you are recognized for 5 minutes.

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

Mr. BURTON. Thank you, Chairman Garrett, Ranking Member Maloney, and members of the subcommittee. My name is David Burton, and I am a senior fellow in economic policy at The Heritage Foundation. The views I express in this testimony are my own and should not be construed as representing any official position of The Heritage Foundation.

The focus of my testimony today is going to be on the secondary market for securities with a particular focus on Chairman Garrett's discussion draft of the Main Street Growth Act, which would establish venture exchanges.

Improving the secondary market for small capitalization firms will help investors and help them achieve a higher rate of return and reduce risk. It will improve entrepreneurs' ability to raise capital and will also promote innovation, lower costs—innovation with respect to production processes—new products for consumers, and generally enhance prosperity in the United States.

There are three key steps, in my view, to improving the secondary market for small firms. One is improving the regulatory environment for existing non-exchange over-the-counter ATS securities.

This can primarily be achieved by providing exemption from owner's blue sky laws with respect to primary and secondary securities for companies that have continuing reporting obligations, which would include small public companies, but also the new regulation A tier 2 companies, as well as potentially crowdfunding companies, if that regulation is ever at issue.

We could also improve the markets by re-establishing a list of marginable OTC securities that existed before NASDAQ made the transformation from a broker-dealer market to an exchange that was maintained by the Federal Reserve.

And we could remove impediments to the market making by dealers, particularly in thinly capitalized stocks caused by regulation SHO's requirement that broker-dealers cover their short position within 3 days.

The second thing we can do, which I will talk mostly about, is establish venture exchanges.

The third thing we can do is improve the secondary market for private resales, including the codification of Section 4(a)(1-1/2), with a particular focus on making sure that platforms that facilitate those transactions are covered by the statutory exemption.

Now, the discussion draft that Chairman Garrett came up with is a very positive framework for establishing venture exchanges. I have a few recommendations on things that would make it work better. Probably the first would be changing the definition of "venture exchange."

It incorporates, by reference, the Title I definition of "emerging growth company," which has a 5-year time limit. And I don't think we necessarily want to limit the ability of firms to participate in these venture exchanges to only 5 years. That has a relatively easy fix: Just alter the definition by eliminating the 5-year requirement in emerging growth companies.

Again, changing regulation SHO with respect to market makers, in effect, holding short positions so they can meet buy orders. Making it clear that the large exchange listing requirements that are in Section 18(b)(1)(B) with respect to covered securities don't apply to securities in the venture exchanges. It is, I think, very important for that to get handled, and it is not so evident when you are thinking about these things.

And then the last thing I would raise is permitting market-making support programs so that an issuer that wants to engage market makers and get an active market made in the securities can compensate the broker-dealer both to make markets, and also to provide research in the security potentially.

With that, I will close my statement. And I appreciate the opportunity to testify today.

[The prepared statement of Mr. Burton can be found on page 62 of the appendix.]

Chairman GARRETT. Great. Thanks, sir, for your testimony.

Professor Bullard from the University of Mississippi, welcome to the panel. You are recognized for 5 minutes.

STATEMENT OF MERCER E. BULLARD, PRESIDENT AND FOUNDER, FUND DEMOCRACY, INC.; AND MDLA DISTINGUISHED LECTURER AND PROFESSOR OF LAW, UNIVERSITY OF MISSISSIPPI SCHOOL OF LAW

Mr. BULLARD. Chairman Garrett, Ranking Member Maloney, and members of the subcommittee, thank you for the opportunity to appear before you today.

I am going to briefly summarize my thoughts on the four bills before the committee today. And although I don't necessarily agree with all of them, I certainly commend the subcommittee for diligently seeking to improve and modernize the Federal securities laws.

I have two general thoughts that apply broadly to these bills as well as some that have become law. The first goes to the public-private distinction for securities offerings and issuers on which the Federal securities laws are based.

Recent legislation and recent bills are threatening to undermine the integrity of that construct by creating conflicting standards. Those who seek further reform should consider an omnibus bill, similar to the approach taken when the Federal securities laws were first enacted.

The second broad point goes to the role of regulation and regulators. Legislation is getting too far into the weeds where the SEC can simply do a better job. The crowdfunding bill is an example of what can go wrong when Congress attempts to draft detail rules. Also, statutes are inherently poor vehicles for complex regulation. Congress should lay down broad principles and allow or direct the SEC to implement them.

As for the bills before the panel, the one that most concerns me is the Accelerating Access to Capital Act. The Act would allow reporting issuers to conduct shelf offerings where they have a public float of less than $75 million and are not exchange created. Shelf offerings are intended to shorten the time needed to raise capital in the public markets, which generally allows issuers to take advantage of favorable market conditions.

This means, of course, that when issuers are able to sell at a higher price, investors are also buying at a higher price. This is not such a concern when stock prices bear some rational relationship to intrinsic value. But non-exchange-traded micro cap stock prices are extremely volatile and highly illiquid and their investment returns look more like a lottery than a market.

Providing a high-speed vehicle for micro cap offerings will inevitably result in sales at grossly inflated prices. Volatility, illiquidity, and lottery-like returns also make non-exchange-traded micro cap stocks the favorite playground of market manipulators.

While micro cap stocks constitute a tiny part of the market, they represent an overwhelming majority of enforcement actions for market manipulation. The same characteristics that make shelf offerings riskier—high volatility, pricing inefficiency, investment returns with extreme outliers—make micro cap stocks attractive candidates for market manipulators.

The SEC carefully crafted the shelf offering eligibility test at the act of the weak, and then it did so as part of an ongoing review that has demonstrated sensitivity and responsiveness to the concerns of small businesses. The action is an example of micromanaging securities regulation that is better left to rules and regulators.

The Fair Access to Investment Research Act correctly reflects the failure of the SEC to regulate research conflicts as to registered investment companies and ETFs to appropriately reflect the difference between those and other securities.

And I agree that ETF research regulation should be less restrictive. However, the Act uses a nuclear bomb where a mallet and a chisel are needed. It also uses legislation in an area that calls for the kind of flexibility that only regulations can provide.

Regarding the Venture Exchange Act, Congress has historically allowed the SEC substantial leeway to regulate securities exchanges. The SEC has continuously and effectively exercised that authority to create a remarkably broad range of options for exchange operators, issuers, and investors.

In the Act, Congress takes the opposite approach by assuming the role of regulator and dictating specific operational characteristics of the exchange. The requirement of pricing in nickel increments, for example, directly conflicts with the SEC's pilot nickel pricing program. The wholesale exemption for both reg NMS and reg ATS is unwarranted, as I believe at least Mr. Burton on this panel agrees.

Finally, the Regulatory Review Act requires the SEC to review its rules every 10 years, and this is exactly what the SEC should do. However, the SEC is already subject to retrospective rule requirements that make the Act unnecessary. In addition, I have made a number of suggestions in my written statement that would make the Act more workable.

I thank you again for the opportunity to appear before the committee today and, again, for your ongoing commitment to the revision of the Federal securities laws. I would be happy to answer questions about these bills or any others that are before the subcommittee.

[The prepared statement of Mr. Bullard can be found on page 38 of the appendix.]

Chairman GARRETT. The gentleman yields back.

From the U.S. Chamber of Commerce, welcome, Mr. Quaadman.

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

Mr. QUAADMAN. Thank you, Chairman Garrett, Ranking Member Maloney, and members of the subcommittee. Thank you again for the opportunity to testify before you today here at Part II of the hearing.

At Part I of the hearing 2 weeks ago, I talked about the need to generate long-term economic growth and job creation and that, in order to do so, businesses must have the tools and opportunity to grow from small to large. Efficient capital markets that are liquid, deep, and well-regulated are a key for this growth to occur.

I am also a fan of the ideal espoused by Justice Oliver Wendell Holmes that the free marketplace of ideas is where the best ideas should come out to the fore. The bills that are before us today meet that ideal and also advance the efficient capital markets we need through innovation, injecting competition, and giving regulators the tools to keep up with dynamic markets.

The SEC retrospective review bill drafted by Mr. Hurt is needed because past efforts at retrospective reviews by the SEC have either been ignored or have been ineffectual at best. The JOBS Act and the discussions that we have been having the last several weeks about a JOBS Act 2.0 are needed because of the failure of the SEC to ever conduct such a rule or to modernize its regulations.

This bill will allow for periodic review to ensure that regulations are meeting their intended purpose, whether or not changes are needed, or, if rules are obsolete, that they be removed from the books.

I would suggest four changes to improve the draft bill. First, regulations should be prioritized so that the regulations that are economically significant should be reviewed first. Under that term, "economically significant" are those regulations that cost the economy $100 million or more, and that is a term that has been used in different legislation such as the Unfunded Mandates Reform Act (UMRA) or the Small Business Regulatory Enforcement Fairness Act (SBREFA).

Second, rules with thresholds that have not been adjusted for 20 years should be prioritized. Again, an example is reg A or, as we were discussing 2 weeks ago, the Rule 701 thresholds that have not been adjusted since 1988, making it more difficult for companies to attract and retain talent.

Third, a retrospective review should undergo public notice and comment process as provided by the Administrative Procedure Act. Such a notice and comment process will allow the SEC to get informed commentary from a wide variety of stakeholders. This will also prevent what has submarined other retrospective reviews, namely, that it gets shuffled into staff-driven process and is quietly ignored.

Fourth, entities that have delegated powers, such as the Financial Industry Regulatory Authority (FINRA) or the Public Company Accounting Oversight Board (PCAOB), as examples, should also be included in such a retrospective review, since, in fact, their standard setting or rulemaking can be as economically significant as regulations drafted by the SEC.

The Main Street Growth Act drafted by Chairman Garrett would authorize venture exchanges to help drive liquidity to companies that are going public. This should also be viewed in the context of creating a competing system with the OTC markets and alternative trading systems. We believe that bills should be adjusted to give exchanges and the SEC the flexibility to develop systems to efficiently match investors with businesses.

Additionally, we would ask that there be authorized a retrospective study to look at past efforts, such as the American Stock Exchange, AIM in London, Boston exchange, to find out what worked, but, most importantly, what did not work.

Second, we think there should also be authorized under the bill a prospective study to collect data by a certain date to see if venture exchanges are working and how they are operating in conjunction with the OTC market systems and ATS. This is similar to what is in the Tick Size Pilot Program.

Finally, the other two bills before us—the Fair Access to Investment Research Act by Congressman Hill, we believe that this is a common-sense change that will provide more information to investors to assist in their decision-making.

Additionally, the Accelerating Access to Capital Act by Congresswoman Wagner would modernize the use of registration to allow businesses to become public companies faster, assisting liquid markets.

Thank you again for the opportunity to testify on these bills, and I am happy to answer any questions you may have.

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

Chairman GARRETT. And, again, thank you for your testimony.

Mr. Weild, welcome to the panel. And you are recognized now for 5 minutes. Thank you.

STATEMENT OF DAVID WEILD, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, WEILD & CO., INC.

Mr. WEILD. Thank you. Chairman Garrett, Ranking Member Maloney, and distinguished members of the subcommittee, thank you for inviting me to speak today at this important hearing.

My named is David Weild. I am chairman and CEO of Weild & Co. I was formally vice chairman of the NASDAQ Stock Market with responsibility for all of its listed companies, and I ran the equity new issues business at Prudential Securities.

The Main Street Growth Act, which is going to be the focus of my comments, will establish a new class of stock exchanges catering to the needs of small cap companies and their investors. It has the potential to go down as one of the most important acts to come out of this or any Congress by creating essential infrastructure to support U.S. economic growth, bring back American entrepreneurial swagger, re-ignite the American dream, and create millions of jobs.

When corporations access capital, they hire people. Those people spend money on the economy. And everything from lawyers and accountants to construction workers and restaurant workers—there is a multiplier effect. The benefits become widespread. Startups, according to the economist Robert Litan, have collapsed, from nearly 15 percent of all companies in the late 1970s, to just 18 percent by 2011.

For the first time in 3 decades, business deaths exceeded business births. In our published studies, we have documented a collapse in the number of small IPOs, a collapse in the number of publicly listed companies, and a collapse in the number of small IPO book-running investment banks, from 164 in 1994, to only 31 in 2014.

One-size-fits-all U.S. stock markets have been a disaster for our economy. The Main Street Growth Act would reverse this by establishing an alternative market structure, one allowing its sponsors broad discretion in addressing the needs of small cap companies, their investors, and the broker-dealers, research providers, and market makers needed to support them. This is a noble and important act for the American people, and it deserves the attention and support of both parties.

I offer the following improvements to the Act. Some are similar to what David from Heritage Foundation said. First, venture exchanges should be opened up to all currently reporting SEC-registered U.S. companies that are under $2 billion in equity market value or have less than $1 billion in revenue and are public for 5 years or less. That is the EGC definition.

But to his point, they really should be broadened and people shouldn't automatically just be pushed off the exchange. A venture exchange could help already public companies attract new investors, attract research coverage that they so desperately need, improve share prices, and lower the cost of growth capital.

Second, create an orderly transition for companies to graduate from a venture exchange. Companies should be permitted to stay on a venture exchange, for example, until they have met some higher threshold, say $2.5 billion for 12 consecutive months.

Third, explicitly permit broker-dealer member-owned venture exchanges. And fourth, we recommend that listing thresholds be adjusted annually for inflation.

Consumers, investors, and the poor are harmed by low-cost, one-size-fits-all stock markets. This is what I refer to as the low-cost paradox of small cap markets. The lack of sufficient aftermarket economic incentives causes broker-dealers and institutional investors to pull out of these markets.

The Main Street Growth Act will reverse this harm. Consumers will benefit as more companies are able to access equity capital. More new companies means more competition and innovation. Thus, the apparently simple, unarguable benefit of low-cost trading has paradoxically harmed the consumer by causing a collapse in the capital formation infrastructure of our economy.

Venture exchanges, by improving access to equity capital, will support the scientists, engineers, and entrepreneurs who will find cures for cancer, global warming, and the other great challenges that we face. Investors will benefit as the trajectory of long-term economic growth will be tilted upward by improving the rate at which startups are created and by improving the rate at which companies go public to free up more equity capital for investors to reinvest and start new companies.

And finally, the poor will benefit. I have said this to members of the Black Caucus, and I will repeat it here: African Americans, according to the Pew Institute, have an average net worth of only $11,000 as of 2013. They are not day-trading stocks, as they simply don't have enough money to be invested in the stock market. Thus, they derive no personal benefit from low-cost trading. But poor people do need jobs. They need higher wages. And these are things that venture exchanges in the Main Street Growth Act can bring in time.

I believe that the Main Street Growth Act will help create a better future for all of America's children. It is in that spirit that I brought my 14-year-old son here today to leave a lasting legacy for future generations of a better, more competitive America, filled with opportunity for all.

And I urge both parties, Democrats and Republicans, to come together and pass this important Act because I think, really, sincerely, America's future will greatly benefit from it. Thank you.

[The prepared statement of Mr. Weild can be found on page 91 of the appendix.]

Chairman GARRETT. Thank you, Mr. Weild, and your son, also, for joining us today.

I thank the panel. And I will begin by yielding myself 5 minutes for questions.

Just in case anyone missed it, Mr. Weild, you gave actually one of the most comprehensive statements with attachments, some charts, and what have you, but let's not miss your second paragraph, the second sentence, of your statement. I just take this one at random here.

"It has the potential to go down as one of the most important acts to come out of this, or any, Congress by creating essential infrastructure in support of U.S. economic growth." In case anyone missed that point, I just wanted to reemphasize that. So thank you for that.

Yes. Now that I have humility, I always say I have everything.

So to get to it, first of all, in a sentence or two, since we don't have much time, where are we right now with regard to not venture exchanges—we don't have the venture exchanges, per se, but we do have small cap companies trading elsewhere. In a sentence, explain to us where that market is right now.

Mr. WEILD. Small cap markets trade on either the low end of the NASDAQ or the low end of the New York Stock Exchange or in the over-the-counter market. And those markets are really pretty dysfunctional many times because they are what academics call asymmetrical order-book markets, big buyers, no sellers.

They need intermediaries to create liquidity. And since there is no economic model to support that, a lot of that liquidity isn't there. And so institutions have actually progressively moved capital out of small cap stocks over time.

Chairman GARRETT. Okay. So that is where we are right now. I am going to jump back and forth.

Mr. Burton, you list two or three different things that we could do. You are in support of the bill, but you say there are one, two, three things we could do.

What we do in this bill—and it is just a draft—is to set up exchanges. Right? What your suggestions are, you could do this with exchanges.

And back to Mr. Weild again on this as well.

Do you need exchanges in order to get this done?

Mr. BURTON. I think the exchange is very positive. It would create an alternative framework that private actors may decide is the best way to go.

And we do have an established OTC market today, and making that work better is also positive. And it has one advantage over the exchange approach; namely, it could be done immediately and it is self-effectuating.

The exchange process, while it is very positive, is going to take time because the SEC has to write rules and then private actors have to establish the exchange rules and get them up and running and raise the capital to make it happen.

Chairman GARRETT. Let me just jump in there.

As a real side note, Professor Bullard, you raised that we get into the weeds too much on some of these bills. And then really quick to Mr. Quaadman, only a sentence each.

We saw with the JOBS Act 1.0 that we are waiting 2-plus years after the fact and we still don't have the regulations even though that passed as bipartisan and the President signed it, and everyone was on board.

You will agree that sometimes the regulators don't actually work in a timely manner, even though when Congress is explicit as to what they want them to do and set more than just the principles, but explicitly what they want in a bipartisan matter. You will agree with that, won't you?

Mr. BULLARD. I agree with that.

Chairman GARRETT. Okay. And so, Mr. Quaadman, then, is there a time and place where we need to dig down a little bit in the legislation, whether it is my bill or some of these other ones, to actually specify exactly what we want more than just principle?

Mr. QUAADMAN. Yes. And I think what you are doing with your bill and with the other bills is you are setting out those broad policy directives and letting the SEC work out the details.

Chairman GARRETT. Okay. Then running down to Mr. Weild, so on ours—and I am still trying to get this picture in my mind. I am asking for your help on all these things to try to see this continuum as far as what the market is made up of, what listing of exemptions that we need to have in order to facilitate this, and what we need to make sure that you don't actually drive out—either kill some of the markets that are working good today—right?

Mr. WEILD. Right.

Chairman GARRETT. —but, also, maybe to facilitate it going forward.

So is that what we really want to have, maybe a continuum in the opportunity for doing this, with exchanges being a piece? Is that clear?

Mr. WEILD. I think that the beauty of an exchange solution that is focused on it is to give you a statistic. About 80 percent of listed companies are sub $2 billion in market value, but they only represent about 6 percent of total market value. So they are very different than large-cap S&P 500 stock.

So to create an institutionalized solution where people are focusing explicitly on the needs of this very different group of stocks and their ecosystem I think will actually set this country's stage so that we can drive a lot more capital formation into companies a lot sooner, which, in turn, will trickle down and start creating a higher start-up rate and get our entrepreneurial mojo back.

Chairman GARRETT. There you go, to coin a phrase.

And at the end of the panel—

Mr. KRUSZEWSKI. Ron is fine.

Chairman GARRETT. Ron. Yes. Thank you. I was going to call you Ron, but it didn't seem appropriate.

Mr. KRUSZEWSKI. That is fine.

Chairman GARRETT. Would you like to comment?

Mr. KRUSZEWSKI. All the things you have been reading about over the last 15 years from "Flash Boys" to everything else, what has happened is that market structure has gone towards speed in many things while destroying ecosystem for small companies.

And this idea in re-creating an ecosystem for small companies to have liquidity is extremely important. Of course, the devil is in the details, and that is where it lies. But, without question, this needs to be done.

Chairman GARRETT. Great. Thank you very much. I appreciate the panel.

With that, I yield to the gentlelady from New York for 5 minutes.

Mrs. MALONEY. Thank you very much.

Professor Bullard, I would like to ask you about the ETF research bill. I support the concept of reforming the rules for research reports on investment companies like ETFs, but I share many of the concerns with the current draft of the bill that you outlined in your testimony.

So my question is, wouldn't we be better off simply directing the SEC to amend the Rule 139 safe harbor for research reports to include registered investment companies subject to the appropriate conditions?

Mr. BULLARD. Yes, ma'am. There is a lot that needs to be done with respect to registered investment companies, not just ETFs, because I think the proposers of the bill certainly recognize correctly that they present very different risk.

The problem with research reports is essentially that they become advertising in a form of underwriting message with respect to offerings, whereas registered investment companies, although continuously in registration, do not present the same risks.

And I agree, although it hasn't been decades that the SEC has enacted on ETF research reports, that it needs to do so. And it may very well need to be ordered by Congress to do so.

I think clearly, the SEC has become dysfunctional in terms of doing its rulemaking. I think that you have to look at the leadership of the SEC to answer the question of why that is happening.

But that, in principle, does not mean that the Congress should step in and do detailed rulemaking, such as, for example, Mr. Quaadman said that the Main Street Growth Act applies broad policy directives.

I would like to know from him whether prohibiting penny pricing, requiring nickel pricing, prohibiting sending information to a securities information processor—how those are broad policy objectives.

Thank you.

Mrs. MALONEY. Also, Professor Bullard, on the Accelerating Access to Capital Act, you noted in your testimony that the SEC requires companies to be exchange traded before they can use shelf registration to sell securities because the exchanges have their own investor protection requirements that companies have to meet.

Can you describe some of these standards that the exchange traded requirement brings with it. And why are they so important?

Mr. BULLARD. The exchanges typically impose various governance requirements, certain rights for shareholders. They have what are called listing requirements that apply to the size of the company. And as a practical matter, we know empirically that they offer the kind of trading and liquidity that has been in issue at this table that is indicative of a market price.

But if you look at the empirical research on non-exchange-traded OTC stocks, you see exactly the opposite. You see study after study demonstrating that these stocks are highly illiquid. They are extremely volatile. They have lottery-like returns, in the sense of having huge variance in their returns. As a group, the pink sheets are generally having negative performance.

Now, I think I agree with the panel. Those problems need to be solved. But they are not going to be solved by the approach that is taken by this bill.

Mrs. MALONEY. So if we get rid of the exchange-traded requirement, do you think that the risk to investor protection would outweigh the benefits to the companies?

Mr. BULLARD. Absolutely. What it would allow is non-exchange-traded companies, limited, at least currently, only by a 33⅓ percent cap on their previous offerings, to make offerings with immediate access to an on-ramp in an environment where virtually all of their prices, when there is trading, are fluctuating wildly.

And it is not clear to me why you would want to allow somebody to get even faster access to take advantage of market conditions when, by definition, the market conditions that are favorable to that kind of company are when it is trading at its peak, and studies show that peak has very little to do with intrinsic value.

Mrs. MALONEY. Thank you.

Mr. Kruszewski, I would like to ask you about the M&A broker bill. I noticed in your testimony that SIFMA has significant concerns with the bill, and I would like to understand them a little better.

My understanding is that after the Financial Services Committee passed a similar bill last Congress, the SEC took action on this by issuing a no-action letter that provided relief to small M&A brokers. But the SEC's no-action letter included 10 additional conditions to protect buyers and sellers that this bill does not include.

So I have two questions for you. First, is this bill even necessary anymore now that the SEC has already granted relief?

Mr. KRUSZEWSKI. Well, no. What this bill does effectively, in my opinion, is deregulate M&A across-the-board. The thresholds of $25 million of earnings before interest, taxes, depreciation, and amortization (EBIDTA) can be billion-dollar companies.

At one point, Facebook had no EBIDTA and had a market cap privately well in excess of $1 billion. And there are investor and buyer and seller protections, for which being registered is important.

The idea that the friction should be reduced for selling the local hardware company is notable and is understandable, but the bill goes far, far beyond that by almost deregulating all large private M&A.

Mrs. MALONEY. Wow. And, also, my time is up, but I would like a clarification. This bill doesn't include several important protections that the SEC so-called no-action letter does include.

Would passing the bill have the effect of removing protections that the SEC has deemed to be necessary?

Mr. KRUSZEWSKI. Effectively, yes, because the passing of the bill would make the institutions not subject to broker-dealer requirements. So, effectively, it removes the protections that the SEC outlines in the no-action letter from the marketplace.

Mrs. MALONEY. My time has expired. Thank you very much.

Chairman GARRETT. Thank you. The gentlelady yields back.

And before I say this, I just want a clarification on the record. Professor Bullard says that our bill prohibits data from going to the SIP. Actually, the legislation says that they should not be required to submit any of that information. So not being required to is different from saying that you can't submit the data. So, actually, they could still be doing it.

With that, I will yield 5 minutes to the vice chairman of the subcommittee, Mr. Hurt.

Mr. HURT. Thank you, Mr. Chairman. And I thank you for this hearing. I also thank you for putting up for consideration today a bill that we have submitted relating to a 10-year retrospective review at the SEC of rules that have been adopted there.

It seems to me that in its effort to protect investors, maintain efficient markets, and promote capital formation, this is a common-sense piece of legislation that should be well-received. And I thank all of you who have commented on it for today's hearing.

Mr. Bullard indicates, although he does offer some kind of suggestions, if we proceed with the legislation—he begins with the premise that it is not necessary. And I guess I would like to hear from Mr. Kruszewski and Mr. Quaadman about whether this is necessary.

Do we need to have a 10-year review of regulations and rules at the SEC? And, if so, why so? Do we have other examples where agencies have been asked to do this where you have had positive results?

So maybe we could go to Mr. Kruszewski and then Mr. Quaadman.

Mr. KRUSZEWSKI. Your bill is a very common-sense one. It is. As for the question of whether it is needed, I would just look at the fact that both the Administration and everything I have read suggests that it should be done. It just hasn't been done.

Mr. HURT. And just for the record, you are referring to the President's Executive Order—

Mr. KRUSZEWSKI. Yes.

Mr. HURT. —from July 2011 that sets all of this out, but the SEC has not taken any positive action?

Mr. KRUSZEWSKI. Exactly. Across industry, the review of regulation should be done to determine if it is even necessary anymore, let alone the impact on the economy.

So the fact of this bill seems to be that while everyone wants it done, including the President's Executive Order, apparently, from my seat, it is not being done.

And what I like about the bill, besides its common-sense approach, is the fact that it requires a report to be made to Congress that it is, in fact, being done. So it is a pretty simple bill with simple outcomes, but important outcomes for the economy.

Mr. HURT. Thank you.

Mr. Quaadman?

Mr. QUAADMAN. Mr. Hurt, number one, the JOBS Act itself is chock-full of regulations which were outmoded and which the SEC could have modernized on its own and did not do so.

As I mentioned in the last hearing as well, we also issued a report last year where we identified 15 to 20 regulations in the corporate disclosure area that are outmoded and out of date and no longer make sense in the 21st Century economy.

I believe, also, in Executive Order 13563, the Obama Administration ordered Executive Branch agencies which were under their direct control to do such a retrospective review, which is currently under way.

I just want to just mention one point, which was raised earlier, which Professor Bullard mentioned. If he had read page 6, paragraph 3 of my testimony, he would have seen what our position was on the Tick Size piece.

Mr. HURT. Okay. So I guess another question that I have is, Mr. Quaadman, do you think that the 5-year timeframe in order to kind of get this decennial review on a regular timeline—is that 5 years enough for the SEC to be able to conduct this for significant regulations?

Mr. QUAADMAN. Yes. And that is why I made the suggestion that this be prioritized with economically significant regulations, then thresholds. I think, with the 5-year timeline, you could do that. With the decennial period on top of that, you can get at the low-hanging fruit.

The problem with previous reviews has been that it has been a lot of window dressing. So either there have been meaningless regulations that have been looked at or they have just been swept under the rug. So, yes, I think that timeline provides the process that could be built out for it.

Mr. HURT. And I would love to work this in really quick.

Mr. Bullard, you said that you believe that the APA should not be applied to this if it goes forward. I think I am correct in your statement.

And I was wondering if I could get Mr. Quaadman's response to your assertion that APA shouldn't—go ahead, Mr. Bullard, do you want to articulate your position? Mr. Bullard, if you want to quickly articulate your position. And then, if Mr. Quaadman has time to respond.

Mr. BULLARD. It is primarily an administrative issue. The burdens on the SEC of having to deal with both APA requirements and the litigation that would follow would, again, just throw gum in the works and make it difficult for them to do their jobs.

Mr. HURT. Okay.

Mr. BULLARD. And, otherwise, I just think it is necessary, given that you can communicate on the basis of rules, anytime you want. I filed the rulemaking petition. The SEC adopted the rules.

Mr. HURT. Okay. Mr. Quaadman, really quick.

Mr. QUAADMAN. Transparency is a good thing and stakeholders should have the right to explain to their government why regulations may be working or not working.

Mr. HURT. Okay. Thank you.

Thank you, Mr. Chairman. My time has expired.

Chairman GARRETT. The gentleman's time has expired.

Mr. Scott is recognized for 5 minutes.

Mr. SCOTT. Thank you, Mr. Chairman.

I'll tell you what concerns me a little bit about the venture exchange. From my reading of it, it seems that it permits venture exchanges to operate with lower listing standards for issues and exempts them from some requirements and from some investor protections that are applicable to the other national security exchanges.

Do you all feel some concern about that, that while the intent is very good—there is no question about that—reducing investor protections in this venture exchange bill tends not to put the consumer concerns and protections in proper focus? Do you have any concerns about that?

Mr. BURTON. I don't think it meaningfully reduces the key consumer protections or investor protections. It doesn't change anything relating to fraud with respect—or misrepresentation at the Federal or State level. It doesn't change disclosure requirements.

It does alter the way that markets are made, and it does reduce the listing standards in the sense that you don't have to achieve New York Stock Exchange governance requirements or New York Stock Exchange capitalization requirements.

But if you impose those sorts of requirements on small cap companies, they are not going to be able to ever be listed. So that is almost a necessary predicate to going down this route of having an intermediate-level exchange. So I understand your concern, but in this case, I really don't think it is warranted.

Mr. SCOTT. Okay. But if the bill reduces certain disclosures, it reduces compliant costs, don't you think that might make it more difficult for investors to properly evaluate the companies as a potential investment?

Mr. BURTON. If it did that, I think that there would be cause for concern. But any of these companies are either going to be registered companies that have to comply with the smaller reporting company disclosure rules, or reg A companies, which a lot of people call mini-registrations. It is a hop, skip, and a jump from being a public company.

So these firms all have very serious disclosure obligations with respect to the key things that investors need to know to make an informed investment judgment.

Mr. SCOTT. So why would we have two sets here, one for these venture smaller operations and with the national firms? Why would we have certain protections for them for the customers and not for the investors, but not here? That is sort of what I am trying to figure out.

Mr. WEILD. I don't think it really changes investor protections at all. I think from a disclosure standpoint, it was already Title II of the jobs that were regulation A plus. This Act doesn't speak to disclosure, per se.

And, actually, the thing that I am concerned about in the current functioning of stock markets is that listing standards in both the New York Stock Exchange and NASDAQ are actually quite low or quite accessible. It is not the listing standards that are the problem.

The problem is that the companies—that the whole ecosystem has collapsed, meaning smaller broker-dealers to take these companies public and support them; the economic model doesn't work.

And I think that what the Venture Exchange Act allows you to do is to create an economic model that will get firms back into the game to support small companies once again.

But I don't think it—if there is an investor protection issue, it would be around sales practice abuses. And my view there is that the right way to deal with sales practice abuses is through enforcement, not prevention, not to kill the goose that lays the golden egg.

Mr. BULLARD. If I could just disagree there, I don't think the question is really being answered. The question is, why should there be listing standards that are developed completely outside the reg NMS and the reg ATS structure the SEC has created, which Mr. Burton, in his written testimony, has agreed is inappropriate as a wholesale exception, and they should not.

What will happen with the venture exchanges is you will now create something that is outside of a very good structure where the SEC, unlike in many cases, has been very effective and extremely responsive, and there is really no reason to do that.

If you look at the OTC market's Web site, what you will see is a pretty thorough and entertaining set of standards that they have provided for these small companies within the existing regulatory structure.

They require that a skull and crossbones appear next to a lot of listings. I think the message there is pretty clear. But, apparently, Congress wants to get into the business of deciding whether private businesses should include those kinds of warnings.

That is the issue and that is the question being answered here.

Mr. KRUSZEWSKI. OTC markets does it in compliance with their own rules. The skull and crossbones is not dictated by ATS.

Mr. BULLARD. I did not say it was.

Mr. KRUSZEWSKI. I know that.

Mr. BULLARD. But they are subject to reg ATS.

Mr. KRUSZEWSKI. But the venture exchange legislation would be basically comparable in many respects to what is currently done on regulation ATS.

Mr. BULLARD. Why don't you support complete wholesale exemptions from reg NMS and ATS? In your testimony, you said you did not support that. Are you now changing your position?

Mr. KRUSZEWSKI. Wouldn't that—

Mr. BULLARD. I am not supposed to ask the questions.

Chairman GARRETT. Just like the skull and crossbones, it was entertaining as well to hear the back-and-forth.

With that said—

Mr. BULLARD. I haven't seen it.

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

Mrs. WAGNER. That was the most entertaining round of questioning. So I thank you all. And thank you, Mr. Chairman.

I have submitted, as I mentioned earlier, a discussion draft, the Accelerating Access to Capital Act of 2015, which would allow smaller emerging growth companies that have an established reporting history with the SEC to use the more simplified Form S-3 when offering securities. Once again, this is an idea that the SEC's own working group on capital formation has recommended previously, but has seen no action on since.

I am doing to do kind of a lightning round here. So work with me, gentlemen, if you would.

Mr. Weild, this series of questions, sir, is for you.

In comparison to the Form S-1, how does Form S-3 relate in terms of cost to small issuers?

Mr. WEILD. It drops the cost fairly significantly. It allows you to pre-register securities and take them down opportunistically without any inhibition whatsoever to get into markets. And in my written testimony, I am actually for expanding the application of Form S-3 to smaller companies.

Mrs. WAGNER. How does being able to offer securities off the shelf under Form S-3 help small issuers?

Mr. WEILD. I was the one who did the first overnight equity offering off of the Form S-3 shelf registration back in the 1990s because it allows the hedge fund to meet up with the institutional investors. The more that you hung out as a company marketing a security, the more that investor—or certain types of investors would parse and short the stock and manipulate the stock price to the adverse consequence of the company.

So this allows them the flexibility of getting in the market without taking less price risk, and I think it is very beneficial. It drives down the cost of capital for corporations.

Mrs. WAGNER. Due to accessibility of documents filed with the SEC available over the Internet, is the one-third cap on securities offered through Form S-3 still necessary?

Mr. WEILD. I think the concern is the level of dilution of a company and people not having an opportunity to react to it. And I think—and that is a micro—that particular point is something I would rather let the SEC decide, and I would defer on that one.

But I think it is very important. The market structure is so dysfunctional and we work with some really small cap companies that it is grinding up value for these corporations.

Managements are struggling with it to get them support. They should be spending their time running their businesses. And our view is that we really need to worry about the systemic risk of not starting businesses, which is what we are seeing in the economy. It is probably the bigger threat to the U.S. economy.

It is not the flashy systemic risk of flash crashes and credit crises and things like that, but it is just as important and it is just as big a threat to the long-term survival of this country.

Mrs. WAGNER. Thank you, Mr. Weild.

Now moving to the flashy, Mr. Quaadman, how does the requirement that securities be listed on a national securities exchange for Form S-3 hinder the ability of smaller issuers to raise capital?

Mr. QUAADMAN. What you are creating is—what we have now is we have a system where the cost and the compliance cost, without the information that is going to be useful for investors, is actually inhibiting the ability of businesses to go into the markets.

So I think, if you take this bill in conjunction with your 1723 bill, you are going down the road of creating a company file that allows for information to get out to investors without the inhibitions to raising capital.

Mrs. WAGNER. To Mr. Weild's point, Mr. Quaadman, why do Federal securities laws treat all issuers as if they are all large, highly sophisticated companies?

Mr. QUAADMAN. I think this is where Congress made a very important point with the JOBS Act that has been very successful, is that we need to split it up. You can have your traditional public company, but then you also have to recognize that for emerging growth companies that are acting in these thinly traded markets, we need to give them a little more.

So we have actually done a pretty good job of balancing investor protection and liberalizing some of the disclosure requirements, which I think are to Mr. Scott's point.

And I think this also allows for—because, remember, these are companies that are registering with the SEC already—providing for that registration, getting information out, yet getting rid of some of the inhibitions that have been preventing this from happening.

So it is not that the information isn't going to be there or that the SEC cannot oversee this to prevent abuses from happening.

Mrs. WAGNER. Does this bill recognize, do you think, the difference between small and large companies? And how else can we further recognize that difference in our securities law?

Mr. QUAADMAN. I think what your bill does is that, by allowing this change, you are getting rid of a hurdle for these companies to get into the market. So I think it actually speeds it up and it is helpful.

I think, in conjunction with Mr. Garrett's bill, you start to put these things together and you actually create competing mechanisms against existing systems. So that is why I said in my oral statement that you are actually creating competition, which should work.

And the reason why we called for a study by a certain date is you can look at all these things collectively to see what is working, what is not, and what can be adjusted.

Mrs. WAGNER. Great. Thank you very much.

I yield back.

Chairman GARRETT. The gentlelady yields back.

I just want to correct the record. Did you say you were moving from the flash to the flashy with Mr. Quaadman? Is that what you were saying?

Mrs. WAGNER. I was speaking about highly sophisticated companies versus smaller and emerging growth companies. But what I understand—

Mr. QUAADMAN. As long as it is not a flash crash.

Chairman GARRETT. Thank you.

I now recognize Mr. Ellison for 5 minutes.

Mr. ELLISON. I would like to thank the chairman and the ranking member for the time.

Mr. Bullard, do you have any concerns about H.R. 1965? That is the bill that exempts two-thirds of the firms from submitting XBRL data.

Mr. BULLARD. Absolutely. I think we just heard a reference from Mrs. Wagner as to the importance of that information being accessible. And I can tell you, as a professor, it is extremely frustrating, even being very familiar with the electronic data gathering, analysis, and retrieval system (EDGAR), trying to find information and decipher it.

For example, the SEC still does not require the most obvious way to let people know what changes in registration statements have happened, which it is required of people to provide a red-lined version. And I mentioned that at a PCAOB Advisory Council meeting at which Chair White was in attendance, and we still see no movement there.

The SEC continues—I think everyone in this committee room would probably agree—to be a 20th Century agency in terms of technology, and eliminating any kind of accessibility information is exactly the wrong direction to go.

Mr. ELLISON. What are other countries doing in terms of this registration?

Mr. BULLARD. I have no idea.

Mr. ELLISON. Okay.

Mr. BULLARD. In terms of our use of extensive markup, anybody—

Mr. ELLISON. I guess my question is, will this put the United States at any kind of a competitive disadvantage?

Mr. BULLARD. I think it weakens our position. If I were to guess, I would say we are probably much more technologically advanced than other countries, but I haven't looked at that question.

Mr. ELLISON. Okay. Thank you.

Turning to another question, I would like to get similar views regarding the policy implications of the Accelerating Access to Capital Act. Myself and 25 other Democratic Members voted against the Wagner bill last session because we were concerned that the bill reduced important information to investors.

Do you have any concerns that this bill could reduce information to investors?

Mr. BULLARD. Yes. That really is the issue. The bill asked the right question that the SEC should be looking at, and that is with respect to the paragraph 6, opportunity for an entity that has less than a $75 million public float, should they still be subject to a restriction on how many securities they sell as a percentage of their float. That is what Mr. Weild is referring to as the dilution problem. And I think reasonable minds can disagree about that.

But the SEC, when it established that float, had originally proposed a 20-percent float. It did some research to answer the question asked before as to what was an appropriate number, and they were persuaded to raise that number.

Unfortunately, I was not able to find any further research on where that number is, and that is exactly the kind of research that the SEC should be doing on an ongoing basis and is animating Mr. Hurt's concerns.

Those kinds of issues that are extremely detailed really need to be considered by the SEC, but it is not fair to ask me to defend the SEC's capacity to do that review. I think that is a separate issue.

And I agree they may need to be required to look at those questions, because I think it is asking exactly the right question. It is looking in the right direction, but Congress is not the place to do that.

Mr. ELLISON. So, as I indicated before, last May is when we looked at this bill before.

Have there been any new developments since that time that bear on this issue of whether this is the right approach?

Mr. BULLARD. As to the use of Form S-3?

Mr. ELLISON. Yes.

Mr. BULLARD. Nothing comes to mind—

Mr. ELLISON. Okay. Never mind.

Mr. BULLARD. —that would change that environment.

Mr. ELLISON. Yes. My staff recommended that question. So we will just move on along.

All right.

Mr. BULLARD. My staff failed to give me an answer.

Mr. ELLISON. No problem.

Last Tuesday, the SEC announced its approval for a 2-year Tick Size Pilot Program which would study the impact of requiring small company shares to be quoted or traded in nickel increments.

Considering the SEC action, is the Garrett bill appropriate?

Mr. BULLARD. I think it is an example of the SEC doing exactly what it should be doing in many areas that are the subject of some of these bills, and that is looking at flexible options and doing a lot more experimentation.

We really need the SEC to stop feeling that, if it adopts a rule, it has to apply to everyone because it feels it has to defend any potential failures on just one front. We need to see a lot more of that. The SEC is doing it. And then requiring that you have a venture exchange that has nickel pricing is really interfering with and undermining that effort by the SEC.

The current structure of the regulations propriety exchanges where I think you have over 90 ATS exchanges has created an enormous amount of diversity in that market, and we need to reward the SEC for providing additional flexibility in the form of the pilot program and not undermine it by creating competing exchanges that have provisions that will be very difficult to change, given that they are in statutory form.

Mr. ELLISON. I have exceeded my time. Thank you. I yield back, Mr. Chairman.

Chairman GARRETT. Thank you. The gentlemen yields back.

The gentleman from Arizona is recognized for 5 minutes.

Mr. SCHWEIKERT. Thank you, Mr. Chairman.

And to my friend at the other side, my staff has just stopped writing questions because, apparently, I don't ask them.

There is actually—I would love a little more depth on the discussion on researchers being able to publish on ETF. And for whomever feels they are the most competent on this one, I sat through this seminar a couple of weeks ago and it was the first time I had come across something called a managed ETF.

How does this work? What happens with the information? Tell me why it is wonderful.

Mr. BULLARD. I spent a lot of time on ETFs while I was at the SEC in the office that approves them when they were first being approved. And the managed ETF is a new product that should have been allowed to come out a decade ago, but it is—

Mr. SCHWEIKERT. It is now starting to get some legs?

Mr. BULLARD. Right. And what it does is it uses a particularized pricing mechanism that still relies on the close-of-the-day NAV to be the price at which you buy rather than actually buying at an ongoing price in the market.

Mr. SCHWEIKERT. I am sort of a fan of the concept.

Mr. BULLARD. Yes.

Mr. SCHWEIKERT. My interest here was, for whomever is on the panel, on my ability as a researcher to put out data saying, "Here is the concentration risk. Here are these things." Because right now, I come from a world where I think it is absurd that there is a restriction on putting out information.

Mr. KRUSZEWSKI. We should all be for transparency for more information. And it is a safe harbor that is required so that you can put out more information on a sector of the market that is growing very fast.

And so it is very hard to understand any objection to providing thoughts on a product that is now $1.6 trillion. It will be double that, probably, in a few years. It is a very fast-growing product, and the SEC rules are outdated with respect to that product.

Mr. SCHWEIKERT. Sad question.

Is our language broad enough to make it the publication of research information on a managed product?

Mr. BULLARD. Oh, it would be broad enough to allow an enormous amount of research by issuers, broker-dealers, on products that aren't even ETFs.

To get to the substantive answer of the question, I don't see it as a size issue. It is that, essentially, registered investment companies are pools of securities. They are not operating companies. And they are in continuous registration.

So the risk of the underwriter, when going to market in an IPO, putting out these research reports essentially as a way of conditioning the market does not exist for these types of products.

And the SEC should have had a completely different, much less regulated track quite some time ago. But it is just as applicable to other registered investment companies as ETFs.

Mr. SCHWEIKERT. You said something—I want to come back. But this is sort of a follow-up from my conversation from Mr. Quaadman.

I come from a view of the world that the best regulation is ultimately sunshine information. Do you see a problem here?

The ability to publish research and attach it to your offering—wouldn't the ultimate solution be trying to have as robust of information environment as possible?

Mr. QUAADMAN. Yes. And I agree with Mr. Kruszewski that we need to have that safe harbor to allow that to happen. Because what we have now is two separate standards that have developed with broker-dealers. There are safe harbors that allow for some research, and that allows investors to make a decision. But with ETFs, we don't have that.

I think, also, Mr. Bullard also makes a very good point as well. Markets are dynamic. So we are talking about ETFs today. We could be talking about another product 10 years from now. So I think we also want to be flexible to allow for those safe harbors to provide for those research to benefit investors.

Mr. SCHWEIKERT. Okay. Mr. Chairman, just probably one or two left.

Professor, you actually said something earlier that sparked my ears. And you sit on which committee over at the SEC?

Mr. BULLARD. I was at the SEC's Office of Exemptive Applications, which is where you would go to create ETFs.

Mr. SCHWEIKERT. And a little while earlier in the testimony, you said the rulemaking right now is dysfunctional.

Mr. BULLARD. Yes.

Mr. SCHWEIKERT. Is that an argument for us to be substantially more prescriptive when we work on pieces of legislation here?

Because I am still—is the word "outraged" or "enraged?"—on crowdfunding and on some of these other things that we passed as our goal to try to expand opportunity for everyone.

And we are sitting here, what, some 3 years later, and it is still trapped over there. There is something horribly wrong at the SEC.

Should we become dramatically more prescriptive to them because of their inability to do their job?

Mr. BULLARD. I would agree in terms of mandating rulemaking. But I think that, ultimately, it is counterproductive to become prescriptive in the sense of detailing the rules.

Mr. SCHWEIKERT. When you say "mandating"—and, sorry, Mr. Chairman—timeline?

Mr. BULLARD. The timeline, self-executing.

Mr. SCHWEIKERT. Right.

Mr. BULLARD. Broad policy. Just tell the SEC to create an exemption for registered investment companies from 139 and do it within a year.

Mr. SCHWEIKERT. Okay. I yield back. Thank you, Mr. Chairman.

Chairman GARRETT. All right. Or else.

Mr. BULLARD. There is no "or else," unfortunately, but—

Chairman GARRETT. And there is the rub, isn't it?

I now recognize Mr. Carney.

Mr. CARNEY. Thank you, Mr. Chairman. First, let me apologize for not being able to hear most of the hearing up to this point, but I would like to ask a couple of questions about the two bills.

By the way, when I speak, I don't have questions that my staff wrote. But when I speak, you can see Craig's lips moving over there, and it is actually coming from him.

But I have interest in the ETF bill, which Congressman Hill has been working on, and I would like to be a part of that. And I have worked with Mr. Duffy a little bit on the venture exchange bill.

There seems to be some consensus that making global access to research for ETFs makes a lot of sense. Is there anybody on the panel who disagrees with that? Did I miss anything?

And so then my question would be, is there anything—it goes, I think, to the question that Mr. Schweikert just asked about how prescriptive legislation is. Is there anything in the draft legislation that has been developed that raises any concerns for any of the panelists?

Mr. BULLARD. I have highlighted in my testimony essentially a laundry list of issues. One is the extent to which it departs from the basic foundation of Rule 139.

Of greater concern is it provides a sweeping insulation from private liability, which I don't think was the author's intention.

But if you look at the way the bill is drafted, it eliminates generally liability for the research reports to the extent that the liability depends on there being an offer.

Mr. CARNEY. Safe harbor provision. You think that there is an opportunity to clean that up or make it more reasonable?

Mr. BULLARD. Again, I would rather work from the point of view of asking the SEC to do a registered investment company exception.

Because I think the current departures from Rule 139 in the bill would be hard to fix, and it also would remove any flexibility the

SEC would have going forward in changing the rule for the benefit of ETFs down the road.

You do something in a statute, and you have essentially locked it in place, and the SEC would not be able to liberalize it or strengthen it in the future.

Mr. CARNEY. So you would argue for doing something less prescriptive rather than more, going back to the question from Mr. Schweikert?

Mr. BULLARD. Yes. Less detailed. But I think, if this is what you want, you tell the SEC to do it and, as Chairman Garrett suggests, you do have to give them a timeline.

Mr. CARNEY. Do any other panelists have a different view of that?

So the second issue is venture exchanges. Mr. Duffy and I have been talking about that for some time, and I know others have, as well.

We spend a lot of time back in our districts, and I was talking to a woman who runs a large corporation pension fund and raised some concerns about—which surprised me, frankly—with respect to starting a venture fund exchange. Excuse me.

What are the concerns that any of the panel might have on that idea?

Mr. QUAADMAN. Mr. Carney, not necessarily a concern. I think—

Mr. CARNEY. Her concern was, basically, that the unsophisticated investor could really be taken for a ride in a venture exchange.

Mr. QUAADMAN. Yes. What I have in our testimony and I also talked about in my oral statement is that I think there needs to be the ability for the SEC and the exchange, when they are developing the system, to develop it in such a way that you have sufficient investor protections in place and they have sufficient systems in place to allow that exchange to operate. I think we can get at those concerns through that process.

Additionally, as I said—

Mr. CARNEY. Through the process of setting up the exchange itself?

Mr. QUAADMAN. Through the process of setting up the exchange. But then the reason why we also ask for a prospective study on it is to take a look at it on a certain date in the future to see how the venture exchange is operating, if there are changes that need to be made, then also to see how it is operating in competition with the OTC markets, with the ATS systems, to see how that is all working. So I think we have two bites at the apple to take care of those concerns.

Mr. CARNEY. Good.

Mr. Burton?

Mr. BURTON. I think that maybe your constituent didn't fully understand the proposal, which is understandable because it just goes for—

Mr. CARNEY. Because I explained it to her.

Mr. BURTON. The venture exchange is really a question of how you structure the marketplace. The individual investor can go buy those stocks because they are public companies on OTC markets over their E*Trade or Ameritrade account today.

And the way the proposal is structured, it would also include the new regulation A plus securities, but they also have quite a bit of disclosure and probably are going to become tradable as well.

So I think the investor protection core of it, particularly the fraud rules at both the State and Federal level, but also the disclosure rules at the Federal level, are sound. And that is not really what the legislation addresses.

It addresses the structure of the marketplace and how that can be changed to make smaller capitalization firms have a better secondary market, which will help investors, not hurt them, because they will have a more liquid market where they can sell their securities when they need to and they are more likely to get a better price.

Mr. CARNEY. Thanks so much.

I would love to hear your response, but I am out of time.

I yield back.

Chairman GARRETT. The gentleman yields back.

Mr. Huizenga is recognized now for maybe the last 5 minutes.

Mr. HUIZENGA. Thank you, Mr. Chairman. I appreciate that.

Mr. Kruszewski, I have a quick question for you about this particular bill with Ann Wagner. In going through your testimony, I didn't see whether you support it or oppose it, or SIFMA does.

Mr. KRUSZEWSKI. Congressman—the S-3, Congresswoman Wagner's bill?

Mr. HUIZENGA. Yes.

Mr. KRUSZEWSKI. We did not comment on that bill. No.

Mr. HUIZENGA. Any reason why?

Mr. KRUSZEWSKI. First of all, everything that has been said here, from venture exchanges, to this bill, to research, is a recognition by this body, which I applaud, that the cost of capital for small companies is extremely high, and we are not creating the jobs we should from the job engine, which are small companies.

Mrs. Wagner's bill attempts to do that. And you are trying to balance access to capital with investor protection. All I am saying is I am not sure where that pivot point is, and I am not prepared to discuss that today.

Mr. HUIZENGA. Okay. But you are comfortable with the timeframes that the SEC has been dealing with and not acting on this?

Mr. KRUSZEWSKI. I didn't say that either.

Mr. HUIZENGA. Oh, okay. I am just curious because you seem satisfied, when it comes to my bill, that the SEC took 7 years to act on anything and we have a no-action letter.

But, Mr. Quaadman, I would like for you to maybe comment transitioning to my bill, which wasn't formerly what we were going to be talking about with the mergers and acquisitions. But I know Mr. Kruszewski had decided to spend a considerable amount of time on it.

I am just curious if you would like to comment on some of those points?

Mr. QUAADMAN. Yes. As we discussed before, I think your bill is important because many businesses today are looking to be acquired, so your bill allows for that activity to occur more easily.

The problem, as I raised before in the last hearing, is that while I think the SEC no-action relief was a good thing, what we have also seen in the past is that what the regulator giveth, the regulator taketh away.

In the area of corporate governance, this past January, on the Friday night before Martin Luther King Day weekend, the Chair at 6 o'clock at night decided to overturn decades' worth of past staff practice in the Whole Foods decision.

So the unfortunate part is, with no-action relief, it does not provide the necessary certainty going forward, which is what we think the bill does.

Mr. HUIZENGA. Sorry. I appreciate that.

And I guess that is a significant concern I have as well. The SEC had this recommendation listed as a priority for themselves for, I believe it was 7 or 8 years. It did not do anything with that.

A no-action letter isn't binding on the law. There is no size cap today with that, is my understanding. We are talking about $25 million in EBITDA, but we are also dealing with $250 million in gross sales. So it seems to me that we are limiting this, and I am hoping that we are going to be able to move through this.

And I understand why SIFMA may be wanting to protect its members, shielding them from protected territory that they have. But there is nothing in the bill that is going to deny them referrals.

Actually, that, we believe, will help the flow, as Mr. Weild is talking about it, trying to get deal flow happening that—we believe, as it gets pushed down that stream, that will actually allow for capital to get freed up.

We have 10 trillion estimated dollars tied up in these non-public, closely held businesses that, under this legislation, would only apply the ability to use this if that business is purchased and then run by the purchaser and either wholly owned or either directly or indirectly controlled by that buyer. So it seems to me that is a bit different than the Facebook example that was brought up.

So I have 20 seconds. But having five reasons named Garrett, Adrian, Ally, Will, and Sieger for why I am here in Washington, I just wanted to applaud you for bringing your son here today and letting him see that there are people who are concerned about not just our own interests, but yours, too, buddy.

We want to make sure that you have the same opportunities that your dad has had, your mom has had, and that those of us here have had. So I am glad you are here with him today.

And my time has expired. Thanks.

Chairman GARRETT. Thank you. The gentlemen's time has expired. I appreciate those comments.

I now recognize Mr. Poliquin.

Mr. POLIQUIN. Thank you, Mr. Chairman.

Thank you, gentlemen, for being here. I appreciate it very much.

I represent Maine's 2nd District, which is the most rural district east side of the Mississippi. We have a couple of population centers, like Bangor and Lewiston and Auburn, that have about 35,000 people in them, and then we have 400 small towns. We have 70,000 moose and about 35,000 bear. And most of them vote. So it is a great place to live. If you haven't been there, you should get back there as soon as you can because we need the business now.

This has been about the most anemic economic recovery in 80 years. We have a lot of folks in our district who are working two and three jobs. Part-time jobs have replaced full-time jobs across the country. Millions have just given up working. And we have the lowest participation rate in probably 30 years. So it is not working.

Now, in our district, we have tens of thousands of small businesses. Many of them might not be in your space. But we are a district in a State of small-business owners and we know firsthand how costly overregulation is and how it causes people to shut down their business and pass on their costs, if they are able to, to the consumers, which raises fees and reduces options and opportunities for our consumers.

Now, I am looking at these bills that Mr. Hill and Congresswoman Wagner and Mr. Garrett and Mr. Hurt have all put before you folks today to comment on. They all make a lot of heck of sense to me.

But what I would like to do is drill down a little bit more, if I may, Mr. Kruszewski. I believe you are the first individual who has come before this committee or a subcommittee of this committee dealing with fiduciary standards, a new rule that is now before the DOL.

And I happen to believe that you have brokers—and there are about 600,000 of them across America who work for your firm and other places in this space—that, in my opinion, are regulated properly, and now they are being proposed to be held at the same fiduciary standards as some of the largest money center banks in the world.

I would like to hear from you, sir, if I can, what you think that will do to the customers that your brokers serve, whether they have an IRA or a 401(k) or they are a husband and wife, they are planning for retirement, or maybe they are folks saving for their kids' college education.

What does this do to you, as far as running your business, in the type of information, the type of counsel that you folks might or might not be extending to the folks on the other side of the transaction?

Mr. KRUSZEWSKI. You are speaking of the DOL proposal?

Mr. POLIQUIN. Yes, I am.

Mr. KRUSZEWSKI. It has been interesting to stand here and testify on a bill from a business perspective—and I run a company where the implementation of this bill as written—and it is a very complex bill—would be financially very beneficial for most companies.

This deals with non-managed small IRA accounts where we would be pretty much—we would have to, because of legal and other matters, charge these accounts fees. In a very simple way, I would tell you that—and I have done analysis—we would raise the cost of our small IRA investor by 75 percent.

Mr. POLIQUIN. And when that happens, what does that do to the rate of return on those investments for those folks who are trying to prepare for their retirement?

Mr. KRUSZEWSKI. It is—again, it doesn't necessarily—it would obviously go down by the amount of fee—

Mr. POLIQUIN. Sure.

Mr. KRUSZEWSKI. —by pure math.

But the fact of the matter is that this is a bill that I think imposes additional cost and limits choice. And I find it somewhat ironic, when I look at it purely financially, it is over $100 million to my firm alone if I just applied fees to smaller investors that I do to my larger managed accounts on a percentage basis.

So it is interesting, and I think it requires a lot of debate. And I think there are a lot of investors who do not understand the cost or, if they want to avoid the cost, then they are going to have to leave this model and do a do-it-yourself. And I think a lot of investors don't want that.

Mr. POLIQUIN. Mr. Weild, you have been in this space for a long period of time. Tell me your thoughts with respect to this, sir.

In particular, when we have a government that is increasingly encroaching upon our small-business community and every facet of our lives and they are more and more dependent on the government, but we have a Social Security system that is about a $15 trillion unfunded defined benefit pension plan—

Mr. Weild. Right.

Mr. POLIQUIN. —what does this whole problem do to the folks who have been experienced with as far as serving their clients and making sure they do not run out of money before they run out of time?

Mr. WEILD. In our testimony, we have level participation rates and we have done a round trip on them. We have gone all the way back to where we were in the late 1970s.

But, interestingly, the 16- to 19-year-olds are not getting work, which is important, I think, particularly to low-income communities where kids need to kind of get assimilated.

But, also, if you look at the over 65, the scary part is that the one part of the economy where the level participation rates are going through the roof is people over 65, which means they can't retire. They are scared to retire. They are clinging on to their jobs. So this is a sign of an economy which is really, really incredibly unhealthy.

And then, when you look at the Robert Litan numbers on startups from the late 1970s, where 15 percent of all companies were less than 1 year in age, and now it is down to 8 percent—holy mackerel, if we are not scared, we should be petrified right now.

We are not getting things moving on the low end of the economy, and that is one of the reasons why the Venture Exchange Act, Congressman Scott, is, I think, so important, because it institutionalizes the discussion around what we need to do for small companies. And I think that in and of itself would be incredibly helpful.

If you look at SEC committees as sort of the stepchild of the Division of Corporation Finance, it has always been the small-business area of the Division of Corporation Finance. They have a small-business forum every year. They make lots of recommendations. The recommendations tend to go nowhere. And, meanwhile, what we are doing is we are fiddling while the United States economy is burning. We have to correct this.

Small companies fail at higher rates. And people losing some money, that is okay. Because, if you think about it, in the aggregate, it is not big numbers when 80 percent of your publicly listed companies, NASDAQ and New York, are under $2 billion, but they only represent 6 percent of your aggregate asset value. But it is outsized in terms of its job impacts on the U.S. economy.

So we need a different way of looking at these things, and I think that is one of the reasons why this Venture Exchange Act is absolutely critical to our long-term American interests.

Mr. POLIQUIN. Thank you all very much. I appreciate you being here and participating in this process.

Mr. Chairman, I yield back my time. Thank you, sir.

Chairman GARRETT. Thank you. And, once again, Mr. Poliquin, I appreciate the advertisement for Maine.

Mr. Hill is now recognized for 5 minutes.

Mr. HILL. Thank you, Mr. Chairman.

I appreciate the panel being here with us. Thanks for your tenacity of sitting here this long.

I want to appreciate your comments that some of you have made about the discussion draft that I have put forward called Fair Access to Investment Research.

In my view, this is a common-sense proposal which mirrors other research safe harbors that have been implemented by the SEC and would clarify the law allowing broker-dealers to publish research regarding certain ETFs, allowing investors access to this information.

Since I started my last brokerage firm in the late 1990s, I have seen this area explode—and I think that has been talked about today—from about 100 funds with $100 billion up to today's market with over 1,300 fund offerings and over $1.6 trillion in assets.

And that speaks to this issue, I think, handily, particularly whether they are managed or used in a managed account or whether they are bought standalone. So there are now 6 million households that are using ETFs.

And to the Professor's point about longevity—and I do appreciate being accused of dropping a nuclear bomb. I think Washington needs a lot more metaphorical nuclear bombs in the regulatory system. So thanks for the compliment.

But looking back at the regulatory history, the Division of Investment Management in 1987 was asked by Charles Schwab to provide no-action relief in this area. It declined.

Merrill Lynch approached the Division of Investment Management regarding no-action relief for open-end investment companies in May of 2000. The staff supported it—perhaps you were there then—but never took it up.

In 2004, as a part of the Securities Offering Reform proposal, the Commission requested comment on whether reliance on proposed Rule 139 should be permitted if an issuer is an open-end management investment company or another investment company. Again, all the comments were positive. Nothing happened. And it is to the chairman's point. There is no "or else" in Washington, D.C.

And if you think we like to have prescriptive legislation directed at our independent regulatory agencies, you are mistaken. The problem is, in this society, we have no choice now because we have no responsiveness from our independent regulatory agencies, whether they are subject to the appropriation process or not.

So I do appreciate your comments. I thought they were very helpful, and I appreciate them. And I think that addresses maybe Mrs. Maloney's point.

But one other I would add is that this safe harbor is still pursuant—these firms are still subject to FINRA's Rule 2711, governing research. And, of course, these are all subject to the antifraud provisions of the Commission and Rule 10b-5.

So, this is not some grand-sweeping, out-of-the ordinary proposal. With that, I would maybe, if you would like, Mr. Bullard, to respond to that again, add your thoughts?

Mr. BULLARD. Sure. I think you said that it mirrors the existing approach. And there is a paragraph in my testimony that gives six or seven examples of how it goes further, one of which is that it allows issuers to issue the reports. It is not limited to broker-dealers publishing them. And under 139, issuers aren't allowed to publish anything. So that is one major difference.

Another, as I think you mentioned, is it doesn't affect the antifraud provisions. It actually is a carve-out that would prevent the SEC from bringing Section 17 enforcement action because of the limit on liability.

And I don't think those were necessarily intended by the rules, and it is obviously something that happens when Congress, dealing with the full breadth of the world of legislation, tries to rewrite an SEC rule.

I cannot defend the SEC. When I was there, I saw this. And it is one of the reasons I left, is that it is an agency that, unlike a lot of other Federal agencies, has five or six tiers rather than having, as a lot of entities do, an assistant director who oversees a lot of people.

So there are structural reasons why the SEC has problems. They haven't really taken any steps to fix them. And I can't defend their not having an adopted rule.

I would still, though, stand by the recommendation to give a mandate a try, and if it doesn't work in a year, then come back and bang them on the head.

And I agree with most of what you said. My core area of expertise is the investment company area, and it is distressing to see they haven't taken any steps on this.

Although, in their defense, exchange traded funds are a creation of the SEC, as are money market funds, as are 12b-1 fees. So there are a lot of examples of the SEC's responsiveness having in the past been a benefit to both investors in the industry.

Mr. HILL. Thank you, Mr. Bullard.

I yield back.

Chairman GARRETT. Thank you.

So, with unanimous consent, I am going to yield to Mr. Scott for an additional question or two.

Mr. SCOTT. Thank you very much, Mr. Chairman.

I am very interested in the subject, and I certainly commend Mr. Garrett on the legislation. But I do think we need to really exhaust these concerns that we have about a loss of consumer and investor protections in the area.

The reason I am acquainted somewhat with this is as a student at the Wharton School of Finance, we did a student project at that time. And this is why I commend Mr. Garrett, because access to capital is a very serious problem, particularly in the minority community with minority African-American-owned businesses. And we put together a forum, a venture capital effort, then, to help those companies in the Philadelphia area.

So my question, going back to that, is that if, for example, the new venture exchanges have permissive or what we call de minimus listing standards and the securities traded on these exchanges become exempt from the State blue sky laws, does that give rise to any investor protection concerns? And particularly, Mr. Bullard, I would like for you to answer that question and Mr. Kruszewski—you represent SIFMA, correct, the financial institutions?

I think that to help Mr. Garrett have smooth sailing with his bill, we really definitely need to clear the air on this low hurdle of a great concern that consumer protections may be deflated. Could you answer that question first, Mr. Bullard, Mr. Kruszewski, anybody else, too?

Mr. BULLARD. Okay. I guess I would separate the investor protection between the exchange-provided protection and the exemption from State regulation.

Frankly, to answer the question asked, I think by Mr. Carney earlier, the exchanges already let you take your investors to town. And we accept that they have very low listing standards and that a lot of them will fail and that there will be potential investor abuses.

My main objection is that the venture exchange would operate outside of the system that the SEC has currently been authorized by Congress to administer. It is that by removing all of reg ATS and all of reg NMS, which are not principally investor protection provisions, but do include some, Congress is essentially undoing its own work and creating something that becomes another breed where you would definitely see new investor protection concerns arising.

On the State registration side, I just haven't seen out of Congress a coherent approach of when, if ever, they think a State view is appropriate. Now, if Congress just wants to eliminate States altogether, that is one thing.

But to arbitrarily have cutoffs as to when the States are allowed to regulate small offerings, especially when it is flatly consistent with what I understood to be the deal when the JOBS Act was on a bipartisan basis approved, I think is inappropriate.

Mr. SCOTT. Okay. Mr. Kruszewski?

Mr. KRUSZEWSKI. Yes. I would just say that I think it is very important at the highest level to separate investor protection from the liquidity and the market access that we are trying to achieve.

I don't think this bill in any way—or I should not say in any way—to the extent that you increase liquidity and capital, you have more companies that potentially can fail. And that is part of capitalism. So I am not going to suggest that.

But this cannot be about investor protection. It is not. This is about in many ways undoing some of the things that have destroyed the ecosystem for small companies. And many of the rules that were put in place have destroyed the ability to do this.

I represent many companies that we have to sell that could be job-creating machines because they do not have access to the capital markets out of certain of their growth funds or their growth stages. And so, I believe this is a very important issue. And it is not an investor protection issue. It is a liquidity issue and a trading issue for small companies.

Mr. SCOTT. And both of you are very comfortable that the SEC has the resources available to monitor these new exchanges and the securities traded on them?

Mr. BULLARD. No. I don't believe that it does.

Mr. KRUSZEWSKI. They are already trading. Many of these are already trading. I don't understand that comment. They are already trading. We are talking about providing a marketplace that supports the growth and formation of small companies and, by an extension, jobs in this country.

Mr. QUAADMAN. The complexity of the markets really came from all the legislation and all the rulemaking that created Reg ATS and NMS and decimalization and the proliferation of trading venues. There are over 50 trading venues, and that in and of itself has put the SEC on this treadmill of trying to keep up with the sheer volume of complexity.

These markets will actually be much simpler—and, interestingly, Congressman Scott, if you listen to the language coming out of the SEC, the SEC is now openly questioning the wisdom behind one-size-fits-all markets. There is definitely an interest on the part of the Commission in reexamining this along the lines of what I think this bill does.

Mr. SCOTT. Thank you for your courtesy, Mr. Chairman.

Chairman GARRETT. Thank you.

So, I will leave it at that. And maybe Mr. Weild's final comment was the comment that we can take away on this, is that this simply—although it would be changing the law, the simpler that you can make something sometimes actually inures to both the benefit of the marketplace, but also inures to the benefit of the investor as well.

If it is clear exactly where I am trading and what I am trading, it is good for him and it can also be good for the agency as well, that they don't have the complexity in these other areas and continually fighting in these other areas as well.

And, also, the other takeaway earlier in your comments was—well, that actually is Mr. Bullard's comments—that there was nothing in NMS really—not nothing—but nothing really about NMS was really about investor protection, and that is really what we are not—we are not talking about those issues as well here. That was Mr. Weild's comment. We are really not talking about those here.

At the end of the day, if and when we have a final draft on this, maybe we just sort of restate that, to restate that our intention here is not to be focusing on those areas to ensure that all current investor protections are in place and they will continue to be in place for these stocks that are already trading. How we word all that, we just want to make sure that message comes through.

So, with that, we were expecting one other Member, but he is not here. So he misses his chance. But he doesn't miss it entirely.

As we come to the conclusion of today's panel, I thank the members of the panel for being here.

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

So, with that, I very much appreciate the education and the insight from your various perspectives on the various bills that we had today.

And, with that, this hearing is adjourned. Thank you.

[Whereupon, at 3:55 p.m., the hearing was adjourned.]

A P P E N D I X

May 13, 2015

Testimony of Mercer E. Bullard
President and Founder, Fund Democracy, Inc.
and
MDLA Distinguished Lecturer and Professor of Law
University of Mississippi School of Law

before the

Subcommittee on Capital Markets and Government Sponsored Enterprises
Committee on Financial Services

United States House of Representatives

Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens, Part II

May 13, 2015

Chairman Garrett, Ranking Member Maloney, members of the Subcommittee, thank you for the opportunity to appear before you today. It is an honor and a privilege to appear before the Subcommittee today. I am the Founder and President of Fund Democracy, a nonprofit advocacy group for investors, and a Professor of Law at the University of Mississippi School of Law.

In this written submission, I have discussed various bills that are being considered by the Subcommittee as set forth in the table below. In addition, I have two general suggestions that apply the bills as a group.

First, when Congress amends the federal securities laws it should seek to do so pursuant to a consistent regulatory model, whatever that model might be. When enacted, the federal securities laws constituted a coherent regulatory structure based on the concept of public and private offerings and companies. However, the recent piecemeal, haphazard reforms have rendered the public-private distinction almost meaningless. The relevance of the size, type of securities and target market for an offering, as well as the size, float and operating history of an issuer, to the particular rules that apply to an offering or issuer has grown increasingly arbitrary and unpredictable. This approach cannot help but undermine efficient markets, suppress capital formation and drive investors further from the equity markets.

Second, Congress should be wary of assuming the role of regulator for itself. The Commission has far greater competence than Congress in promulgating detailed securities rules. The Commission also has the advantage of making administrative rather than statutory law, which provides the law with a critical degree of flexibility that statutory law cannot match. Congress should use statutes to establish broad parameters within which the Commission may or may be required to conduct detailed rulemaking.

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I. Fair Access to Investment Research Act of 2015

Section 5 of the Securities Act regulates non-exempt securities offerings by triggering certain requirements upon the "offering" of the securities. Section 5(c), for example, generally prohibits offers prior to the filing of a registration statement (this is known as the "quiet period"). The term "offer" is interpreted broadly, which means that even a broker-dealer's routinely published research reports can be offers under the Securities Act and, when published during the quiet period, can violate Section 5(c).

The Securities and Exchange Commission ("Commission" or "SEC") has adopted certain safe harbors for broker-dealer research that establish tiered requirements reflecting the potential for abuse in various situations. Rule 137 imposes limited requirements when the broker-dealer is not participating in the relevant issuer's offering, and Rule 138 proposes more stringent requirements when the broker-dealer is participating in the offering but the report does not address the particular securities being offered and is published in the regular course of the broker-dealer's business.

Rule 139 addresses the scenario that presents the greatest potential for abuse, where the broker-dealer is both participating in an offering and reporting on the securities offered. In this situation, the Commission requires that the issuer:

1. meet minimum float requirements or be a well-known seasoned issuer,

2. be a reporting company that is current on its periodic report filings, and

3. not be a blank check company, shell company or issuer or penny-stock issuer.

The Commission also requires that the report:

1. cover a substantial number of issuers in the industry or include a comprehensive list of securities currently recommended by the broker-dealer,

2. afford no more prominence to the issuer than to other issuers, and

3. be published in the regular course of the broker-dealer's business.

Finally, the Commission generally requires that the broker-dealer have previously issued a report on the issuer (known as the "initiation" or "re-initiation" requirement), *i.e.*, a report would not be part of a "regular course of business" if used to initiate coverage in connection with the offering.

The foregoing rules represent only one part of an extensive regulatory regime, which also includes Regulation AC and FINRA rules, that is designed to combat demonstrated abuses in connection with biased and manipulative analyst reports. Henry Blodget's infamous buy recommendations made in 1999 for Internet bubble securities that he privately described as "pieces of sh*t" are a stark reminder of the incentives of underwriters' conflicts of interest when publishing research,[1] as are years of research analysts' "recommendations" acting as nothing more than a signal repeater set to "buy."[2]

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[1] Complaint, *SEC v. Blodget*, Civ. Action No. 03-2947 (S.D.N.Y Apr. 23, 2003) *available at* https://www.sec.gov/litigation/complaints/comp18115b.htm.

[2] At the height of the Internet boom, for example, 74% of recommendations were buys and 2% were sells. *See* Brad Barber, Reuven Lehavy, Maureen McNichols and Brett Trueman, *Buys, Holds and Sells* at 3 (Sep. 2005).

Notwithstanding the foregoing, exchange-traded funds ("ETFs") raise special issues because the potential abuses arising from published research on registered investment company securities, especially those representing diversified investment companies, are different from abuses arising from published research on operating company securities. Registered investment companies are subject to a host of investor protection provisions, including mandatory fair value pricing, prohibitions on affiliated transactions, and limits on complex capital structures and leverage, that may mitigate some of the concerns that animate research report regulation. These differences could reasonably form the basis of different rules for investment company research reports.

The Fair Access to Investment Research Act of 2015 ("ETF Research Act") offers one approach to the regulation of ETF research reports, but it is too flawed to serve as the basis of reform in this area. The Act essentially destroys the foundation of Rule 139 by undercutting the Rule's most fundamental principles. It creates a *statutory* safe harbor, which precludes the kind of flexible, timely responsiveness that only *rule-based* regulation can provide and that is essential for the effective regulation of research conflicts. It insulates issuer-published reports that are distributed by broker-dealer, whereas Rule 139 covers only broker-dealer publications. It insulates issuer advertisements produced for the purpose of selling shares, whereas Rule 139 covers only broker-dealer research produced in the regular course of its business. It expressly insulates the reports even if they are initiated solely in connection with a particular offering, where Rule 139 excludes such reports. It insulates oral research reports, whereas Rule 139 excludes only written reports. It banishes FINRA from the regulation of research reports, whereas Rule 139 is designed to work in tandem with a comprehensive regulatory regime of which FINRA is an integral part.[3]

[3] It should also be noted that the Act's definition of "exchange-traded fund" is not accurate or consistent with the use of that term by the Commission, commentators or practitioners, *see* ETF Research Act Section 2 (adding subparagraph (f)(4)(B) to Securities Act Section 5), and not only because it includes unregistered pools of commodities, and currencies and derivatives thereof under new subparagraph (f)(4)(B)(iii)(II).

The foregoing flaws, which alone render the ETF Research Act's regulation of ETF research reports effectively inoperable, are not even its most significant weaknesses. The Act virtually destroys the entire fabric of legal accountability that would otherwise apply to ETF research reports. It insulates issuers and broker-dealers from private antifraud claims under the federal securities laws.[4] It precludes any SEC enforcement action under Section 17 that is based on a covered ETF research report.[5] Finally, the Act insulates issuers and broker-dealers from all claims under federal and state laws and regulations of which a necessary element is that the report be considered an offer, solicitation, or inducement of any person to purchase or sell any security.[6]

In effect, the ETF Research Act converts the Rule 139 safe harbor for broker-dealer publications made in the regular course of their business into a safe harbor for communications by an issuer for the sole purpose of promoting the sale of its securities. Due to the Act's effect on liability provisions, ETFs would need only willing broker-dealer accomplices to make offers that are free from Securities Act prospectus liability under Section 12, SEC enforcement action under Section 17, and liability from any legal claim that is based on the report being considered an "offer, solicitation or inducement."[7] While reform of the regulation of research reports on registered investment companies is long overdue, the Act does not provide a reasonable starting point for such reform.

[4] *See* ETF Research Act Section 2 (adding subparagraph (f)(3)(A) to Section 5 of the Securities Act). Although this is the necessary effect of the Act's adding subparagraph (f)(3)(A) to Section 5 of the Securities, it is directly contradicted by new subparagraph (f)(3)(B)'s Rule of Construction, which states that excluding a covered ETF research report from being considered an "offer, solicitation or inducement" shall not limit the applicability of the antifraud provisions of the federal securities laws. However, because this Rule of Construction applies only to new subparagraph (f)(3)(A), it has no effect on new subparagraph (f)(1)'s elimination of prospectus liability under Section 12 because such liability arises from the meaning of "offer" under Section 2(a)(10).

[5] *See* ETF Research Act Section 2 (adding subparagraph (f)(3)(A) to Section 5 of the Securities Act). The issue regarding new subparagraph (f)(3)(B)'s Rule of Construction, *see supra* note 4, applies equally here.

[6] *See id.*

[7] The removal of section 12 liability for a reporting company is particularly incongruous in light of Congress's having, only three years ago, *created* Section 12 liability for crowdfunding and and Regulation A issuers.

II. Accelerating Access to Capital Act of 2015

Issuers use Form S-3 to conduct what are known as "shelf" offerings. An issuer may incorporate by reference its prior Exchange Act filings in Form S-3, which means that its financial information is deemed to be complete and current on an ongoing basis. This also means that the issuer can quickly take its registration statement "off the shelf" and sell shares (a "takedown") and thereby avoid many of the amendments and staff comments that that might otherwise delay an offering. Form S-3 benefits issuers by allowing them to take advantage of favorable market conditions in times of market volatility.

However, only certain issuers are eligible to use Form S-3. An issuer must be a reporting company, of course, because it otherwise would not have Exchange Act filings to incorporate by reference. The Commission requires that an issuer have been filing for at least one year. The Commission also generally requires that Form S-3 users have a public float of at least $75 million. An issuer with a smaller public float ("micro-cap issuer") generally can use Form S-3 only if its shares are traded on a national securities exchange ("exchange-traded"), provided that it is not a shell company and has not in the preceding year issued common equity in reliance on this exception in excess of one-third of the value of its public float (the "Exchange-Traded Exception").

The Accelerating Access to Capital Act of 2015 ("Access Act") would expand the number of micro-cap issuers that are eligible to conduct shelf offerings. Specifically, the Act would allow a micro-cap issuer to use Form S-3 if it was either (1) traded on a national securities exchange or (2) was not a shell company and had not in the preceding year issued common equity in reliance on this exception in excess of one-third of the value of its public float.

For a number of reasons, the Access Act would not be consistent with the efficient markets or capital formation or the protection of investors. One reason is that the

Act would directly conflict with the SEC's ongoing review of small company regulation. The Commission created the Exchange-Traded Exception in 2007 as part of that review and in response to input from its Advisory Committee on Smaller Public Companies and members of the micro-cap issuer community. After careful consideration of the interests of market efficiency, capital formation and investor protection, the Commission adopted the substantially liberalized Exchange-Traded Exception for the riskiest category of reporting companies.

The Commission settled on the three elements of the Exchange-Traded Exception as a combination of factors that comprised an adequate proxy for the market integrity that is a necessary predicate for shelf offerings. While shelf offerings benefit micro-cap issuers by enabling them to move quickly to take advantage of favorable market conditions, allowing micro-cap issuer to move quickly to market can also undermine market efficiency, impair efficient capital allocation and harm investors. Speedy access to markets facilitates accounting fraud, market manipulation, insider trading and sales of watered stock, all of which are abuses that occur with greater frequency among the micro-cap issuers that the Access Act would permit to conduct shelf offerings.

A long history of empirical research shows the heightened risks that micro-cap companies pose for markets and investors. In a 2006 study of SEC enforcement actions, researchers found that more than 80% of manipulation cases involved non-exchange-traded stocks.[8] The market capitalization of the New York Stock Exchange ("NYSE") far exceeds the combined capitalization of all non-exchange traded stocks, yet the NYSE accounted for less than 3% of market manipulation cases. The authors found a positive correlation between lower disclosure requirements and otherwise weaker regulation and the likelihood of manipulation, concluding that the "lack of disclosure requirements and regulatory oversight allows manipulators to operate with ease."

[8] Rajesh Aggarwal and Guojon Wu, *Stock Market Manipulations,* 79 Journal of Business 1915, 1935 (2006). This total includes 29.58% of cases involving stocks for which market information was unavailable (and presumably were no traded on a national securities exchange).

A more recent study provided a detailed look at the characteristics of OTC (non-exchange-traded) stocks.[9] It found that volatility for OTC stocks was twice as high as the already very high volatility of NASDAQ Small Cap stocks.[10] It also found that a quarter of pink sheet stocks trade on 10% or less of trading days. When these stocks do trade, daily volume is about $100,000, which contributes to their exhibiting "episodes of extreme returns over the sample period (e.g., returns above 100% or below -95%)." The 2006 study found that the price of stocks with high volatility and low liquidity were easier to manipulate. These are defining characteristics of the stocks that the Access Act would allow to conduct shelf offerings.[11] Both the 2006 and more recent studies one found a positive correlation between market efficiency and liquidity on the one hand, and regulatory oversight on the other. These measures were higher for: reporting companies, companies headquartered in states with more rigorous merit review regimes, and companies that are published in securities manuals (a quasi-regulatory characteristic).[12]

The concerns highlighted by these studies are precisely the concerns that led the Commission to limit shelf offering access to micro-cap issuers. The Commission disallowed shell companies because they have no operating history or meaningful financial information; their susceptibility to market manipulation is self-evident. As discussed above, substantial offerings as a percentage of an OTC company's value have been specifically identified by researchers as characteristic of market manipulation and a key tool for market manipulators. These concerns are mitigated by the requirement that the securities be exchange-traded, which, as discussed above, correlates with a far lower incidence of market manipulation. From 1990 to 2001, for example, securities traded on

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[9] *See* Ulf Brüggemann, Aditya Kaul, Christian Leuz, and Ingrid M. Werner, *The Twilight Zone: OTC Regulatory Regimes and Market Quality*, Fisher College of Business Working Paper No. 2013-03-09 (August 1, 2013) *available* at ssrn.com/abstract=2290492.

[10] *Id.* at 5.

[11] *See Stock Market Manipulations, supra*. The study discusses how creating the appearance of increased liquidity and volume and a rising stock price are common elements of market manipulation schemes, each of which is easier to accomplish for stocks with low liquidity and volume and highly volatile prices.

[12] *Id.* at 6.

the NASDAQ Capital (Small Cap) Market accounted for 1.9% of market manipulation cases, in comparison with non-exchange-traded securities' 80%-plus share.[13]

The Commission originally proposed a 12-month, 20%-of-value limit on an issuer's offerings, but ultimately increased the limit to 33.3% only because "of the additional protection afforded by the new requirement . . . [that] the registrant hav[e] a class of common equity securities listed and registered on a national securities exchange."[14] The SEC staff also based this percentage limit on its finding that the 33.3% limit was well above the median 12-month percentage-of-value of takedowns in 2006 for companies with a public float from $75 to $140 million.[15] The current shelf offering rules reflect careful analysis of the costs and benefits of allowing micro-cap issuers to access public markets with virtually no opportunity for market review.

The volatility of micro-cap company stocks makes shelf-offering eligibility for such companies particularly inadvisable. Shelf offerings are intended to enable companies to access markets more quickly and take advantage of optimal market conditions. In the context of stocks that are inherently volatile, the ability to take advantage of optimal market conditions is more aptly characterized as the ability to opportunistically exploit random upswings in prices that have little relationship to intrinsic value. The market in non-exchange-traded microcap stocks already has the empirical characteristics of a lottery.[16] The median share price for an OTC stock is $1.01. As a group, OTC stocks had returns from 2001 to 2010 of "-27% and -37% (annualized), respectively, indicating that the majority of the firms exhibits a negative performance."[17] Betting on micro-cap stocks is already like picking the lame horse to win the race.

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[13] *Id.* at 1935.

[14] 72 FR 73534, 73538 (Dec. 27, 2007).

[15] *Id.* at note 42.

[16] *Twilight Zone, supra,* at 20 (describing OTC securities "small 'penny-stocks' with lottery-like payoffs, that is, negative average stock returns and high return volatility.").

[17] *Id.* at 5.

Helping micro-cap companies to sell shares at the top of extreme, irrational upswings in price will move the odds further against investors and make investing in micro-caps like betting on the lame horse when it is ten lengths behind halfway through the race.

Non-exchange-traded micro-cap securities already provide market manipulators with the perfect petri dish of infrequent trading, low trading volume, high volatility, usually negative performance, extreme performance swings, and penny stock prices. The Access Act will further enrich the micro-cap market as a breeding ground for market manipulation and thereby unfairly inhibit capital formation for currently shelf-eligible micro-cap companies and inflict significant losses on unsuspecting investors.

III. Main Street Growth Act

A. Venture Exchanges

Congress has granted the Commission broad authority to regulate securities exchanges. Under that authority, the Commission has created two categories of exchanges. A small number of exchanges register with the Commission and are known as national securities exchanges. These include exchanges such as the NYSE and NASDAQ. The vast majority of exchanges are not registered and are regulated by the Commission as Alternative Trading Systems ("ATS"). This regulatory structure provides issuers with a broad range of venues on which to list their shares and investors with a broad range of venues on which to buy and sell securities. Both groups have substantial freedom to operate their exchanges as they see fit.

Over the last two decades, the regulation of securities exchanges has been in greater flux than any other area of securities regulation. Some would attribute this to market factors and technological advances. In my view, the changes are the direct result of regulatory flexibility and responsiveness. Constant change in the regulation of exchanges reflects both Congress's decision to delegate regulation of the structure and operation of securities exchanges to the Commission, and the Commission's active and continuous exercise of that delegated authority.

In the Main Street Growth Act, Congress now proposes not only take back the broad authority it has granted to the Commission but also to codify minute elements of exchange regulation. The Commission has created a dual structure for regulating exchanges as national securities exchanges and alternative trading systems and two primary sources of law in the form of Regulation NMS and Regulation ATS. The Act would create a complete exemption from both Reg NMS and Reg ATS while also dictating to the penny the increments at which securities must trade.

By prohibiting penny trading increments and requiring nickel increments, the Main Street Growth Act rules out precisely the flexibility that the Commission has demonstrated and continues to demonstrate regarding the regulation of price increments at which securities trade. On May 6, the Commission approved a tick-size pilot for small company stocks under which more than 1,000 companies shares will trade in five-cent increments. The pilot demonstrates the SEC's commitment to exploring the optimal set of rules for trading increments, while the Act does the opposite by forbidding one tick size and mandating another. Establishing mandatory or prohibited tick sizes is well outside of Congress's competence and represents the kind of inflexible trading regime that will put the U.S. at a competitive disadvantage with other securities markets.

The Main Street Growth Act rejects Regulation NMS wholesale only to re-incorporate aspects such as the dissemination of last sale and quote information on fair, reasonable and not unreasonably discriminatory terms. The Act then makes another about face by prohibiting the exchange from submitting "any data" to a securities information processor, regardless of whether the exchange believes that, as a business matter, a securities information processor might provide the most efficient means of disseminating quotes and transaction data. The Act thereby substitutes Congress's business judgment for the judgment of exchange management, a likely sign of regulatory rent-seeking by firms with monopolistic intentions. Whatever its purpose, the Main Street Growth Act will weaken U.S. competitiveness in international markets.

B. State Preemption for Venture Securities

Section 3(b) authorizes the Commission to exempt certain small offerings from provisions of the Securities Act. Under this authority, the Commission exempted offerings of up to $5 million under Regulation A. This exemption has been in place for decades and offerings under it have been subject to state regulation[18] for just as long.

In the JOBS Act, Congress required the Commission to create a Section 3(b) exemption for offerings of up to $50 million. Accordingly, the Commission recently adopted amendments to Regulation A that will become effective on June 19. New Regulation A creates separate rules for offerings in any 12-month period of up to $20 million ("Reg A") and up to $50 million ("Reg A+"). Notably, in the JOBS Act Congress chose to leave state regulation of Regulation A offerings undisturbed. And possibly out of consideration of concerns expressed regarding the state registration process, the national organization for state regulators, NASAA, began work on streamlined, multi-state protocols for Regulation A offerings to reduce compliance costs for small companies seeking to raise capital. The members of NASAA approved the Coordinated Review Program for Regulation A Offerings on March 7.

Nonetheless, the Commission decided to exempt Reg A+ offerings from state regulation. The JOBS Act granted the Commission the authority to grant such an exemption, but only for securities that are offered or sold to "qualified purchasers," a term that has historically meant, and can reasonably *only* mean a purchaser who has the financial sophistication or resources to make the investor protection provisions at issue unnecessary. The Commission read that provision differently and, in a remarkable

[18] For purposes of simplicity, this discussion uses the term "state regulation" to refer to registration requirements as opposed to anti-fraud enforcement authority. The latter would be unaffected by the Main Street Growth Act.

demonstration of regulatory chutzpah, defined "qualified purchaser" as any investor in a Reg A+ offering. The Commission apparently reasoned that the act of investing in a Reg A+ offering itself renders an investor "qualified" to invest in a Reg A+ offering. The Main Street Growth Act would codify the SEC's extra-legal state exemption and take it one step further by extending it to all Reg A offerings ("Venture Security Exemption").

There is no evidence that the Venture Security Exemption is appropriate or necessary. The claimed Regulation A registration delays that some have blamed on the states pale in comparison to the empirically demonstrated delays imposed by the Commission. The Venture Security Exemption is legislative overkill, as it ignores NASAA's recent adoption of streamlined registration protocols that, if Congress was concerned about the burdens of state registration, could be required as a condition of a state's exercising regulatory authority. The only effect of the Venture Security Exemptior will be to reduce investor protection by eliminating the important role played by states as the primary regulator for Reg A and A+ offerings.

The SEC staff will submit a report to the Commission on the effect of Reg A and A+ on, among other things, the amount of enforcement actions take in connection with these offerings and "whether any additional investor protections are necessary for either [Reg A or A+]." Yet Congress would charge ahead without regard to these findings and cut back on investor protections before a single offering under the new rules has even begun. The Venture Security Exemption not only ignores what the Commission may find in the future, it also ignores what the Commission concluded in just the last few months. Even the Commission, in its overreaching exercise of nonexistent exemptive authority, was forced to recognize that state registration was appropriate and necessary for the protection of investors at least in Reg A offerings. But before the ink is dry on that finding, Congress proposes to remove state regulation from the entire Regulation A playing field.

Congress should address state preemption in the context of Regulation A, but not by expanding it. Rather, it should restore the bipartisan basis for the JOBS Act, which was the continued state regulation of Regulation A offerings of all sizes. It should also repeal the SEC's absurd interpretation of the meaning of "qualified purchaser" and further define that term as meaning purchasers who are "qualified" to invest in the relevant securities based on the characteristics of the "purchaser."

IV. Regulatory Review Act

The Regulatory Review Act would require the Commission to evaluate and vote on all "significant regulations" (presumably "major rules" under 5 U.S.C. § 804(2)) within five years and every ten years thereafter. I agree that the Commission should regularly revisit the efficacy of its rules and other regulatory actions to ensure that they continue to promote efficient markets, facilitate capital formation and effectively protect investors. The Commission has granted many exemptions and adopted many exemptive rules, for example, that contravene all three of these goals. In addition, conducting such reviews on at least at ten-year schedule is reasonable. Indeed, when granting exemptions or adopting rules, the Commission should identify the metrics by which it intends to measure their efficacy.

In my view, however, the Regulatory Review Act is unnecessary. The Commission already conducts retrospective reviews under the Regulatory Flexibility and Paperwork Reduction Acts.[19] The agency also voluntarily complies with Executive Order 13563, which requires it to develop a plan for the retrospective review of rules to identify those "that may be outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them" as appropriate.[20]

If the Regulatory Review Act were to progress further, it could be improved in significant respects as follows:

[19] *See* 5 U.S.C. § 610, 44 U.S.C. § 3506.

[20] *See Improving Regulation and Regulatory Review*, Executive Order 13563 (Jan. 18, 2001).

1. The SEC's review should not be required every ten years regardless of when a rule was adopted, but rather within ten years of every ten-year anniversary of the rule's adoption. As currently drafted, the Act would require a review for any rules adopted immediately or not long before the ten-year deadline.

2. The Act appears to require that the Commission submit a report on every vote every ten years. If that is the case, then the reporting requirement should be amended to apply on a rolling basis (*e.g.,* assuming review under the schedule suggested under #1 *supra*, a single report should be provided every one or two years) and to permit multiple votes to be included in a single report.

3. The Act's requirement of both an SEC review and report renders the SEC vote both redundant and excessively burdensome. If the Commission reviews its rules and then reports on its reviews, then a non-vote will provide a clear an indication of its position.

4. Any SEC vote should be deemed not to be final agency action for purposes of judicial review. Permitting judicial review of SEC votes under the Act would substantially interfere with the SEC's ability to carry out its mission.

5. Some of the Act's substantive standards should be removed because they are not consistent with the statutory standards that would have applied in the original rulemaking. Otherwise, the original evaluation and subsequent review may work at cross purposes. For example, SEC rulemakings are not subject to a statutory determination as to whether a rule is (or is not) "outmoded," "ineffective," "insufficient," or "excessively burdensome." These terms are perfectly appropriate as general standards of review, as reflected in Executive Order 13563. Nonetheless, their use as statutory standards will conflict with the different standards that apply to the original adoption of a rule. They will also create legal uncertainty due the lack of judicial precedent regarding their meaning.

6. The Act should be amended to clarify that the APA does not apply. The application of the APA would cripple the SEC"s ability to accomplish its mission.

7. The requirement that the Commission review all of its significant rules within five years should be deleted as the agency does not have the capacity to conduct such a review in that timeframe.

V. Encouraging Employee Ownership Act of 2015

Rule 701 exempts small, nonreporting issuer offerings to the issuer's employees as part of a written compensatory benefit plan from Section 5 of the Act. Within certain dollar limits, these offerings are subject to virtually no federal securities regulation. The securities need not be registered. Issuers are not required to provide *any* disclosure to employees other than a copy of the plan. Nor is there any restriction on the wealth or sophistication of investors.

The dollar amount of a Rule 701 offering may not exceed the greatest of the following amounts during any 12-month period:

- $1 million;
- 15% of the total assets of the issuer; or
- 15% of the outstanding amount of the class of securities being offered and sold in reliance on Rule 701.

In addition, Rule 701 offerings may not exceed $5 million in any 12-month period unless certain disclosures are provided, including primarily information about the risks of the securities and the financial statements required for a Regulation A offering. Rule 701 offerings are not integrated with any other offerings. Nor are Rule 701 securities counted in determining whether a company must register and report under the Exchange Act.

The Encouraging Employee Ownership Act of 2015 ("Employee Ownership Act") would increase Rule 701's disclosure trigger from $5 million to $10 million. In other words, an issuer making a $10 million offering every year would not be required to provide employees with the same unaudited information that Regulation A filers have for decades been required to file for smaller offerings or even with "[i]nformation about the risks associated with investment in the securities sold."[21]

[21] Securities Act Rule 701(e).

These disclosure requirements cannot reasonably be viewed as too burdensome for an issuer that must have at least $34 million in total assets.[22] Congress recently enacted crowdfunding legislation that would require substantially more disclosure by a hot dog stand with almost no capital to raise $10 thousand, and these offerings would still be subject to a $2,000 limit on investments by certain investors. Congress now proposes to allow nonreporting companies with at least $34 million in assets to raise up to $10 million with no disclosure or any limits on employees' investments or sophistication.

The most striking problem with the Encouraging Employee Ownership Act is that it would "encourage" employees to overconcentrate their retirement accounts in employer stock while failing to help achieve the legitimate goals of employee ownership. The benefit of employee ownership is the alignment of interests between employers and their employees. Employees who have a direct economic stake in their success should be both more productive and more satisfied with their work.[23] As a result, employers should be more profitable. I learned this early in my career, as my first job out of college was with Science Applications International Corporation, one of America's most successful employee-owned businesses. Congress should seek to facilitate employee equity ownership and, while reasonable minds may disagree as to how employee share purchases should be regulated, some relaxation of normal public offering rules is appropriate.

However, Rule 701 is not designed to promote the benefits of employee ownership. The Rule and the Act are premised on the assumption that greater sales of employer stock, regardless of the effect on the breadth of employees' ownership or the

[22] In order to make a $5 million offering, a company must have at least $34 million in assets so that the offering will not exceed the value of 15% of the issuer's total assets (15% * 33 < 5 < 15% * 34). It is possible, although highly unlikely, that the issuer would have less than $34 million in assets if it had at least $34 million in Rule 701 securities outstanding including the securities sold in the offering, in which case it could rely on the alternative 15% test under the Rule.

[23] *See* Mark Iwry, *Promoting 401(k) Security*, 7 Tax Policy & Options 1, 2 – 3 (Sep. 2003) ("many believe that employee holding of company stock tends to align employees' interests with shareholders', giving employees an incentive to be more productive") *available at* http://taxpolicycenter.org/UploadedPDF/310876_promoting_401k_security.pdf.

concentration of employer stock in an employee's retirement, is an unmitigated good. It is not. At some point, an employee's additional purchases of employer stock will produce declining marginal benefits. One reason is the collective action problem. An employee receives the benefit of the additional company value they create only in proportion to the employee's ownership stake (the rest is shared with all other shareholders).[24] It is not clear at what rate or in what degree the utility of an employee's stake in a business declines at that stake grows, but the utility necessarily yields declining benefits at some tipping point.

What is clear, in contrast, is that concentration risk increases as the percentage of an employee's portfolio invested in employer stock grows.[25] It is a virtual cliché among financial planners that an investor should not invest more than 10% of their assets in the stock of a single company, and in no event should invest more than 10% in the stock of same firm on which the employee relies for their income. Following these rules becomes critically important when investing for retirement.

Additionally, employees are subjective to cognitive biases regarding investment in their employers' stock. Employees are likely to overestimate their employer's likely future performance and underestimate their employer's bankruptcy risk. They are more likely to trust their employer than to trust other issuers. Employees' rose-colored views of their employers may have a positive effect on productivity, morale and overall well-being, but they inevitably distort employees' evaluation of employer stock as an investment.

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[24] *Id.* at 3 ("Because in most firms few individual employees can realistically expect to have any noticeable impact on the company's stock price, any incentive effect for most employees might ordinarily be achieved by owning a limited number of shares, enough to give employees some sense of identification with shareholders and some personal interest in the value of the stock").

[25] Concentration risk will almost always increase with additional purchases of employer stock because very few employees will have additional funds to invest in other options so as to keep the percentage of their assets in non-employer-stock at the same level.

This perfect storm of cognitive biases will cause the Encouraging Employee Ownership Act to "encourage" employees to do exactly what they should not do – overconcentrate their retirement accounts in employer stock. As Mark Iwry, Deputy Assistant Secretary for Retirement and Health at the Treasury Department, has explained:

> Employer stock can play a useful part within a diversified portfolio. It often provides substantial returns, offsets some workers' tendency to allocate their assets entirely to guaranteed investment contracts or money market funds, and aligns workers' interests more closely with those of shareholders, possibly boosting productivity and morale. But over the years, mounting accumulations of employer stock in retirement plans have become too much of a good thing. In the many 401(k) plans that offer investment in company stock, roughly 30 percent of all assets is invested in that stock.[26]

In 2012, 8.4% of employees had more than 50% of their 401(k) accounts invested in employer stock where such investment was an option, and 5.6% had invested more than 90% of their accounts in employer stock.[27] These percentages have steadily declined (from 21.3% and 12.4%, respectively, in 1998),[28] but it will be cold comfort to the retiree impoverished by their employer's bankruptcy that fewer other Americans are experiencing the same fate than previously.

At the same time that Congress prohibits companies from investing more than 10% of defined benefit plan assets in their own stock, a policy that ultimately protects only the company, its shareholders and the government, and *not* employees (whose pensions are government-insured), Congress offers tax incentives for employees to invest

[26] *Promoting 401(k) Security*, *supra*, at 1 (citation omitted).

[27] Jack VanDerhei and Sarah Holden, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2012*, 394 Employee Benefit Research Institute Issue Brief at 37 (2013) *available at* http://www.ebri.org/pdf/briefspdf/EBRI_IB_012-13.No394.401k-Update-2012.pdf. The 8.4% and 5.6% data points may seem counterinteruitive, but they are correct – employees who invest more than 50% in employer stock are far more likely than not to invest more than 90% in employer stock. The overconcentration concern is mitigated for small company 401(k), where employer stock is generally not an investment option. *Id.* at 18 (in 2012, less than 1% of participants in small plans were offered company stock). However, the same data for Rule 701 securities may be different because the Rule is specifically designed for small companies.

[28] *Id.* at 37.

up to 100% of their retirement assets in company stock. Now Congress would further undermine employees' retirement security by increasing the special benefits to employers of selling stock to employees rather than in the marketplace. This incentive would follow closely on the footsteps of the added incentive created by the JOBS Act for employers to issue stock to employees as means of raising capital without triggering Exchange Act registration. Both distort retirement investing in harmful ways without having any necessary relationship to expanded employee stock ownership.

Retirees in the U.S. are facing a declining standard of living as Social Security becomes actuarially untenable and income from robust defined benefit plans are replaced with meager 401(k) plans (or, even worse, IRAs managed by broker-dealers subject only to a suitability obligation). It is remarkable that Congress would even consider further encouraging employees to overconcentrate their retirement accounts in the stock of a single issuer, especially where employees are particularly susceptible to distorting investment biases.

Rule 701 is oblivious to considerations of employee overconcentration in employer stock,[29] as it is indifferent to whether a $5 million offering is purchased by 5 million employees or only one. Rule 701's structure fails to encourage broad employee ownership, because it speaks only to the sale of *more stock* and not to the sale of stock to *more employees*, while implicitly encouraging employees' overconcentration in employer stock in their retirement plans.

Congress can do better, as it *knows* that investor risk is partly a function of the investor's degree of diversification. Congress recently passed legislation that, with respect to investor eligibility requirements, reflected such a forward-thinking, diversification-based model. The JOBS Act limits investors' eligibility to buy crowdfunded securities based on the amount of the particular issuer's securities and all

[29] Similarly, the SEC's definition of "accredited investor" is based on the value of an investor's net investments, not their makeup. The effect is to allow an individual with $1 million in investments to bet (and lose) all of it in a single private offering, while an individual with $999,999 in investments cannot allocate even an appropriately small portion of their portfolio to such investments.

crowdfunded securities combined that the investor purchased in the preceding 12 months. Yet now Congress proposes to allow the same individual who cannot purchase more than $2,000 in securities from a single crowdfunding issuer to purchase an unlimited amount of securities from their employer. This is not the kind of encouragement Congress should be providing.

In summary, the Act does not make it easier or less costly to allow *more employees* to own company stock. Rather, it makes it easier and less costly to allow employees to own (and employers to issue) *more stock*. Rule 701 should be amended, but not under a guiding principle of encouraging employees' over-concentration in company stock. Rather, Rule 701 should be amended to support the legitimate principle of promoting broad but prudent employee ownership of company stock. Rule 701 offerings should "encourage" offerings that actually increase the number of employees who own company stock while "discouraging" offerings that result in overconcentration in the percentage of employees' portfolios invested in company stock. The Encouraging Employee Ownership Act does precisely the opposite.

VI. Small Business Mergers, Acquisitions, Sales and Brokerage Simplification Act of 2015

The Small Business Mergers, Acquisitions, Sales and Brokerage Simplification Act of 2015 ("M&A Act") would exempt broker-dealers from registration who are in the business of effecting transactions on behalf of "eligible privately held companies." The Act defines such companies as nonreporting companies with either EBITDA of less than $25 million or revenues of less than $250 million.

One objection to the M&A Act is that it is unnecessary, as the Commission has already (and inadvisably) provided no-action relief that is fairly co-extensive with the Act. A more serious objection is that the Act would harm small businesses by effectively de-licensing the M&A professionals on which these businesses rely for advice about complex, corporate transactions. The structure of M&A compensation is complex and rife with opportunities for abuse, the cost of which will often dwarf any potential savings realized from reducing broker-dealers' regulatory burdens. Permitting unlicensed M&S advisers to negotiate deals with unsophisticated small business owners will simply result in a greater transfer of wealth from the latter group to the former.

The M&A Act is an open invitation to fraudsters as it imposes no restrictions on bad actors' providing M&A advice to unsuspecting business owners. The Act would allow brokers who have been barred from the industry to continue to hold themselves as qualified professionals to the business owners that rely on them. There is no rational basis for barring bad actors in virtually every other similar situation but not in this context. The M&A Act would also permit the use of shell companies in connection with eligible transactions, notwithstanding that shell companies are commonly employed by fraudsters to take advantage of small business owners.

The effect of the M&A Act would be to create a parallel industry of unregistered M&A brokers who seek to avoid the costs of registration. The costs of broker-dealer registration are high, and many M&A broker-dealers therefore would have a strong incentive to forego registration in order to maximize their profitability. These broker-dealers would also gain a cost advantage over their competitors, which would create an unlevel playing field and lead to strictly law-generated fragmentation in the industry.

The incentive for M&A advisers to break away from regulated firms will be exacerbated by the size of the market to which the exemption would apply. The M&A Act's definition of "eligible privately held companies" would create a large market in which M&A advisers could operate. The revenue test of $250 million would include very large companies. The EBITDA test would include even larger companies because early stage companies may grow to enormous size and even conduct IPOs without any earnings.

Successful small business owners invest a lifetime of sweat equity in their businesses. The sale of their businesses will likely be the most important financial event in their lives. The M&A Act will facilitate advisers' skimming a larger share of the proceeds of the small business owner's life's work and far too often turn this once-in-a-lifetime event into a personal and financial disaster.

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CONGRESSIONAL TESTIMONY

"Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens: Venture Exchanges"

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

May 13, 2015

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

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

The focus of my testimony will be how to improve the secondary markets for the securities of entrepreneurial firms generally and, specifically, Chairman Garrett's discussion draft of the "Main Street Growth Act" which would create venture exchanges.

Summary

- Improving the secondary markets for small capitalization firms will help investors achieve a higher return and reduce risk, improve entrepreneurs' access to capital and promote innovation, economic growth and prosperity.

- The three key steps to improving secondary markets for small firms are:

    1. improving the regulatory environment for existing non-exchange over-the-counter (OTC) securities traded on alternative trading systems (ATSs), primarily by (a) providing the same reduced blue sky burden that large companies currently enjoy, (b) re-establishing the list of marginable OTC securities and (c) removing impediments to market making caused by Regulation SHO;
    2. amending the Securities Exchange Act to establish venture exchanges; and
    3. improving the regulatory environment for secondary sales of private securities, primarily by codifying the so-called section 4(a)(1-1/2) exemption and ensuring that platform traded securities are eligible for the exemption.

- The discussion draft of the "Main Street Growth Act" is a very positive framework for establishing venture exchanges although some improvements are necessary for it to fully achieve its objectives. The improvements recommended include (1) amending the definition of venture security, (2) changing Regulation SHO as it applies to market-makers, (3) making it clear that large exchange listing requirement are inapplicable to venture exchanges, (4) permitting market maker support programs and (5) a few other relatively minor changes.

The Existing Secondary Market

A primary securities offering occurs when an equity or debt interest in a company is issued or sold by the company. A secondary offering is when an investor who owns a security sells it to another investor. A secondary securities market is a market where investors trade securities among themselves. Stock exchanges are the leading example of secondary markets.

Many relatively small capitalization companies are listed on NASDAQ. However, a secondary market exists in securities not listed on stock exchanges. This non-exchange secondary market is the primary market for small capitalization company securities that either do not meet the exchange listing standards or do not want to incur the expense of an exchange listing.[1] These non-exchange markets fall into two broad categories. The first category is called the over-the-counter market (OTC).[2] Most OTC equity or debt securities are today traded on one of OTC Markets' three tiers.[3] Some are traded on other alternative trading systems (ATSs)[4] and some are traded by other means. The Financial Industry Regulatory Authority (FINRA) recently closed its OTC Bulletin Board (OTCBB) because its trading platform generated increasingly little interest.[5] The second category is the private market where investors buy and sell securities, often restricted securities,[6] with or without broker-dealer intermediation.[7]

Why Secondary Markets Matter

Entrepreneurial capital formation is important to a well-functioning economy. Dynamic small and start-up companies are critical to job creation, productivity improvement and new consumer product development.[8] Yale economist William Nordhaus has estimated that 98 percent of the

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[1] Expenses include relatively high listing fees and compliance with various exchange requirements regarding corporate governance and other matters.
[2] 17 CFR §240.15c1-1 through §240.15c6-1, "Rules Relating to Over-the-Counter Markets"; "Regulation of the OTC Equities Market." See also, OTC Markets http://www.otcmarkets.com/content/doc/otc-market-regulation.pdf.
[3] About 10,000 securities are traded using OTC Markets' ATS. See "Our Three Tiered Marketplaces," OTC Markets Group http://www.otcmarkets.com/learn/otc-market-tiers.
[4] See Regulation ATS, 17 CFR §242.300 *et seq.*; Alternative Trading System ("ATS") List http://www.sec.gov/foia/ats/atslist0415.pdf. As of April 6, 2015 there were approximately 90 Alternative Trading Systems with a Form ATS on file with the SEC. ATSs serve many functions. According to a recent SEC paper, 96 percent of ATS trading volume is in credit instruments or derivatives, Laura Tuttle, "Alternative Trading Systems: Description of ATS Trading in National Market System Stocks," October 2013, p. 5 http://www.sec.gov/marketstructure/research/ats_data_paper_october_2013.pdf.
[5] John McCrank, "Wall St. Watchdog to Shut Penny-Stock Market, Boost OTC Oversight," Reuters, October 8, 2014 http://www.reuters.com/article/2014/10/08/finra-regulations-otc-idUSL2N0S32A120141008; David Feldman, "FINRA Plans OTCBB Shutdown," October 29, 2014 http://www.davidfeldmanblog.com/finra-plans-otcbb-shutdown/; FINRA, "OTCBB.com Shutdown," http://www.finra.org/industry/otcbb/otcbbcom-shutdown.
[6] Generally, restricted securities are securities acquired in unregistered, private offering from the issuing company or from an affiliate of the issuer, 17 CFR §230.144(a)(3).
[7] This private market is primarily populated by accredited investors. These sales are often made in reliance on SEC rules permitting resales by investors subject to certain restrictions – in particular, SEC Rule 144, SEC Rule 144A and the so-called section 4(a)(1 ½) exemption. For a short discussion, see Bradley Berman and Steven J Bleiberg, "Restricted Securities vs. Control Securities: What Are the Differences?," *Insights: The Corporate and Securities Law Advisor*, Vol. 27, No. 12, December 2013 http://clsbluesky.files.wordpress.com/2013/12/insights-1213_berman.pdf or Rutheford B. Campbell, Jr., "Resales of Securities Under the Securities Act of 1933," Vol. 52, No. 4, *Washington & Lee Law Review*, pp. 1333-1384 (1995) http://scholarlycommons.law.wlu.edu/wlulr/vol52/iss4/6.
[8] For a discussion of the economic importance of entrepreneurs and the decline in entrepreneurship, see David R. Burton, "Building an Opportunity Economy: The State of Small Business and Entrepreneurship," Testimony before the Committee on Small Business, United States House of Representatives, March 4, 2015 http://www.heritage.org/research/testimony/2015/building-an-opportunity-economy-the-state-of-small-business-and-entrepreneurship. See also Steve Strongin, Amanda Hindlian, Sandra Lawson, Katherine Maxwell, Koby Sadan and Sonya Banerjee, "The Two-Speed Economy," Goldman, Sachs & Co., April 2015, http://www.goldmansachs.com/our-thinking/public-policy/regulatory-reform/2-speed-economy-report.pdf; Magnus Henrekson and Dan Johansson, "Gazelles as Job Creators: A Survey and Interpretation of the Evidence," *Small Business Economics*, Vol. 35 (2010), pp. 227–244 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1092938; Ryan Decker, John Haltiwanger, Ron Jarmin, and Javier Miranda, "The Role of Entrepreneurship in U.S. Job Creation and Economic Dynamism," *Journal of Economic Perspectives*, Vol. 28, No. 3 (Summer 2014), pp. 3–24 http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.28.3.3; Ian Hathaway and Robert Litan. "Declining Business

economic gains from innovation and entrepreneurship are received by people other than the innovator.[9]

A robust and liquid secondary market for the securities of entrepreneurial firms helps investors, helps companies and helps promote general prosperity. Investors usually do not want to hold their investment indefinitely. A liquid secondary market, or the likely prospect of such a market for a particular security in the near future, where securities can readily be sold quickly for a reasonable price with small transactions costs helps investors achieve a higher return on their investment and reduces risk by allowing them to liquidate the investment when they need the resources for another purpose. Lower transactions costs and greater liquidity also makes it much more likely that a security will be purchased by an investor in the first place. Removing artificial regulatory impediments to small firm secondary markets makes it more likely that investment capital will flow to entrepreneurial enterprises. Inadequate access to capital is one of the central barriers to entrepreneurial success and a better functioning secondary market for small firms will improve access to capital for entrepreneurs.[10]

Improving Existing Secondary Markets

Creating venture exchanges is one part of a three part solution to the problem of inadequate secondary markets for small firms. However, Congress should also improve the regulatory environment for the existing secondary markets, specifically alternative trading systems where broker-dealers trade the securities of companies not listed on a national securities exchange. This includes some private securities tradable under Rule 144 and will soon include securities issued under the new Regulation A plus[11] and, potentially, crowdfunding securities.[12] Regulation A plus

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Dynamism in the United States: A Look at States and Metros," Brookings Institution, May 2014 http://www.brookings.edu/~/media/research/files/papers/2014/05/declining%20business%20dynamism%20litan/declining_business_dynamism_hathaway_litan.pdf .

[9] See William D. Nordhaus, "Schumpeterian Profits in the American Economy: Theory and Measurement," Cowles Foundation Discussion Paper No. 1457, April 2004 https://cowles.econ.yale.edu/P/cd/d14b/d1457.pdf. Even if he is wrong by a factor of ten, this would still mean that 80 percent of the gains from entrepreneurship go to the public rather than the entrepreneur.

[10] For a good introduction to the issues, see SEC Commissioner Daniel M. Gallagher, "Whatever Happened to Promoting Small Business Capital Formation?," September 17, 2014 http://www.sec.gov/News/Speech/Detail/Speech/1370542976550#.VFfbl8mGklQ or http://www.heritage.org/events/2014/09/commissioner-gallagher .See also Rutheford B. Campbell Jr., "The New Regulation of Small Business Capital Formation: The Impact - If Any - Of the JOBS Act," April 30, 2014, *Kentucky Law Journal*, forthcoming http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2434264 ; David R. Burton, "Proposals to Enhance Capital Formation for Small and Emerging Growth Companies," Testimony before the Capital Markets and Government Sponsored Enterprises Subcommittee of the Committee on Financial Services, United States House of Representatives, April 11, 2014 http://www.heritage.org/research/testimony/2014/04/capital-formation-for-small-and-emerging-growth-companies ; "2013 State of Entrepreneurship Address: 'Financing Entrepreneurial Growth'," Kauffman Foundation Research Paper, February 5, 2013 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2212743 ; Stuart R. Cohn and Gregory C. Yadley, "Capital Offense: The SEC's Continuing Failure to Address Small Business Financing Concerns," *New York University Jounal of Law and Business*, Vol. 4, No. 1, pp. 1-87 (2007) http://scholarship.law.ufl.edu/cgi/viewcontent.cgi?article=1257&context=facultypub .

[11] Amendments for Small and Additional Issues Exemptions under the Securities Act (Regulation A), *Federal Register*, April 20, 2015, pp. 21806-21925 http://www.gpo.gov/fdsys/pkg/FR-2015-04-20/pdf/2015-07305.pdf.

[12] The SEC has still not promulgated final rules implementing Title III of the JOBS Act relating to crowdfunding.

and crowdfunding are both regulatory categories created by the JOBS Act.[13] As discussed below, Congress should also improve the regulation of the private resale of restricted securities by codifying the so-called section 4(a)(1-1/2) exemption.

Improving the Regulation of Alternative Trading Systems (ATSs)

The most important step that can be taken to improve small firm secondary markets is to reduce the burdens imposed by state blue sky laws.[14] Blue sky laws are state securities laws.[15] They increase costs considerably and introduce very long delays while waiting for state regulatory approval (if it ever comes). In some cases, it is simply impossible to ever achieve blue sky compliance for secondary offerings.[16] This means that companies not traded on a national securities exchange,[17] and therefore not having their securities treated as covered securities exempt from blue sky compliance and fees,[18] have serious regulatory difficulties in secondary markets. In this respect, the largest companies in the U.S. are accorded a substantially lighter regulatory burden than smaller reporting or Regulation A companies.[19] This is because the largest companies are traded on national securities exchanges, which are blue sky exempt under current law, while smaller companies generally cannot meet the exchange listing requirements or are unwilling or unable to bear the costs of exchange listing. Thus, smaller companies must deal with 52 regulators[20] while large companies need deal only with one federal regulator.

As part of the effort to strengthen the secondary markets for smaller company securities, Congress should amend section 18(b) of the Securities Act to treat all securities as covered securities that (1) are traded on established securities markets and (2) have continuing reporting obligations as (a) a registered company, (b) pursuant to Regulation A or (c) pursuant to Regulation Crowdfunding. An established securities market should be defined to include those

[13] Title IV of the JOBS Act created Regulation A+ securities. Title III of the JOBS Act created crowdfunding securities.

[14] Rutheford B Campbell, Jr., "Federalism Gone Amuck: The Case for Reallocating Governmental Authority over the Capital Formation Activities of Businesses," 50 *Washburn Law Journal* 573 (Spring 2011) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1934825 ("In retrospect, there can be little doubt that the failure of Congress to preempt state authority over the registration of securities was a significant blunder."). See also Rutheford B. Campbell Jr., "The Insidious Remnants of State Rules Respecting Capital Formation," Vol. 78 *Washington University Law Quarterly*, pp. 407-434 (2000) http://digitalcommons.law.wustl.edu/cgi/viewcontent.cgi?article=1439&context=lawreview.

[15] Roughly three-fifths of states are merit review jurisdictions where state regulators decide whether an offering is a just or fair offering, effectively substituting their investment judgment for that of investors.

[16] Remarks of R. Cromwell Coulson, President and CEO, OTC Markets Group, Inc. at the 33rd Annual Securities and Exchange Commission Government-Business Forum on Small Business Capital Formation, Thursday, November 2, 2014, "Record Of Proceedings," p. 63 http://www.sec.gov/info/smallbus/sbforum112014-final-transcript.pdf ("The other 10 percent, it's impossible. You cannot become blue sky, whether you are Roche's ADR, you are an SEC-reporting company, you're a billion-and-a-half-dollar community bank holding company. You cannot become blue sky in the United States in every jurisdiction.")

[17] See Securities Exchange Act section 6.

[18] See Securities Act section 18(b).

[19] While Regulation A+ Tier II *primary* offerings are blue sky exempt, secondary sales of these securities are not. This is because Tier II securities are not covered securities. For confirmation of this analysis, see specifically, Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), Federal Register, April 20, 2015, p. 21862, footnote 833 http://www.gpo.gov/fdsys/pkg/FR-2015-04-20/pdf/2015-07305.pdf.

[20] 50 states, the District of Columbia and the SEC.

alternative trading system (ATS) compliant with Regulation ATS.[21] Given the structure of Chairman Garret's discussion draft whereby venture exchanges are treated as national securities exchanges that are exempt from various requirements, securities traded on the contemplated venture exchanges would meet the current definition of a covered security and need not be added.

This approach would have a substantial, immediate positive impact on existing markets. It is self-effectuating and does not require waiting for the SEC to promulgate venture exchange rules and then for the private sector to launch a venture exchange. It would help currently existing markets work better and reduce costs for small companies already in those markets or seeking to raise capital.

Issues involving SEC Regulation SHO (governing short-selling) and the marginability of securities are equally applicable to OTC securities traded on an ATS or the contemplated venture exchanges. They are discussed below.

Marginability of Securities

Before NASDAQ became an exchange, the Federal Reserve maintained a list of marginable OTC stocks that an investor could borrow against.[22] This list should be re-established for stocks traded over-the-counter. Being able to borrow against property is an important attribute of property ownership. This is particularly important to entrepreneurs who may wish to borrow against their stock rather than being forced to sell ownership in their company to generate cash. It should also be made clear that stocks traded on venture exchanges are marginable or, if regulators decide that not all venture exchange stocks should be marginable, then the list of marginable securities should include venture exchange stocks that are eligible.

Private Resales

Securities Act section 4(a)(1) exempts from registration "transactions by any person other than an issuer, underwriter, or dealer" from registration. Thus, the resale of restricted securities purchased by an investor in a private placement is permitted provided that certain requirements are adhered to so that the seller is not deemed an underwriter.[23] Rule 144,[24] and Rule 144A[25]

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[21] See Regulation ATS, 17 CR §242.300 *et seq.*; Alternative Trading System ("ATS") List http://www.sec.gov/foia/docs/atslist.htm. As of November 1, 2014 there were approximately 90 Alternative Trading Systems with a Form ATS on file with the SEC.

[22] See 17 CFR §220.11. For an example, see "List of Marginable OTC Stocks and List of Foreign Margin Stocks as of May 11, 1998 http://www.federalreserve.gov/boarddocs/press/general/1998/19980424/9804otc.pdf.

[23] Robert B. Robbins, "Offers, Sales and Resales of Securities Under Section 4[a](1-1/2) and Rule 144A," ALI CLE Course of Study, March 14-16, 2013 http://www.pillsburylaw.com/siteFiles/Publications/RobbinsSalesandResalesunder4112andRule144A2013.pdf; Rutheford B. Campbell, Jr., "Resales of Securities Under the Securities Act of 1933," Vol. 52, No. 4, *Washington & Lee Law Review*, pp. 1333-1384 (1995), http://scholarlycommons.law.wlu.edu/wlulr/vol52/iss4/6;

[24] 17 CFR §230.144 "Persons deemed not to be engaged in a distribution and therefore not underwriters;" Securities and Exchange Commission, "Rule 144: Selling Restricted and Control Securities" http://www.sec.gov/investor/pubs/rule144.htm .

provide regulatory safe harbors. So called section 4(a)(1-½)[26] is a body of case law (and practices and SEC guidance) that generally allows private resales, subject to restrictions, without the seller being deemed an underwriter and therefore the seller is able to undertake resales without registration.[27] More and more of these private resales are taking place on internet platforms limited to accredited investors such as Second Market or NASDAQ's Private Market.

In the interest of clarity and simplification, it would be desirable to codify this exemption so that investors and the new accredited investor internet platforms such as Second Market or NASDAQ Private Markets can operate without regulatory uncertainty.[28]

Venture Exchanges

Recent Interest in Venture Exchanges

There has been a significant amount of recent discussion about establishing venture exchanges. Commissioner Gallagher has proposed their creation.[29] Commissioner Aguilar has expressed an openness to the idea and offered some useful cautionary thoughts.[30] My co-panelist David Weild

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[25] 17 CR §230.144A "Private resales of securities to institutions;" Securities and Exchange Commission, "Section 138. Rule 144A — Private Resales of Securities to Institutions," http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm.

[26] The older literature will refer to this as section 4(1-½). The JOBS Act renumbered the exemption numbers by inserting a subsection (a).

[27] See *Ackerberg v. Johnson, Jr.*, 892 F. 2d 1328 (8th Cir. 1989) http://openjurist.org/892/f2d/1328/ackerberg-v-e-johnson; Robert B. Robbins, "Offers, Sales and Resales of Securities Under Section 4[a](1-1/2) and Rule 144A," ALI CLE Course of Study, Regulation D Offerings and Private Placements, March, 2013 http://www.pillsburylaw.com/siteFiles/Publications/RobbinsSalesandResalesunder4112andRule144A2013.pdf. For an early discussion, see "The Section "4(1 ½)' Phenomenon: Private Resales of Restricted Securities," Vol. 34, No. 4, *The Business Lawyer* (1979), pp. 1961-1978.

[28] See H. R. 1839, 114th Congress, April 16, 2015, The Reforming Access for Investments in Startup Enterprises Act of 2015 or the RAISE Act of 2015, which would codify the exemption. For a brief discussion, see Nelson Griggs, NASDAQ, testimony before the Senate Banking, Housing and Urban Affairs Committee Subcommittee on Securities, Insurance and Investments, "Venture Exchanges and Small Cap Stocks," March 10, 2015 http://www.banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=68652d9f-3c34-4620-a9ec-58740e3a4750 .

[29] SEC Commissioner Daniel M. Gallagher, "Whatever Happened to Promoting Small Business Capital Formation?, "September 17, 2014 ("I've called for the creation of "Venture Exchanges": national exchanges, with trading and listing rules tailored for smaller companies, including those engaging in issuances under Regulation A. Shares traded on these exchanges would be exempt from state blue sky registration. The exchanges themselves would be exempted from the Commission's national market structure and unlisted trading privileges rules, so as to concentrate liquidity in these venues. This should in turn bring market makers and analysts to these exchanges and their issuers, thereby recreating some of the ecosystem supportive of small companies that has been lost over the years.") http://www.sec.gov/News/Speech/Detail/Speech/1370542976550#.VInvAHt4zYg ; SEC Commissioner Daniel M. Gallagher, "Remarks at FIA Futures and Options Expo," November 6, 2013 ("Through well-designed venture exchanges governed by scaled, sensible regulation, small companies would be provided with a proper runway for them to grow while at the same time providing investors with the material disclosures they need to make informed decisions.") http://www.sec.gov/News/Speech/Detail/Speech/1370540289361#.VIsXvXt4zYg.

[30] SEC Commissioner Luis A. Aguilar, "The Need for Greater Secondary Market Liquidity for Small Businesses," March 4, 2015 http://www.sec.gov/news/statement/need-for-greater-secondary-market-liquidity-for-small-businesses.html.

has put forward a version of the idea.[31] The Senate has held hearings.[32] The recent adoption of Regulation A+ to implement Title IV of the JOBS Act has raised the question of where those securities might be traded. The prospect of Title III crowdfunding raises similar issues.

The Experience Abroad

This committee and outside analysts (including myself) need to become more familiar with the experience of other countries with venture exchanges so that we can learn from that experience. The pioneering efforts in Canada and the United Kingdom undoubtedly provide lessons about what works and what does not work so well. The Canadian TSX Venture Exchange[33] and the United Kingdom's Alternative Investment Market[34] appear to be working well but have undergone some adjustment over time. These markets appear to have had a positive economic impact in the U.K. and Canada.[35] There are at least a dozen similar but smaller markets in various countries around the world.[36]

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[31] David Weild and Edward Kim, "The U.S. Need for Venture Exchanges," March 4, 2015 http://media.wix.com/ugd/c4bcbd_a7218106b4504d98a22c04df863b969a.pdf .

[32] Hearing on "Venture Exchanges and Small-Cap Companies," Committee on Banking, Housing, and Urban Affairs, Subcommittee on Securities, Insurance, and Investment, March 10, 2015, http://www.banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=68652d9f-3c34-4620-a9ec-58740e3a4750 .

[33] "TSX Venture Exchange Celebrates its 15th Anniversary," November 28, 2014 http://www.tmx.com/en/news_events/news/news_releases/2014/11-28-2014_TMXGroup-TSXV-Anniversary.html.

[34] London Stock Exchange, AIM http://www.londonstockexchange.com/companies-and-advisors/aim/aim/aim.htm.

[35] Grant Thornton, "Economic Impact of AIM and the Role of Fiscal Incentives," September 2010 http://www.londonstockexchange.com/companies-and-advisors/aim/publications/documents/grantthorntonaimeconomicimpact.pdf; Edward Peter Stringham and Ivan Chen, "The Alternative of Private Regulation: The London Stock Exchange's Alternative Investment Market as a Model," Mercatus Center Working Paper No. 12-30, Oct 18, 2012 http://mercatus.org/sites/default/files/LondonAIM_StringhamChen_v1-0.pdf; Cécile Carpentier and Jean-Marc Suret, "The Canadian Public Venture Capital Market," April 2009 http://www.cirano.qc.ca/pdf/publication/2009s-08.pdf.

[36] For example, Australia's Asia Pacific Technology Exchange (http://www.apx.com.au/APX/Public/EN/Default.aspx), the National Stock Exchange of Australia (http://www.nsxa.com.au/) and Australia's SIM VSE (http://simvse.com.au/); Hong Kong's Growth Enterprise Market (http://www.hkgem.com/root/e_default.aspx) [Market capitalization: $10 billion]; Euronext's Free Market (https://www.euronext.com/en/marches-libre), Euronnext's Alternext (https://www.euronext.com/en/listings/nyse-alternext) [Market capitalization of predecessor: $8 billion]; Borsa Italiana (http://www.borsaitaliana.it/homepage/homepage.en.htm) [Market capitalization: $0.6 billion]; The Brazilian Organized Over-The-Counter Market (http://www.bmfbovespa.com.br/en-us/services/trading-platforms/otc-market.aspx?idioma=en-us) maintained by BM&FBOVESPA (Bolsa de Valores, Mercadorias & Futuros de São Paulo) [Market capitalization: $28 billion]; China's ChiNext (http://www.szse.cn/main/en/ChiNext/aboutchinext/) [Market capitalization: $140 billion], Japan's JASDAQ (which appears to serve both NSADAQ type companies and venture companies), Korea's KOSDAQ (venture company classification) (http://www.kosdaqca.or.kr/Eng/Greeting/; http://www.icsa.bz/img/research_pdf/Financing%20of%20SMEs%20through%20Capital%20Markets%20in%20Emering%20Market%20Countries%282013.2%29.pdf) [Market capitalization: $102 billion (not all of which represents venture-type companies]; India's National Stock Exchange Small and Medium Enterprises (SME) Platform (http://www.nseindia.com/getting_listed/content/sml_med_enterprise.htm) and the Enterprise Securities Market of the Irish Stock Exchange (http://www.ise.ie/Products-Services/List-your-company/ESM/) [Market capitalization: $38 billion]. The Toronto TSX Market has a market capitalization of $41 billion and the U.K.'s AIM has a market capitalization of $100 billion. Market capitalization figures are from Laura Biasion, "UK and Italian Alternative Investment Markets: challenges and opportunities" (2012) http://tesi.cab.unipd.it/44175/1/Biasion_Laura.pdf based on 2012 World Federation of Exchanges data.

The American Stock Exchange's Emerging Company Marketplace (ECM) Experience

On March 18, 1992, the American Stock Exchange (Amex) launched the Emerging Company Marketplace (ECM) with an initial 22 firms. Amex closed the market on May 11, 1995. During its life, the ECM listed a total of 65 firms. The median market capitalization fell from its original $18.4 million down to $6.8 million.[37]

There are a number of lessons that may be learned from this experience. As part of the Amex, the ECM had no incentive to keep firms from graduating to a regular Amex listing. The successful firms generally graduated to a listing on the senior market, leaving behind the unsuccessful ones. Thus, there may be merit in venture exchanges being independent from larger exchanges. In addition, a number of scandals associated with early issuers damaged the reputation of the exchange. Exchanges should be vigilant in enforcing rules barring "bad actors." Lastly, the bid-ask spreads may have been so small that broker-dealers were unable to profitably make markets or otherwise support ECM companies.[38]

The Discussion Draft of the "Main Street Growth Act"

The core provisions of the discussion draft and its structure are sound. It would have a positive impact on the secondary markets. There are, however, some changes that need to be made for the proposal to fully achieve its objectives.

The bill would allow national securities exchanges or national securities exchange applicants to elect to become venture exchanges. In the discussion draft, venture exchanges would be exempt from Regulation NMS[39] (except for 17 CFR 242.613 relating to a consolidated audit trail) and would also be exempt from Regulation ATS.[40] Regulation NMS is the core regulation governing stock exchanges. NMS stands for national market system. Regulation ATS regulates alternative trading systems. In addition, venture exchanges would not be required to submit any data to a securities information processor or to use decimal pricing.

Venture exchanges would only be able to trade 'venture securities.' Venture securities are defined in the draft as the securities of either an 'early-stage, growth company' or an "emerging growth company." The latter is a category of company created by Title I of the JOBS Act and is, in general, a company that has total annual gross revenues of less than $1 billion. An 'early-stage, growth company,' as defined, is effectively a Regulation A issuer that has not gone public that has $2 billion or less in assets.

Importantly, an emerging growth company is a temporary category. Under Securities Act section 2(a)(19)(B), after five years a company is no longer an emerging growth company for purposes

[37] Reena Aggarwal and James Angel, "The Rise and Fall of the AMEX Emerging Company Marketplace," April 1998.
[38] Ibid. See also SEC Commissioner Luis A. Aguilar, "The Need for Greater Secondary Market Liquidity for Small Businesses," March 4, 2015 http://www.sec.gov/news/statement/need-for-greater-secondary-market-liquidity-for-small-businesses.html.
[39] 17 CFR §242.600 *et seq.*
[40] 17 CFR §242.300 *et seq.*

of the Act. This, in effect, puts a five year time limit on any registered company's time on the venture exchange. The company would then either have to meet the requirements of a NASDAQ or NYSE listing or leave the exchange, presumably for the OTC Markets ATS. This would make the venture exchange a much less attractive place to list in the first place but also quite often force profitable, successful firms that are actively traded from the exchange. This would make it much less likely that the venture exchange would be successful. This defect can be easily remedied through the simple expedient of defining a venture security as the securities of an 'early-stage, growth company' or of any registered company that had total annual gross revenues of less than $1 billion in the previous fiscal year.[41]

The definition of a venture security, if this change is made, would be sufficiently broad – a billion in annual gross revenues or $2 billion in assets – that it would appear to address, as a legal matter, the "adverse selection" concerns that successful firms will quickly graduate to NSADAQ or the NYSE while only less successful firms will remain on the venture exchanges and, therefore, that the venture exchange market come to be thought of as a market populated by either very new and risky firms or relatively unsuccessful firms. By way of comparison, firms at the bottom of the Fortune 1000 have revenues of about $2 billion.[42] It is, of course, quite possible that firms will choose to list on NASDAQ for business reasons and the adverse selection problem will develop in any event.

NASDAQ's lowest tier – the "capital market" -- has three potential ways to meet NASDAQ listing standards: (1) an equity standard, (2) a market value standard and a (3) net income standard. They are all multipart standards. In general, a firm that has been operating for two years, has equity of $5 million and a public float of $15 million will meet the equity standard. A firm with equity of $4 million and a public float of $15 million and a market capitalization of $50 million will meet the market value standard. A firm with equity of $4 million and a public float of $5 million and earnings of $750,000 will meet the earnings standard. There are also requirements as to number of shareholders, number of market makers, number of publicly held shares, share price and corporate governance.[43] It is clear that the contemplated venture exchanges will compete with the NASDAQ capital market tier.

NYSE listing standards are complex, but in general, the NYSE requires firms to have earnings of $10 million annually or a market capitalization of $200 million.[44]

Securities Exchange Act National Securities Exchanges Provisions

Section 6 of the Securities Exchange Act governs national securities exchanges and would, under the draft, govern venture exchanges. In reviewing section 6, I did not find any of its provisions to be problematic for venture exchanges. The SEC retains strong authority over the nature of the

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[41] Rules would have to be provided for venture exchange exit of firms that no longer met the requirement because they exceeded the revenue limitation. There is nothing that says that cannot be handled by rules of the exchange itself or by SEC rule.
[42] MEDNAX, Inc. was ranked no. 998 in 2013 and had revenues of $1.8 billion. http://fortune.com/fortune500/2013/mednax-inc-998/
[43] NASDAQ Initial Listing Guide, January 2015 https://listingcenter.nasdaq.com/assets/initialguide.pdf.
[44] NYSE Listed Company Manual, Section 1, The Listing Process http://nysemanual.nyse.com/LCM/Sections/.

venture exchanges because they must petition the Commission for national securities exchange status.

Covered Securities

Importantly, since venture exchanges are national securities exchanges under the draft, securities listed on a venture exchange would be covered securities under section 18(b)(1)(B) of the Securities Act. However, because section 18(b)(1)(B) of the Securities Act provides that the national securities exchange must have "listing standards that the Commission determines by rule (on its own initiative or on the basis of a petition) are substantially similar to the listing standards applicable to securities" traded on the NYSE or NASDAQ. This latter provision entails the possibility that the SEC may feel bound, or may choose to do so on policy grounds, to require standards that are inappropriate for a venture exchange. Accordingly, I would recommend that the draft be revised to make it clear that large exchange listing standards provisions of subparagraph (B) are inapplicable to venture exchanges.

Regulation NMS

The draft exempts venture exchanges from most of Regulation NMS. This is probably appropriate. It is certainly appropriate for the many aspects of Regulation NMS that are not appropriate in a periodic auction model which may be how venture exchanges choose to trade some of the smallest capitalization companies.

It is not, of course, the case that all of the rules in Regulation NMS should be ignored by a venture exchange. It is, however, likely that the exchange's rules combined with FINRA rules will be adequate. Allowing the exchange to decide many of these issues will provide needed flexibility and room for experimentation. Moreover, different venture exchanges may adopt different competing rules and, as a general proposition, this is likely to be constructive. Having Congress and the SEC try to dictate in advance the proper set of rules in detail is almost certainly a mistake. Moreover, given the slowness of the political process, a mistake by Congress or the SEC could take years to correct and potentially doom the venture exchange experiment. Finally, the SEC will have substantial authority over venture exchange structure and rules by virtue of the petition process.

Section (m)(2)(C) of the draft itself requires venture exchanges to "disseminate last sale and quotation information on terms that are fair and reasonable and not unreasonably discriminatory." This is analogous to the basic requirement of Regulation NMS Rules 601 and 602. A venture exchange is going to have to fashion rules governing customer limit orders, customer account statements, the financial strength and exchange conduct of participating broker-dealers, the role of market makers, and so on.

The draft rejects the provisions of Regulation NMS Rule 612 which requires stocks be priced in increments of one penny. Section (m)(2)(B) of the draft requires pricing increments of at least $0.05. I believe that a larger pricing increment than a penny is almost certainly appropriate in relatively thin markets like those on a venture exchange. However, in general, decisions as to size of the pricing increment should be left to the exchanges.

Regulation ATS

To the extent that Congress seeks to be more prescriptive and impose rules on venture exchanges rather than allow the exchange to adopt its own rules, Regulation ATS is generally a better place to look than Regulation NMS. For example, as a supplement to the requirements of Section (m)(2)(C) of the draft, Congress may want to consider something analogous to the fair access rules in Regulation ATS Rule 301(b)(5) and the record-keeping requirements in Rule 302 (they are logical and benign and something similar would have to be in any exchanges rules). In addition, a comparison of Rule 303 (relating to record preservation requirements) to Regulation NMS Rule 613 may show that Rule 303 is a better model than Rule 613 for venture exchanges.

Regulation SHO

Market makers are instrumental to the marketplace. They provide liquidity by continuously providing both bid and ask quotes (i.e. offers to buy and to sell). For broker-dealers making a market in a less actively traded securities such as OTC securities or those traded on the contemplated venture exchanges, the short sale close-out requirement under Regulation SHO should be relaxed. The relatively short close-out period under 17 CFR §242.204(a)(3) – three days after settlement –makes market makers reluctant to fill substantial buy orders without raising the security's price because of "buy-in risk." Allowing them more time to cover their short positions will lead to less volatility in these less liquid markets. A revised draft should address this issue which, I believe, most market participants regard as problematic in small capitalization stocks.

Some have suggested that broker-dealers should be required to "hard locate" shares to borrow before shorting any security.[45] Although this idea should be evaluated seriously, it may impede the willingess of market-makers to seamlessly fill buy orders.

FINRA

Policy-makers should not forget that the rules of the Financial Industry Regulatory Authority (FINRA) will apply to broker-dealers in connection with their venture exchange transactions. There may be some FINRA rules that need to be modified to accommodate venture exchanges. This needs to be systematically evaluated. On the other hand, FINRA rules will regulate broker-dealers operating on the exchanges and, therefore, there is a need for fewer additional statutory or SEC rules governing the venture exchanges. For example, FINRA Rule 5310 (relating to best execution and interpositioning) imposes duties on broker-dealers to buy or sell so that the resultant price to the customer is as favorable as possible under prevailing market conditions and prohibits interpositioning third parties.

Ownership and Governance

The question of whether it is better for venture exchanges to be member (broker-dealer) owned or investor owned is an interesting and important question. NASDAQ made the transition from

[45] See, e.g., Weild & Kim, op. cit., p. 18.

member ownership to investor ownership in 2000. It is likely that sponsors of venture exchanges will choose different ownership and governance models. It is not clear which approach will be more successful. I do not believe that Congress or the SEC should specify the type of ownership.

Issue Support

It is important that the venture exchange be structured so that broker-dealers can make money by making markets in securities listed on the exchange. Part of the formula will be creating interest in the listed issues, which will require research and analyst coverage. Venture exchanges need to take this into account when adopting their rules and structuring the exchange if they are to be successful. Congress and the SEC, however, should stay out of these decisions. The venture exchanges have a strong interest in getting the balance right and competition from NASDAQ, OTC Markets and others will prevent them from adopting a model that is unfair to investors.

Congress should, however, make it clear in the venture exchange legislation that market maker support programs are permitted (both on the exchanges and in the OTC market) so issuers, if they choose, can compensate broker-dealers for making a market in their stock.

Sarbanes-Oxley

Emerging growth companies are exempt from the Sarbanes-Oxley internal control reporting requirements for five years. These costly requirements should not be applicable to venture exchange listed companies or any reporting companies that are not listed on a national securities exchange.

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Written Statement of Ronald J. Kruszewski, Chairman and CEO, Stifel

on behalf of the Securities Industry and Financial Markets Association

before the Committee on Financial Services

Subcommittee on Capital Markets and Government Sponsored Enterprises

U.S. House of Representatives

May 13, 2015

Chairman Garrett, Ranking Member Maloney, and distinguished members of the Subcommittee, thank you for providing me the opportunity to testify today on behalf of SIFMA[1] and to share our views on such a critically important topic.

To put any discussion of capital formation in context, I would highlight that the U.S. securities industry employs nearly 900,000 people across the country. There are over 4,000 registered broker-dealers with 378,000 financial advisors in 162,000 branch offices, serving clients with over $16 trillion in assets. Those firms, in aggregate, raised $2.4 trillion for businesses and municipalities in the U.S. last year, playing a crucial role in the capital formation that fuels economic growth and job creation. SIFMA member firms participate in nearly all of those underwritings and some 75% of the financing that fuels the American economy comes from our capital markets. For those reasons, the work this Committee is doing to fine-tune and improve our securities laws is important and appropriate.

We applaud your focus on promoting capital formation and decreasing burdensome friction in our securities laws while upholding necessary customer protections. For too long, the pendulum of regulation has been swinging against capital formation without due consideration for the consequences on job creation. Market reforms like decimalization, Sarbanes-Oxley, and various

[1] SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

SEC rulemakings and disclosure requirements have produced benefits for investors but have also resulted in unintended obstacles standing in the way of capital formation and created a "one-size-fits-all" market structure that fails to provide adequate flexibility for small cap issuers. Many of the proposals that SIFMA and the other panelists have been asked to discuss today seek to establish a more common sense balance between investor protection and capital formation. These proposals build on the success of the Jobs Act and on efforts like that by Reps. Duffy and Carney to experiment with wider tick sizes for small cap stocks. We appreciate the opportunity to comment on the bills or discussion drafts before us today and on some of the other proposals that are also currently being debated in this Committee.

Access to Research

SIFMA strongly supports Rep. French Hill's "Fair Access to Investment to Research Act of 2015," which aims to reduce obstacles to the provision of research on exchange traded funds and registered investment companies. Anomalies and conflicts in current regulation result in disparate treatment for research on different types of securities. Rep. Hill's legislation rightfully attempts to rationalize and clarify the securities laws by providing a statutory safe harbor for certain covered ETF research reports and directs the SEC to promulgate rules, as appropriate, for research on other funds under the Investment Company Act of 1940. These two common sense clarifications will facilitate greater access to research on products widely used by investors today and SIFMA urges the Committee to pass this legislation.

Retrospective Review of Existing Regulation

SIFMA has also been asked to discuss a proposal by Congressman Hurt that directs the SEC to review all its significant regulations to determine whether such regulations are necessary in the public interest or whether they should be amended or rescinded. As you may know, in 2011 the SEC invited interested parties to submit comments to assist the Commission in considering the development of a plan for a retrospective review of its regulations. The SEC has sought comment on its rule review process in response to Executive Order 13579, "Regulation and Independent Regulatory Agencies," which states that, to facilitate the review of existing significant regulations, such agencies "should consider how best to promote retrospective analysis of rules that may be outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them in accordance with what has been learned." SIFMA submitted comments at that time and provided suggestions on the process and scope of such reviews. As a threshold matter, SIFMA believes that the SEC should periodically review all of its significant rules and regulations (not just those rules finalized in the last ten years as is the current practice) as most executive branch agencies are required to do pursuant to Executive Order 13563, "Improving Regulation and Regulatory Review." Furthermore, SEC rules that impose a relatively high cost on market participants and investors should be prioritized and reviewed with a frequency that is directly based on the costs and impact of the rule or regulation. In addition to formal SEC rules and regulations, SIFMA believes that any other "standard setting" release, interpretation, "no-action" position or exemption issued by the SEC or its staff must be in scope for the retrospective review. SIFMA believes the SEC should issue a release at the conclusion of its review of each rule that responds to the comments filed and explains why it chose to maintain the existing rule as written, modify the rule, or delay a final decision, pending further analysis or review. We generally support efforts by Congress to ensure that substantive rule reviews by the SEC are conducted on a regular basis. We have yet to see meaningful progress on that review envisioned in the 2011 SEC request for comment. Importantly, we believe regulators increasingly need to review the interplay between the rules and the aggregate effects -rather than just each rule in isolation.

Venture Exchanges

The Discussion Draft put forward by Chairman Garrett would amend the Securities Exchange Act of 1934 to permit the formation of so-called "venture exchanges." SIFMA supports the SEC moving forward with a study of innovative ideas to improve liquidity in small-cap and mid-cap stocks. At the same time, however, robust competition in our equity markets has fueled innovation and it is critical that any changes to market structure for less liquid securities be considered carefully to avoid the unintended consequence of impeding competition in the name of possibly increasing liquidity. SIFMA and its member firms are committed to working with Chairman Garrett to ensure that the legislation establishes a regulatory regime for venture exchanges that is workable and efficient.

RAISE Act

SIFMA is generally supportive of Congressman McHenry's efforts in HR 1830 to codify the long standing uses of 4(a)(1 ½) that have become accepted market practice based on legal precedent and case law. The "Reforming Access for Investments in Startup Enterprises Act," or RAISE Act, is specifically focused on providing a transaction exemption under Section 4 of the Securities Act of 1933 for investor to investor re-sales of unregistered securities. However, 4(a)(1 ½) has additional uses not reflected in this proposal and we would suggest that the bill as constructed is too narrowly focused and fails to provide certainty to the full spectrum of existing 4(a)(1 ½) transactions. For example, the bill specifically does not extend the exemption to dealers. As a result, our members are concerned that the codification of only one aspect of 4(a)(1 ½) could imply that any others uses are unpermitted or could otherwise call them into question.

Again, SIFMA is committed to working with the sponsor of the legislation and with other members of this Committee to ensure that there is a workable solution.

Access to Capital for Emerging Growth Companies

HR 1659, which would modify existing regulation of Emerging Growth Companies (EGCs), is also laudable and SIFMA supports each of the four provisions. Section 1 amends the Securities Act of 1933 to reduce the quiet period requirements from 21 days to 15 days for public filing prior to public offerings by EGC's. Currently, an EGC must file its registration statement publicly and must refrain from marketing the securities through its underwriters or otherwise for 21 days. In theory, this requirement allows for the dissemination, access and review of such information across the broader marketplace before a broker-dealer begins to actively market and solicit orders. In our experience however, this 21-day period is excessively long given the ready online access the public now possesses to such filings. The volatility in our markets can narrow the window of opportunity for an IPO to launch and price successfully and a 21-day quiet period inordinately and unnecessarily restricts an EGC's ability to come to market in a timely manner. We support the reduction in the quiet period as contemplated in the bill.

Sections 2 and 3 of the legislation add clarity and efficiency to two areas of securities regulation without impairing investor protection. Section 2 provides a grace period for a change in status of an EGC by allowing an issuer that qualifies as an EGC at the time of the filing of its confidential registration statement for review to continue to be treated as an EGC through the date on which it consummates its initial public offering. The limitation of the current regulatory construction, which would require the issuer to qualify as an EGC both at the time of confidential submission of the registration statement and at the time the registration statement is publicly filed, risks disincentivizing fast growing companies that could grow out of EGC status in the months required to essentially complete SEC review and make public the registration statement – despite having started the process with the SEC as an EGC.

Section 3 is designed to simplify the financial statement disclosure requirements for EGC's. Currently an EGC must include the previous two years of audited financials when it files its registration statement for review. The time required for SEC review could however cause the EGC to roll into a new fiscal year before it launches its IPO, and as such the relevant two-year period may change. For example, an EGC may file its registration statement in the third or fourth quarter of 2013, and accordingly include in that filing full audited financial statements (and related Management Discussion and Analysis) for 2011 and 2012. If, however, the IPO does not launch until 2014, the 2011 audited financial statements generally would no longer be required for the offering. The cost and effort to create audited financial statements (and related narrative disclosures) for IPO issuers are significant, and is an entirely unnecessary burden for them where those financial statements will not be required to be included in a preliminary prospectus or final prospectus distributed to investors. It is our understanding that other securities regulators (for example, the UK FSA) currently permit the suggested approach.

The last provision in the bill extends the ability for EGC's to file a confidential registration statement not only for their initial public offering but also for a follow-on offering. The JOBS Act provided this confidential filing with a recognition that EGC's do not want to make proprietary information public too early or otherwise prematurely disclose their intention to make an offering—and thereby impair their competitive standing if there is risk that market dynamics or the time required for SEC review may force them to delay (or abandon) an offering. The new provision extends that same reasoning to follow-on offerings so that EGC's are able to derive a similar benefit for those offerings and thus encourage them to engage in further capital raising or sales on behalf of their founding investors.

Merger and Acquisition Broker Bill

Despite our strong support for efforts to enhance capital formation and reduce regulatory burdens, SIFMA has significant concerns about H.R. 686 "the Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2015," which provides an exemption from registration for brokers performing services in connection with the transfer of ownership of privately held and, given the parameters of the bill, large companies, either through a merger with or acquisition by another entity. SIFMA and its member firms are concerned that the legislation could expose small business owners and investors to unnecessary risks without any meaningful benefit from the envisioned increase in competition or reduced regulatory compliance burden.

Many of our member firms operating as registered broker-dealers have helped small businesses successfully navigate change of ownership transactions through their mergers and acquisition ("M&A") practice. These transactions are typically the most significant event in the life of that small, often family-owned business – representing the life's work of the owners and the largest portion of many of the employees' net worth. These changes of ownership transactions can be complex and small businesses tend to rely heavily on their M&A advisor to guide them through this process. Registered broker-dealers are subject to a variety of regulatory requirements that non broker-dealer M&A advisors are not, including, without limitation, regarding (1) anti-money laundering, (2) privacy of customer information, (3) supervisory, reporting and record-keeping requirements, (4) inspections by the SEC and SROs (such as FINRA), (5) supervision and regulation of employees' trading and outside business activities, (6) insider trading, and (7) regulations governing interactions between a broker-dealer's investment banking and research departments. H.R. 686 risks promoting lower standards and less rigor and regulatory oversight in the provisioning of this important advice.

SIFMA is aware that the SEC issued a related No-Action letter in January 2014, shortly after this Committee took action on Congressman Huizenga's legislation. That No-Action letter stemmed from more than a decade of SEC discussion and consideration. Given the long history of SEC evaluation and the thoughtful conditions included in the very recent no-action relief, it seems premature to write a separate form of relief into statute without the benefit of some time for the SEC to observe the consequences of its no-action letter.

Conclusion

The members of this Committee are to be commended for working together in a bipartisan manner to identify problems and develop solutions to improve capital formation and job creation in America. Our robust capital markets distinguish our economy from every other on earth but without consistent attention and improvement, will not be as efficient as possible. SIFMA and its member firms will remain willing partners with this Committee and your colleagues in Congress as you work to get these bills to the President for his signature.

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Statement of the U.S. Chamber of Commerce

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

TO: House Committee on Financial Services

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

DATE: May 13, 2015

1615 H Street NW | Washington, DC | 20062

The U.S. Chamber of Commerce is the world's largest business federation representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations. The Chamber is dedicated to promoting, protecting, and defending America's free enterprise system.

More than 96 percent of Chamber member companies have fewer than 100 employees, and many of the nation's largest companies are also active members. We are therefore cognizant not only of the challenges facing smaller businesses, but also those facing the business community at large.

Besides representing a cross-section of the American business community with respect to the number of employees, major classifications of American business—e.g., manufacturing, retailing, services, construction, wholesalers, and finance—are represented. The Chamber has membership in all 50 states.

The Chamber's international reach is substantial as well. We believe that global interdependence provides opportunities, not threats. In addition to the American Chambers of Commerce abroad, an increasing number of our members engage in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on issues are developed by Chamber members serving on committees, subcommittees, councils, and task forces. Nearly 1,900 businesspeople participate in this process.

May 13, 2015

Chairman Garrett, Ranking Member Maloney, and Members of the Capital Markets and Government Sponsored Enterprises Subcommittee. My name is Tom Quaadman, and I am Vice President of the Center for Capital Markets Competitiveness ("CCMC") at the U.S. Chamber of Commerce ("Chamber"). The Chamber is the world's largest business federation, representing the interests of more than three million businesses of all sizes, sectors, and regions. I appreciate the opportunity to testify before the Subcommittee today on behalf of the business that the Chamber represents.

Business creation, development, and expansion rely on capital markets that are efficient, well regulated, and have an even playing field for participants. Such well-functioning markets create conditions conducive to growth and sound investor decision making processes. It is an important priority of the Chamber that public policy facilitates effective capital formation to ensure that the United States has the long-term economic growth needed to create jobs. We commend the continued bi-partisan leadership of this subcommittee to achieving these goals.

Policies impacting efficient capital markets take many forms and public company creation is an integral component of a vibrant free enterprise economy. The Jumpstart Our Business Startups Act ("JOBS Act") was an important milestone in updating regulations that were outmoded because of time and changes in market conditions. The United States is starting to see some of the benefits of the JOBS Act and others, such as the European Union, are looking to emulate some of those changes. But more needs to be done. Recent hearings of this subcommittee and the Senate Securities, Insurance and Investment Subcommittee have focused on bills that can further improve on the foundation of the JOBS Act.

These draft bills, which are the subject of today's hearing, would continue that building process and also put in place permanent measures to allow America'sregulatory structure to evolve with the dynamics of the marketplace. The Chamber supports these legislative proposals and I will offer some constructive changes as I discuss these proposals in greater detail.

I. Legislative Proposals

a. **To direct the Securities and Exchange Commission to review all of its significant regulations to determine whether such regulations are necessary in the public interest or whether such regulations should be amended or rescinded.**

In 2009, the Chamber released the report ***Examining the Efficiency and Effectiveness of the U.S. Securities and Exchange Commission***. This was followed in 2011, with the release of a second report: ***U.S. Securities and Exchange Commission: A Roadmap for Transformational Reform***. These reports made 51 recommendations to fundamentally reform the SEC with the goal of restoring it as the world's premier financial services regulator.[1] The Chamber will issue a third reform report shortly on SEC enforcement policies.

The 2011 SEC reform report made a recommendation on a look back of regulations after adoption to address unforeseen consequences:

> The Commission should adopt a regulatory look-back requirement whenever it adopts a "Major Rule" as defined in the Small Business Regulatory Enforcement Fairness Act ("SBREFA").

On January 18, 2011, President Barack Obama issued Executive Order 13563 ("Improving Regulation and Regulatory Review") which reaffirmed, for executive agencies, regulatory principles and rulemaking processes that include an enhanced process for examining the costs and benefits of proposed rules and their alternatives, as well as the necessity of a rule to achieve regulatory goals. In addition, Executive Order 13563 ordered executive agencies to conduct a retrospective review of existing regulations to determine how such regulations can be improved.

On February 1, 2011, Chamber President and CEO Tom Donohue wrote a letter to all independent agencies and then SEC Chair Mary Schapiro requesting that the SEC voluntarily conduct a review of its existing regulations consistent with Executive Order 13563. Following that letter, on July 11, 2011, the President issued Executive Order 13579 ("Regulation and Independent Regulatory Agencies"), which states that independent regulatory agencies, no less than executive agencies, should abide by the heightened regulatory standards of Executive Order 13563. While Executive Order 13579 does not explicitly require the SEC to conduct a retrospective

[1] These two SEC reform reports can be found at: http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/ExaminingtheSECrdcfinal.pdf and http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/16967_SECReport_FullReport_final.pdf

review, the SEC stated that it would voluntarily adopt this process to improve upon the way that reviews of existing regulations are conducted.

Unfortunately, such a retrospective review has not been meaningful, rigorous or conducted in a positive manner.

The major issues in the JOBS Act and many that have been raised in the context of a JOBS Act 2.0 were within the competence of the SEC to update independently. In other words, had a regulatory review process, such as envisioned by the draft bill or the President's executive order, been in place, Congress and the Administration would not have had to step in. Unfortunately, legislation is needed to build out a meaningful retrospective review process that can identify obsolete regulations that may in fact be harmful to an efficient capital market. Through this legislative proposal, regulations that fail to meet the public interest can be amended, modernized or if need be taken off the books.

Unfortunately, without legislation, the 2011 retrospective review went nowhere, while the current efforts on Disclosure Effectiveness—updating corporate disclosures to provide investors with meaningful decision useful information—is threatened by bureaucratic inertia.

The periodic structure of the draft bill and reports to Congress are critical to keeping the SEC's feet to the fire. However, we believe that four changes to the bill can make it even more effective.

First, mandate that the retrospective review first prioritize those rules that are economically significant under the Small Business Regulatory Enforcement Fairness Act. This would allow the SEC to focus on regulations that cost the economy more than $100 million.

Second, mandate that the retrospective review next prioritize those rules that have numerical thresholds that have not been adjusted in over 20 years. This would allow the SEC to focus on issues, such as the Rule 701 thresholds, where limits need to be changed to reflect inflation and fluctuations in the markets. Or if adjustments are not needed, explain why they should not be made.

Third, mandate that the retrospective review allow for public and notice comment as required under the Administrative Procedures Act. This would allow for all stakeholders to provide the SEC with meaningful comment that can help achieve the goals of the draft bill.

Fourth, the retrospective review should also be expanded to include those organizations delegated by the SEC to adopt rules that have a significant impact on the marketplace.

The Chamber believes that this draft bill and these suggested changes would ensure that the SEC adopt to ever changing dynamic markets and that its regulatory structure is periodically updated to meet its goals of investor protection and promotion of competition and capital formation.

b. The Main Street Growth Act

The draft Main Street Growth Act would provide a process to establish venture exchanges. The establishment of a venture exchange could be a welcome development to provide businesses in the formative stages of the public company process with liquidity opportunities that may not otherwise exist. Similarly, this innovation could also provide competition with existing systems, such as the Over the Counter ("OTC") markets and Alternative Trading Systems ("ATS"), that again may lead to increased liquidity for these growing companies.

However, even if successful, these markets, by operation, would be more thinly traded than the more robust existing equity markets. Accordingly, we believe that the legislation should be less prescriptive and allow both the SEC and exchanges the flexibility to create venture exchanges that can best compete and achieve its goals.

Several challenges exist in this regard. This bill would require trading to be in increments of a nickel and not be required to use decimal pricing. This runs counter to the tick size pilot program that the SEC recently approved. Effectively, this bill is making a choice before the results are in. Additionally, because of the thin margins, the appetite for market data may be scarce making it harder and more costly to provide information. Exchanges should be given the flexibility to develop systems that fit their ability to bring investors and businesses together on a transparent basis, starting with the need for venture market legislation to allow an exchange to use a separate license to serve this market or elect to use a special listings tier within their existing exchange license as their venture offering.

Finally, we also believe that a requirement should be put in place for retrospective and prospective studies. First, the SEC should examine similar efforts that have been tried in the United States and abroad with varying levels of success. The SEC should study and evaluate these past efforts, and determine what worked or did not work, thereby generating data that may be useful to making venture exchanges successful. Secondly, a prospective review could evaluate venture exchanges, OTC and ATS systems, by a date certain to determine if liquidity is being provided to formative companies.

Both of these studies would allow for an ongoing evaluative process to study the holistic nature of these markets and if venture exchanges and ATS are successful in providing businesses with resources and investors with appropriate information, protections and returns. Such a process would allow the SEC and Congress to know if venture exchanges and other markets are successful, or if changes to the larger system are needed.

At its core, this bill has the potential to create more competition that if done right will benefit businesses and investors alike.

c. The Fair Access to Investment Research Act of 2015

Financial markets are ever evolving providing new opportunities for investors to achieve a potential return and businesses to raise capital. Exchange traded funds ("ETFs") are index based securities. While ETFs are not directly connected to business capital formation, they have important secondary impacts that provide for business capital formation. In other words, ETFs are important to a well function and liquid efficient capital market.

However, existing impediments prevent investors from obtaining decision useful information regarding ETFs or for these investment vehicles to achieve their potential. Under the Exchange Acts, broker-dealers currently have safe harbors to public research on equity offerings. However, ETFs and open-ended funds do not have similar specific safe harbors, thereby causing enough legal vagueness to restrict information and research that may be helpful to investors. Despite receiving comments supporting an extension of the safe harbor rules to ETFs and open ended funds, the SEC has not adopted a final rule.

This common-sense bill would extend this safe harbor to ETFs and open-ended funds providing investors with more information and improving the efficiency of the overall capital markets.

d. The Accelerating Access to Capital Act of 2015

This draft bill would revise form S-3 and liberalize the offering of securities to accelerate the ability of a business to become a public company. The Chamber has supported this concept before, namely H.R. 4568, the Small Business Freedom to Grow Act of 2014, in the last Congress. This bill would also modernize the use of

Form S-3 and allow smaller issuers to take advantage of the simplified registration statement.

This has been included in the past recommendations of the SEC's own Government-Business Forum on Small Business Capital Formation, held annually at SEC headquarters. Like many other recommendations produced every year at the forum, the SEC has failed to act to modernize registration statements, so Congress has an important role to play to modernize rules, help business gain access to public capital markets and accelerate public company formation.

II. Conclusion

The Chamber views these draft bills, along with our proposed improvements, as critical steps to try new and innovative ideas and give our regulatory system the ability to adopt and fulfill its mission in changing times. Therefore, the items under consideration not only address specific issues that can be corrected, it also allows for experimentation and sustained efforts to modernize regulations.

Taken together these draft bills and the other legislative proposals from the April 29, 2015 hearing would provide a basis to allow entrepreneurs to create new businesses, give investors more information and new ways to invest, and regulators the means to have better oversight of the capital markets. This is a public policy trifecta needed to give businesses the ability to grow and stay competitive while creating new jobs.

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

WEILD&CO.

Hearing on Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens, Part II

Statement of David Weild, Founder, Chairman & CEO of Weild & Co., Inc.,
before the U.S. House of Representatives Financial Services Committee, Capital Markets and Government Sponsored Enterprises Subcommittee, May 13, 2015.

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Introduction

Chairman Garrett, Ranking Member Maloney and members of the Subcommittee, thank you for again inviting me to speak at this important hearing. My name is David Weild. I am Chairman & CEO of Weild & Co., which we founded to improve equity capital formation and support for corporate issuers and their investors. As many of you know, I was formerly vice chairman of The NASDAQ Stock Market with responsibility for all of its listed companies, and I ran the equity new issues business of Prudential Securities, back when Prudential Securities was one of the ten largest underwriters of new issues equities in the United States. We've written extensively on capital formation and recently appeared before the G-20, the Securities & Exchange Commission's Advisory Committee on Small & Emerging Companies and have authored work for the Organization of Economic Cooperation and Development ("OECD") entitled, "Making Stock Markets Work to Support Economic Growth."

The Need for Venture Exchanges

Improving access to equity capital in the United States is, we believe, still a critical need for our economy. Small companies are the job creators of our economy and small companies are started with equity capital – not debt. For all the quantitative easing of the Federal Reserve, banks won't lend to small businesses on the scale necessary until we improve their access to equity capital. For all the good work that this Subcommittee has done – including The JOBS Act and the recently announced SEC Tick Size Pilot - we still have not answered the question that former Democratic Senator Ted Kaufman posed from the floor of the U.S. Senate in 2009, namely, "How can we create a market structure that works for a $25 million IPO — both in the offering and the secondary aftermarket. If we can answer that question, Mr. President, this country will be back in business."[1]

The "Main Street Growth Act," which would establish a new class of stock exchanges catering to the needs of small cap companies, has the potential, with some modifications, to get this country back in business. It has the potential to go down as one of the most important Acts to come out of this, or any, Congress by creating essential infrastructure in support of U.S. economic growth. It has the potential to bring back American entrepreneurial swagger and to reignite the American Dream. It has the potential to create jobs on a scale that will improve labor participation rates and hourly wages and help lift many middle class and lower income people to reach their aspirations of financial well-being.

When corporations access capital they hire people. Those people spend money in the economy on everything from lawyers and accountants to construction and restaurant workers - a "multiplier effect" is created. The benefits become widespread.

The Subcommittee through its work on The JOBS Act and Tick Sizes has done much with the SEC to lay the groundwork to improve equity capital formation. However, the data shows that while small business and IPO activity has improved modestly, it still has a long ways to go. What is needed, is an institutional solution – Venture Exchanges – to an institutionalized problem:

- The economist Robert Litan recently wrote in Foreign Affairs that "In 1978, start-ups—defined in the database as companies less than a year old—accounted for nearly 15 percent of all U.S. firms; by 2011, that figure had slipped to just eight percent. For the first time in three decades, business deaths exceeded business births."[2]
- In our earlier work[3], we concluded that the collapse of aftermarket economic incentives to support small cap companies, brought on by Reg. ATS in 1998, precipitated a collapse in the ecosystem of dealers and in turn the small IPO market. As a result,

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[1] See http://green.lib.udel.edu/webarchives/kaufman.senate.gov/press/press_releases/release/-id=352c7e34-1cad-4ad3-b31c-c267bd492d1a.htm

[2] *Foreign Affairs,* January/February 2015, "Start-Up Slowdown: How the United States Can Regain Its Entrepreneurial Edge" *By Robert Litan*

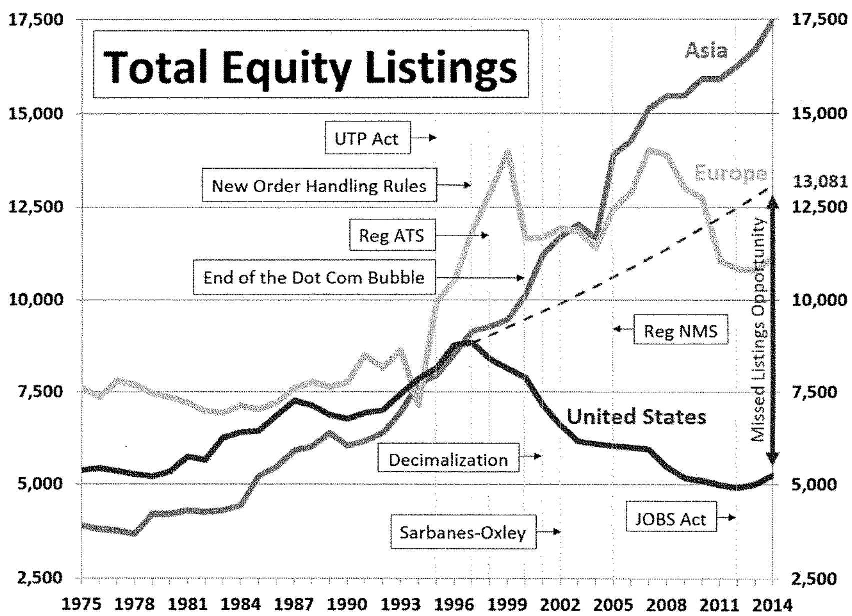
[3] See "Market structure is causing the IPO crisis – and more" by Weild & Kim (Grant Thornton – 2010) and "The U.S. Need for Venture Exchanges" by Weild & Kim (Weild & Co. – 2015).

- The U.S. has averaged only 150 IPOs per year since 2000 versus what was 500 IPOs a year prior to the Dot Com Bubble and should be 950 IPOs a year on today's larger economy.
- The number of small IPO book running managers collapsed from 164 book runners in 1994 to only 31 for all of 2014. Of the 164 book running investment banks in existence in 1994, only 34 of these firms are in existence today.

The Main Street Growth Act (Recommendations)

U.S. stock markets have become one-size-fits-all stock markets optimized to trade large cap stocks. The structure and rules have been a disaster for small cap companies, entrepreneurship and job creation. The "Main Street Growth Act" would change this by establishing a second stock market structure – one allowing its sponsors broad discretion in addressing the needs of small-cap companies, their investors, and the ecosystem of value providers – broker-dealers, research providers and market makers - needed to support them. This is a noble and important Act for the American people and deserves the attention and support of both parties.

The United States once had a very successful venture exchange that gave us companies like Intel, Microsoft, Staples and Starbucks. That venture exchange was called the National Association of Securities Dealers Automated Quotation System or the original "NASDAQ." The "Main Street Growth Act" proposes to allow "Venture Exchanges" to write rules that would be exempt from many of the very changes that caused NASDAQ to quote stocks in penny increments and cater to High-Frequency Traders. This Act establishes a clean canvas on which Venture Exchanges would be able to "paint" solutions designed to meet the needs of small cap growth companies and their investors.



Sources: Weild & Co., World Federation of Exchanges, CFA Institute

My primary concern is that the Act does not go far enough: Many currently public companies are struggling against the current market structure. With that in mind, we offer the following improvements for inclusion in the current Act:

1) **Venture Exchanges should be opened up to all currently reporting (SEC registered) U.S. companies that are under $2 billion in equity market value <u>or</u> have less than $1 billion in revenue and are public for 5 years or less.** Many public companies are struggling to find research coverage and real market making support under the current one-size fits all stock market regime. Not allowing already public companies to have a choice in listing (trading) venue is not fair to those companies and their investors. A venture exchange could help already public companies attract new investors, attract research coverage, improve share prices and lower the cost of growth capital.
2) **Create an orderly transition for companies to graduate from a Venture Exchange – Companies should be permitted to stay on a venture exchange until they have exceeded some higher threshold (say $2.5 billion) for twelve consecutive months.** Stocks frequently trade above and below thresholds – especially in bull markets. Higher prices must be sustainable and there must be a seasoning or "grace" period to allow companies to prepare for a transition and to prepare shareholders for that transition.
3) **Explicitly permit broker-dealer member-owned venture exchanges.** The profitability of the ecosystem of broker-dealers will determine the success of venture exchanges. Stock exchange profitability is much less important than dealer profitability because it is the dealers, and not the exchanges, that support small-cap stocks. In our research, we spoke to participants in the London AIM market, the Toronto TSX Venture Exchange and the Frankfurt Neuer Markt. These markets experienced problems when stock exchange profitability was put ahead of the needs of the dealer system. For this reason, we believe that the most successful model will be one that embraces member-owned exchanges.
4) **Finally, we recommend that listing thresholds be adjusted annually for inflation.**

Benefits to Consumers, Investors and the Poor

Consumers, Investors and the Poor are all indirectly harmed by low-cost, one-size-fits-all stock markets. This is what we refer to as the *"Low-Cost Paradox"* of small-cap markets: Large cap markets are naturally liquid. They don't depend on intermediaries. In this case, low-cost trading benefits consumers. However, small-cap markets are naturally illiquid. Without intermediaries to provide research, marketing, and capital commitment to support liquidity, small-cap markets deteriorate. The lack of sufficient aftermarket economic incentives causes broker-dealers to pull out from these markets. As a result, the capacity to take companies public declines, and share prices decline (through lack of support) harming investors as institutional investors shift capital allocations away from small cap illiquid stocks to large cap naturally liquid stocks.

Stock markets should not be looked at through the lens of other consumer-oriented businesses. They are unlike other products and services because the proper functioning of small-cap stock markets is essential to support access to capital, job creation, economic growth and the very competition from which consumers will benefit broadly throughout the economy.

How do consumers, investors and the poor indirectly benefit from by higher economic incentives? Bear with me, because this many be counterintuitive:

Consumers Benefit

Consumers benefit as more companies are able to access equity capital. More new companies means more competition and innovation. More competition and innovation means consumers benefit. Thus, the apparently simple, unarguable benefit of low cost trading has paradoxically harmed the consumer by causing a collapse in the capital formation infrastructure of our economy.

Venture Exchanges, by improving access to equity capital, will support the scientists, engineers and entrepreneurs who will find cures to cancer, global warming and the other great challenges we face.

Investors Benefit

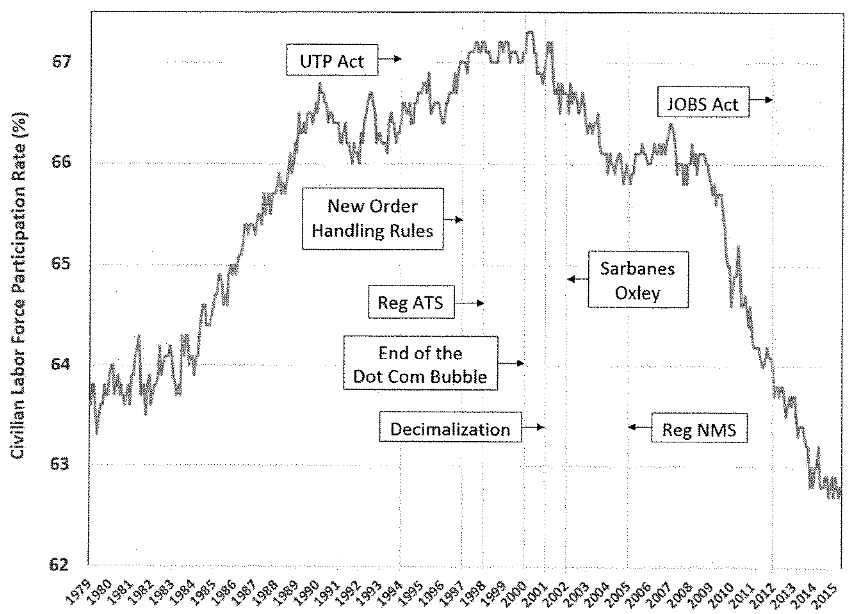
Long-term investment returns are dependent on long-term economic growth. The trajectory of long-term economic growth can be tilted upward by improving the rate at which start-ups are created and by improving the rate at which companies go public to free up more equity capital for investors to reinvest and start new companies – thereby creating a so-called "Virtuous circle."

The Poor Benefit

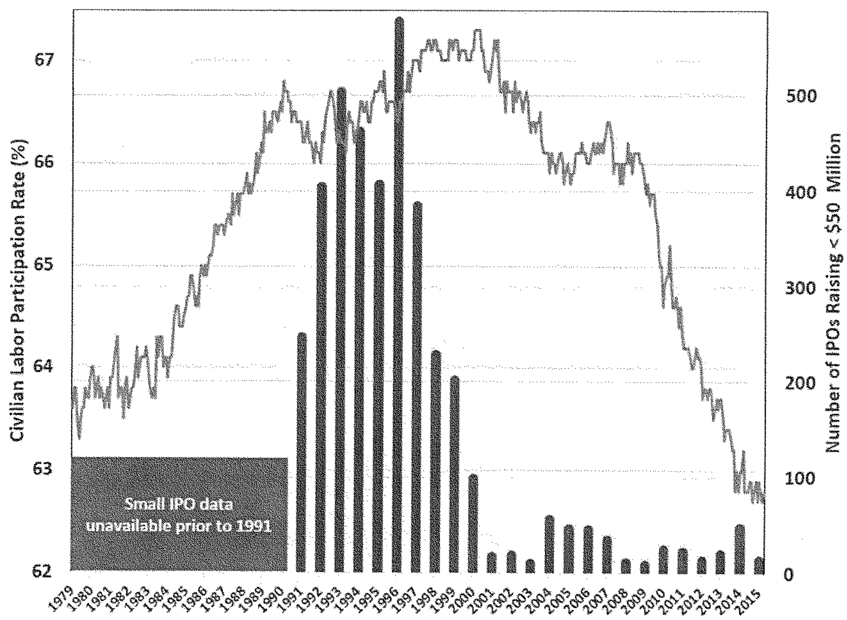
It is very clear that labor participation rates for 16 to 19 year olds, and 25 to 54 year olds – workers in their prime – have been declining since roughly the time that the bottom fell out of the small IPO market. It is also clear that workers of retirement age – 65 and older – are holding onto their jobs longer. The two trends combined – young workers working less and old workers working more – is a sign of a job market and economy under stress. I have said this to members of the Black Caucus and I will repeat it here – African Americans according to the Pew Institute, have an average net worth of somewhat more than $11,000 as of 2013. They are not day-trading stocks, as they simply do not have enough money to be invested in the stock market. Thus, they derive no personal benefit from low-cost trading. But poor people do need jobs. They need higher wages. And these are things that venture exchanges and the "Main Street Growth Act" can bring, in time.

Overall U.S. labor participation rates are now below where they were in 1979.

Labor participation rates stalled when aftermarket incentives were collapsed by Reg. ATS in 1998 and the bottom dropped out of the small IPO market. We believe the two (labor participation rates and the loss of the small IPO) are to some degree related.



Source: US Bureau of Labor Statistics. Seasonally adjusted.

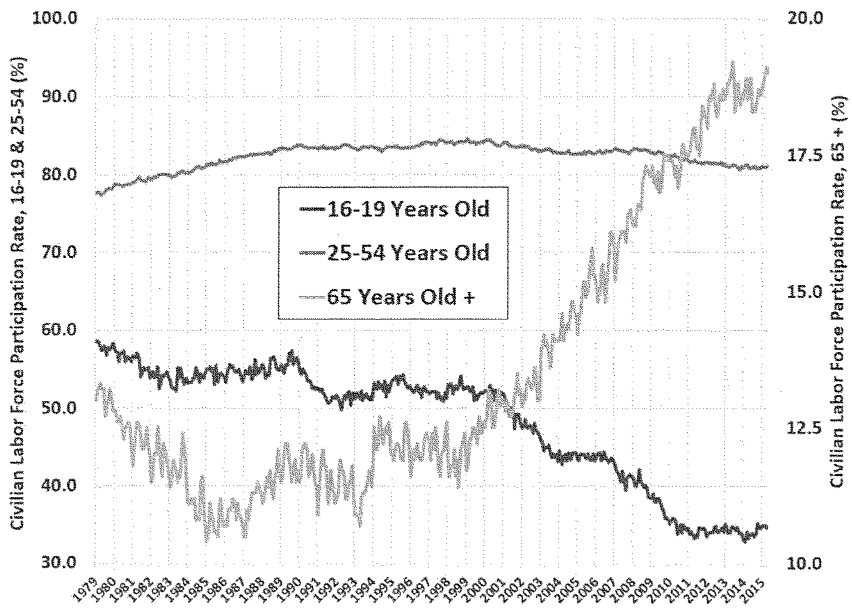


Sources: Labor data from US Bureau of Labor Statistics, seasonally adjusted. Transaction data from Weild & Co. and Dealogic, corporate IPOs only, excluding closed-end funds, REITs, SPACs and other financial vehicles.

Labor participation rates for young people (16-19) and people in their prime (25-54) have declined significantly since the late '90s.

The only segment of the population seeing a steady increase in labor participation rates is workers over retirement age (65+) – A sign, we believe, that older workers can't afford to retire.

Venture exchanges through the "Main Street Growth Act" will help reverse these disturbing trends.



Source: US Bureau of Labor Statistics. Data for 16-19 year olds and 25-54 year olds is seasonally adjusted.

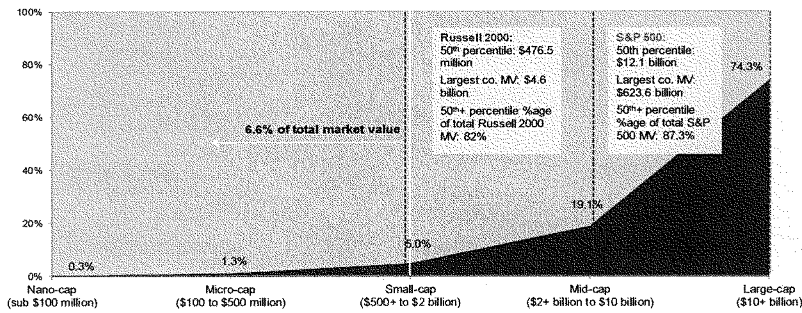
A vibrant capital market is the engine of a healthy economy that creates jobs. We estimate that, if not for the scarcity in public offerings, 3.1 million to 9.4 million additional U.S. jobs might have been created by companies after going public. If we assume a multiplier effect where higher IPO activity accounts for a like-kind number of jobs created in the private market (a conservative effect of only one for one), the range of 3.1 million to 9.4 million jobs created jumps to between 6.2 million and 18.8 million.

A major contributor to employment

In fact, the so-called multiplier effect may be much larger than we estimate above. Enrico Moretti, Professor of Economics at Berkeley, has estimated that as many as five local service sector jobs — ranging from doctors and teachers to wait staff and sales clerks — are created for every one technology and biotechnology sector job produced. These are the very industries that once sought out public offerings as their preferred strategy to raise capital (and exit). This five-to- one ratio of job formation has served to increase the number of employment opportunities at all skill levels and, ultimately, the U.S. standard of living.

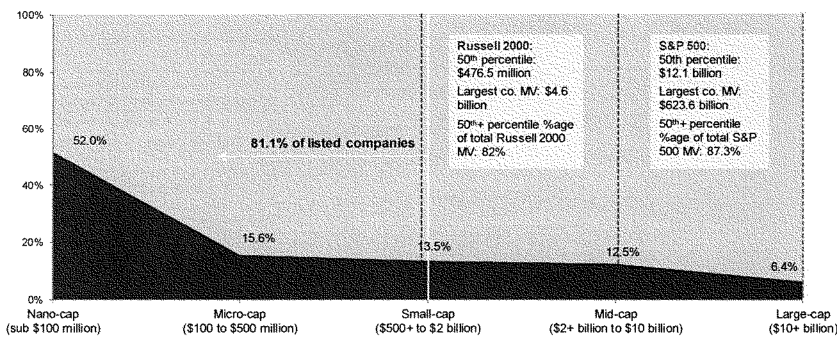
Sub $2 billion market value public companies represent a small percentage of total stock market market value yet drive most job growth (directly or indirectly).

● Percentage of total public company market value



Sources: IssuWorks and Capital IQ
Includes NASDAQ, NYSE (including AMEX) and OTC listings. Corporate issuers only, excluding holding companies, funds, MLPs, SPACs, REITs and other trusts.

● Percentage of total number of listed companies



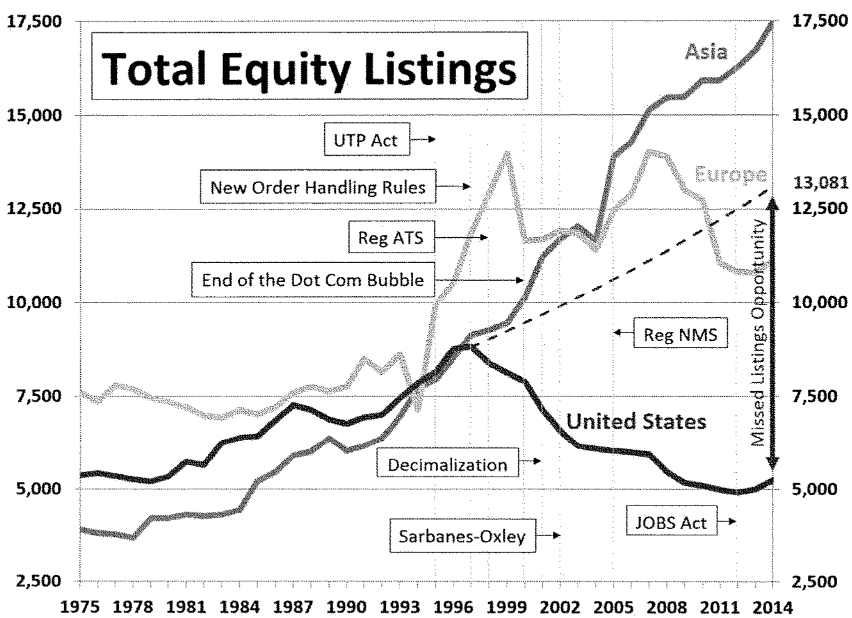
Sources: IssuWorks and Capital IQ
Includes NASDAQ, NYSE (including AMEX) and OTC listings. Corporate issuers only, excluding holding companies, funds, MLPs, SPACs, REITs and other trusts.

Specific responses to legislative proposals

H.R.____, the "Main Street Growth Act" (Chairman Garrett)

We support this Bill with enhancements as outlined above. This is an essential Bill for its potential to improve capital formation broadly and to create jobs in the United States. Our listed stock markets are in the midst of a long-term and protracted collapse which has been self-inflicted. As seen from data originally compiled by the CFA Institute's Jason Voss, the United States today has fewer publicly listed companies than we did at any point since 1975 (see Figure 1).

Figure 1: U.S. stock market listings have collapsed since 1997
The United States has just over 5,000 listed companies when it should have over 13,000.



Source: Weild & Co., World Federation of Exchanges, CFA Institute

In fact, we have slightly more than 5,000 publicly listed companies, when we should have more than 13,000 public companies, but for the fact that changes to market structure gutted the aftermarket support model in 1997 with the implementation of the Order Handling Rules followed by the shift to electronic markets in 1998 with Regulation ATS (Alternative Trading Systems) and one-size-fits-all penny stock trading in 2001 with "Decimalization."

H.R._____, the "Fair Access to Investment Research Act of 2015."

We abstain from comment on this bill. ETF research is not our area of expertise.

However, we would hasten to point out that ETFs are now a more than $3 trillion AUM industry. As ETFs (and other Index Funds) grow compared to actively managed mutual funds and direct stock ownership, they will close off an increasing percentage of equity capital from corporate America.

We urge Congress to consider requiring that all ETFs create a mechanism to participate in equity new issues so that ETFs can not undermine capital formation and economic growth.

H.R._____, To direct the Securities and Exchange Commission to review all its significant regulations to determine whether such regulations are necessary in the public interest or whether such reguolations shold be amended or rescinded.

We support this bill. As a general principle, we are supportive of most measures in government that require the scheduled, but not-too-frequent and burdensome, review and determination of whether each regulation is no longer necessary in the public interest or is outmoded, inneffective, insufficent or excessively burdensome.

H.R._____, the "Accelerating Access to Capital Act of 2015."

We support this bill. It appears to accelerate the availability of Form S-3 "Shelf Registrations" for public companies. The combination of short-selling and penny tick sizes has made it easier for predatory hedge funds to put pressure on stock prices ahead of an offering. Thus, the flexibility, speed and costs savings afforded by Form S-3 "Shelf Registrations" helps corporate issuers to improve their cost of equity capital.

We would also support the expansion of Form S-3 and other shelf registration approaches to improve access to capital for smaller public companies that are current with their SEC filings.

Conclusion

In our work for the Organization of Economic Cooperation and Development (OECD), we examined IPO markets throughout the world. It became obvious to us that the incentives and disincentives created by governments and regulators are the major determinant of the success (or lack thereof) of small IPO markets (and the aftermarket). The inescapable conclusion is that the collapse of the small IPO market in the United States was caused by ill-conceived and nearsighted public policy and that it can be rectified by improved and farsighted public policy that includes the creation of a regime designed to meet the very different needs of small-cap public companies. Intelligently designed "Venture Exchanges" would create a foundation for a resurgence in entrepreneurship, innovation and job creation. We believe that, once established and after perhaps a decade of operation, Venture Exchanges would lead to the creation directly (by companies accessing and investing capital) and indirectly ("muliplier effect" of jobs being created in the service sector of the economy because of the money spent by these companies and their employees) of 10 million jobs for the U.S. economy.

The ability of the United States to sustain itself as a world leader may rest on our ability to reverse the decades long trend of lower company start-up rates and lower IPO rates. Higher levels of entrepreneurship are the bedrock of a vibrant economy. The creation of Venture Exchanges, and the natural advocacy for entrepreneurship that would emerge from these exchanges, is one of the single most important actions that policy leaders can take to reignite the American Dream and restore America's position as the "Capital market envied by capital markets throughout the world."

About David Weild

David is the Chairman & CEO of Weild & Co., which he recently founded to create technologies and services to improve equity capital formation and aftermarket support. Weild & Co., Inc. owns Weild Capital, LLC. (Formerly IssuWorks Capital), a FINRA-registered broker-dealer.

Experience

David is an internationally recognized expert in how market structure affects capital formation. His work has been cited by academics, regulators and lawmakers in the US and overseas and the IPO Task Force Report to the U.S. Treasury. He was the former vice-chairman and executive vice-president of The NASDAQ Stock Market, with oversight of the more than 4,000 listed companies. Prior to NASDAQ, he spent 14 years at Prudential Securities in a number of senior management roles, including president of ecommerce, head of corporate finance, head of technology investment banking and head of equity capital markets in New York, London and Tokyo. He worked on more than 1,000 IPOs, follow-on offerings and convertible transactions and was an innovator of new issue systems and securities underwriting structures, including the use of Form S-3s to mitigate risk for small capitalization companies raising equity and convertible debt capital. He created the Market Intelligence Desk — or MID — while at NASDAQ to support issuers in their quest to better understand what was impacting trading in their stocks.

Education

David holds an MBA from the Stern School of Business and a BA from Wesleyan University. He has studied on exchange at The Sorbonne, Ecole des Haute Etudes Commerciales and The Stockholm School of Economics.

Industry participation

David has participated in the NYSE's and National Venture Capital Association's Blue Ribbon Regional Task Force to explore ways to help restore a vibrant IPO market and keep innovation flourishing in the United States, and is Chairman of the International Stock Exchange Executives Emeriti (ISEEE) Small Business Financing Crisis Task Force. He has spoken at the G-20 in Istanbul and the OECD (Organisation for Economic Co-operation and Development) with the 35 member nations in attendance, plus the European Commission and the IOSCO (International Organization of Securities Commissions). David testified before the CFTC-SEC Joint Panel on Emerging Regulatory Issues in the wake of the May 2010 flash crash, and has spoken at the SEC a number of times, including the SEC Small Business Forum, the

SEC Advisory Committee on Small and Emerging Companies and the SEC Roundtable on Decimalization. David is often interviewed by the financial news media. He has served as a Director of the National Investor Relations Institute's New York chapter, and he is the Chairman of the Board of Tuesday's Children, the non-profit that serves 9/11 families, and recently expanded its charter to make its long-term programs available to first responders, wounded warriors, families of the fallen and those touched by other acts of political and apolitical terrorism (e.g., Newtown).

Publications

David and Edward Kim have co-authored a number of studies, including *The U.S. Need for Venture Exchanges* published by Weild & Co. in March of 2015, *The trouble with small tick sizes: Larger tick sizes will bring back capital formation, jobs and investor confidence (Grant Thornton)* (with Lisa Newport) in 2012 and *Why are IPOs in the ICU? (Grant Thornton)* in 2008. Released in the fall of 2009, *Market structure is causing the IPO crisis (Grant Thornton)* (updated by *Market structure is causing the IPO crisis — and more* in 2010) and *A wake-up call for America (Grant Thornton)* have been entered into the Congressional Record and the Federal Register. They also authored *Making Stock Markets Work to Support Economic Growth (OECD)* (with Lisa Newport) and the chapter, *Killing the Stock Market That Laid the Golden Eggs (FT Press)* in the recent book on high frequency and predatory practices entitled, *Broken Markets,* by Sal Arnuk & Joseph Saluzzi, published in May 2012.

The *Wall Street Journal* published an Op-ed by David Weild entitled, *How to revive small-cap IPOs* on October 27, 2011. This Op-ed called for the establishment of small-cap (venture) exchanges.

I would like to thank Edward Kim, my partner and co-author, for his many contributions to this work.

About Weild & Co.

Weild & Co. is developing next generation equity distribution and aftermarket support platforms to improve new issue performance and revitalize capital formation. Weild & Co.'s goal is to help investment banks, issuers, and the venture capital and private equity communities drive superior results by reducing the cost and complexity of new issue preparation while improving the distribution and aftermarket support of new issues. The combined effect will keep IPO "windows" open longer, resulting in higher throughput (more new issues).

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The U.S. Need For Venture Exchanges

Recommendations for the creation of Congressionally-mandated stock exchanges designed to support small-cap companies and their investors and provide the necessary infrastructure to support a resurgence in innovation, job growth and the American Dream.

March 4, 2015

By David Weild and Edward Kim

WEILD&CO.

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Executive Summary

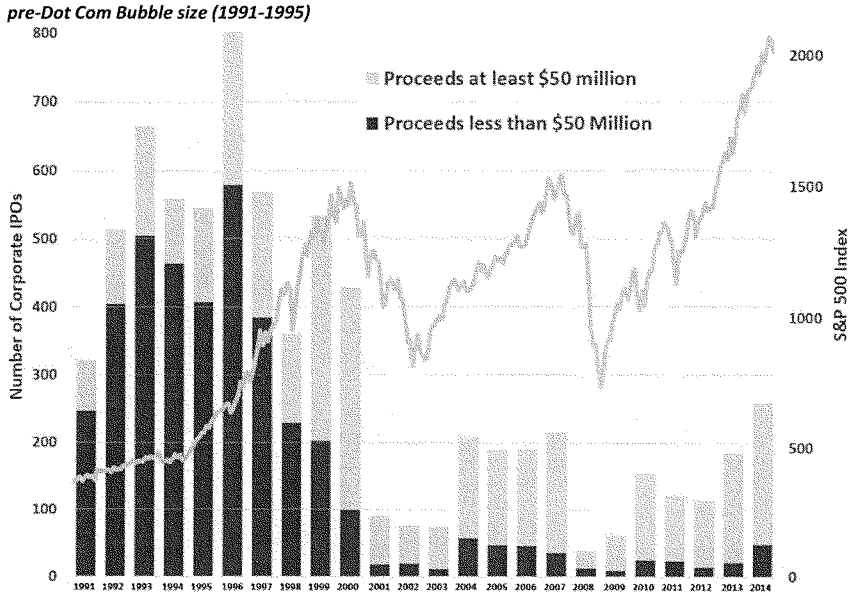
The United States needs a "Venture Exchange" construct that will expand access to capital for entrepreneurs, enable earlier public participation in the company life-cycle, and attract aftermarket support (e.g. research, sales and capital commitment by market makers). One-size-fits-all-stock markets, optimized for large cap trading, have been a significant growth deterrent in the U.S., causing a dramatic and abrupt decline in small IPOs. The U.S. fell from 1st place to 12th in small IPO output behind many smaller economies, and fell to 24th out of 26th in small IPO output on a GDP-weighted basis ahead of only Mexico and Brazil[1] dating back to the 1990s and the widespread adoption of low-cost electronic markets. Certain foreign markets have benefited from their regulators and legislators recognizing the fundamentally different needs of small cap stocks by creating entirely separate markets (what the authors refer to as "Small-cap" or "Venture" exchanges) that embrace lower-cost disclosure models and and higher per share market-making incentives. The authors make recommendations for legislators convinced that the United States can reestablish the small IPO market and its associated ecosystem to its former luster as "The stock market that was the envy of stock markets across the world."

[1] *Making Stock Markets Work to Support Economic Growth: Implications for Governments, Regulators, Stock Exchanges, Corporate Issuers and their Investors*, by Weild, Kim & Newport, OECD Publishing (Organization of Economic Cooperation and Development), July 2013. See http://www.oecd-ilibrary.org/governance/making-stock-markets-work-to-support-economic-growth_5k43m4p6ccs3-en

Need for Dedicated Small-Cap (Venture) Exchanges

While pundits are popping champagne corks in celebration of the best IPO market since the dot com bubble ended in 2000, we sound a note of alarm: While 2014 was the best IPO market in 14 years, it generated fewer IPOs than what is required to stop the U.S. listed markets from shrinking. There were 284 operating company IPOs in 2014 – a pitiful number for a 'bull market' (see stock chart below). It takes 360 new listings per year for U.S. stock markets to break even[2] and it takes 520 IPOs a year to keep up with 3% GDP growth rates.[3] We have the largest economy in the world. On a GDP weighted basis, if the United States was performing at the level of some of the better markets (e.g. Canada, U.K., Singapore), the United States would be enjoying an average of 950 IPOs a year. We estimate that the difference between the number of IPOs that we have been doing since 2001 (approx. 150 per year), and what we believe we should be doing (upwards of 950 per year) is worth an incremental 10 million jobs to the U.S. economy.

Despite major bull markets from 2002-2007 and 2010-2014, the IPO market has not recovered to its pre-Dot Com Bubble size (1991-1995)



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[2] Exhibit 10, page 12, *A wake-up call for America*, by Weild & Kim, published by Grant Thornton, November 2009. See https://www.grantthornton.com/staticfiles/GTCom/Public%20companies%20and%20capital%20markets/gt_wake up_call_.pdf

[3] Ibid.

The inescapable conclusion is that while the JOBS Act has helped IPOs, it only scratches the surface of what must be done to regain our stature. Speak with current and former stock exchange officials anywhere in the world, and most foreigners say that we've overregulated, overcosted and stifled the very IPO market that once was the source of their envy: The IPO market of the 70's, 80's, and 90's which was the bedrock of U.S. economic leadership in such industries as software, semiconductors, personal computers and biotechnology.

On October 11, 2011, the Wall Street Journal published an OpEd by one of the authors of this paper entitled, "How to revive small-cap IPOs." In it, we first called for the creation of dedicated "small-cap" or Venture Exchanges:

> *One-size-fits-all stock trading has become a disaster for all but our nation's largest companies. Our rush to cut trading spreads and commissions has made large caps even more active—but we've abandoned the entrepreneur in the process. These are the people who take on most of the business risk and job creation in this country. With such inhospitable stock markets, mergers and acquisitions have become virtually their only outlet to realize value for their hard work.*
>
> *And as we've so often seen during this tough economy, M&A generates job cuts, not new jobs. That's why young, dynamic companies need renewed capital-market support so they can grow independently without being forced to sell.*
>
> *What's needed now is a new, parallel market for public companies under $2 billion in value. Trading rules in this new market would allow for higher commissions, which would provide adequate incentives for small investment firms to get back into the business of underwriting and supporting small-cap companies.*

Small capitalization stocks have strikingly different characteristics from large capitalization stocks. Small cap stocks generally lack natural visibility, natural followings and natural liquidity. Small cap stocks trade assymetrically: Big buyer, no seller. Big seller, no buyer. So, it should come as no surprise that today's "one-size-fits all" market structure, optimized for low-cost trading, index funds and computer-based trading, has precipitated a collapse in the ecosystem that supports these companies. Logically, this is why the United States has seen a decline from nearly 9,000 listed companies in 1997 to approximately only 5,000 today. If the SEC and Congress had not changed market structure beginning with the Order Handling Rules in 1997 and Regulation ATS (Alternative Trading System) in 1998, culminating in Decimalization in 2001, Sarbanes Oxley in 2002 and Regulation NMS (National Market System) in 2006, the American people would enjoy more than 13,000 listed companies versus the current 5,000 we currently have – and more than 10 million incremental jobs.

Prior to 1997, the United States had a small-cap "exchange" with a different structure: It was the dealer market, otherwise known as NASDAQ or the National Association of Securities Dealers Automated Quotation System. Stock trading on this market was quoted, not electronic. The NASD (now FINRA), of which NASDAQ was a subsidiary, was "member-owned." The NASDAQ of today, just like the NYSE, looks nothing like it did in 1997. Today, both are for-profit stock-held corporations whose primary objective is to grow shareholder value rather than to advocate for the members of the ecosystem (the many small investment banks, institutional investors and corporations whose confidence is required to support small cap markets).

Prior to 1997 there existed a vibrant ecosystem of many small investment banks. These banks thrived in small-cap-stock market making and reinvested profits in equity research analysts, research, salesforces, market makers and investment bankers. The most notable of these firms were the so-called "Four Horsemen" –Alex Brown, Montgomery Securities, Robertson Stephens and Hambrecht & Quist. None of these firms could exist on the same scale today. The economic incentives are wholly inadequate to support the required infrastructure. This is the so-called "Ecosystem theory of small IPO decline," attributed by academics to the work of the authors.

Stated simply, low-cost trading – publicized as a boon to consumers - gutted U.S. capacity to take companies public and to support them. The U.S. stock market no longer has the capital formation capacity that once made it "The stock market that is the envy of stock markets throughout the world."

In 1994, 162 Banks Acted As A Bookrunner On A Small IPO (< $50 million). Only 34 Of These Are in Existence Today.

AB Capital & Investment
Advest
AG Edwards & Sons
Allen & Co
Americorp Securities
Anderson & Strudwick
AR Baron
AT Brod
Auerbach Pollak & Richardson
Banc of America Securities
Baraban Securities
Barber & Bronson
Baring Securities
Barington Capital
Barron Chase Securities
Beacon Securities
Bear Stearns
Brenner Securities
Chase H&Q
CIBC World Markets
Citigroup Global Markets
Commonwealth Associates
Comprehensive Capital
Craig-Hallum Group
Credit Suisse First Boston
D Blech
Dain Rauscher Wessels
Daiwa Securities America
Dean Witter Reynolds
Deutsche Bank Securities
Deutsche Morgan Grenfell
DH Blair
Dickinson
Dillon-Gage Securities
Donaldson Lufkin & Jenrette
Equity Securities Investment
Everen Securities
FAC/Equities
FEB Investments
First Asset Management
First Equity Corp of Florida
First Hanover Securities
First Marathon
Friedman Billings Ramsey
Gilford Securities
GKN Securities
Glaser Capital
Global Capital Securities
Goldman Sachs
Grady & Hatch
Greenway Capital
Hamilton Investments
Hampshire Securities
Hanifen Imhoff
Harriman Group
Harris Nesbitt Gerard
HJ Meyers
Howe Barnes Investments
IAR Securities Inc
ING Barings
International Assets Advisory
Investec
Investors Associates
J Gregory
James Capel
Janney Montgomery Scott
JC Bradford
Joseph Stevens
Josephthal
JP Morgan Securities
JW Charles Securities
Keane Securities
Kennedy Mathews Landis Healy
Kensington Wells
Kidder, Peabody
Kleinwort Benson Securities
Ladenburg Thalmann
Laidlaw Global Securities
Lam Wagner
Lazard Freres
LC Wegard
Legg Mason Wood Walker
Lehman Brothers
LH Alton
Mabon Securities
Marleau Lemire Securities
Mathews Holmquist
McDonald Investments
Merrill Lynch
MH Meyerson
Miller Johnson & Kuehn
Montgomery Securities
Morgan Keegan
Morgan Stanley
Murchison Investment Bankers
NatCity Investments
NatWest Securities
Needham
Neidiger Tucker Bruner
Nesbitt Burns
Nomura Securities
Norcross Securities
Oak Ridge Investments
Oppenheimer
Oscar Gruss & Son Inc
Pacific Crest Securities
Pacific Growth Equities
PaineWebber
Paragon Capital Markets
Paribas Capital Markets
Parker/Hunter
Patterson Travis Securities
Paulson Investment
Piper Jaffray
Principal Financial Securities
Prudential Securities
RAF Financial
RAS Securities
Raymond James
Redstone Securities
Rickel & Associates
RJ Steichen
Robert W Baird
Robertson Stephens
Robinson-Humphrey
Rocky Mountain Securities
Rodman & Renshaw
Roney Capital Markets
Roth Capital Partners
Royce Investment Group
RvR Securities
Ryan Lee
Salomon Brothers
Sands Brothers
Schneider Securities
Schroder
SG Cowen
Smith Barney
Spectrum Securities
Spelman
Stephens
Sterling Foster
Sterne Agee & Leach
Strasbourger Pearson
Stratton Oakmont
Summit Investment
Texas Capital Securities
Thomas James
Toluca Pacific Securities
Tucker Anthony
UBS Securities
VTR Capital
Wachovia Capital Markets
Wedbush Morgan Securities
Wells Fargo Securities
Werbel-Roth Securities
Wertheim Schroder
Westfield Financial
Whale Securities
William Blair
Yamaichi Securities
Yee Desmond Schroeder

In 2014, Only 31 Banks Acted As A Bookrunner On A Small IPO (< $50 million) and the Number of Bookrunners Declined 81% From 1994 to 2014.

Aegis Capital	Feltl	Newport Coast Securities	Scarsdale Equities
Barclays Capital	Henley	Northland Capital Markets	Stephens
Capitol Securities Mgmt	Jefferies	Oppenheimer	Stifel Nicolaus / Keefe
Chardan Capital Markets	JMP Securities	Piper Jaffray	Summer Street
Cowen	Laidlaw	Raymond James	UBS Securities
Credit Suisse Securities	Leerink Partners	Robert W Baird	Wells Fargo Securities
Dawson James Securities	Maxim Group	Roth Capital Partners	William Blair
Deutsche Bank Securities	MDB Capital Group	Sandler O'Neill	

Viewed the World Over

The United States is still the world's largest capital market. Our innovations in markets, for better or worse, are frequently exported (e.g., derivative securities that contributed to the World Financial Crisis of 2007-2008 which still lingers; Knight Securities once occupied the floor of the old London Stock Exchange) but not always worth emulating.

Do not take for granted that the United States will remain the world's largest capital market. Institutional capital is highly mobile. Whether it is Fidelity Investments with operations across the globe, or whether it is Alibaba coming to the U.S. for $25 billion in capital to be journaled into China, the trends clearly point to increasing globalization of institutional capital. We must make the United States a place that attracts "sticky" capital and where entrepreneurs easily congregate to create jobs through innovation and implementation.

We have a responsibility to get it right and to acknowledge when we get it wrong. The world is watching.

Much like a twelve-step program on the path to recovery, the SEC should acknowledge that the U.S. stock markets are no longer the envy of stock markets across the globe. We know. We ask. We listen. Yet Americans, including SEC Chairs, often repeat this claim even to Congress.[4] However, when we ask overseas stock exchange executives, equity capital markets professionals in London and institutional investors, whether they envy U.S. stock markets, foreigners generally react with incredulity. What they once envied was Silicon Valley and the IPO market that birthed entire new industries. They cite U.S. leadership in semiconductors, personal computers and biotechnology as prime examples. In the same breath, however, they note the decline in our small IPO markets, the expansive reach and costs of Sarbanes Oxley and Dodd Frank, and the rise of high-frequency trading. They are deeply concerned.

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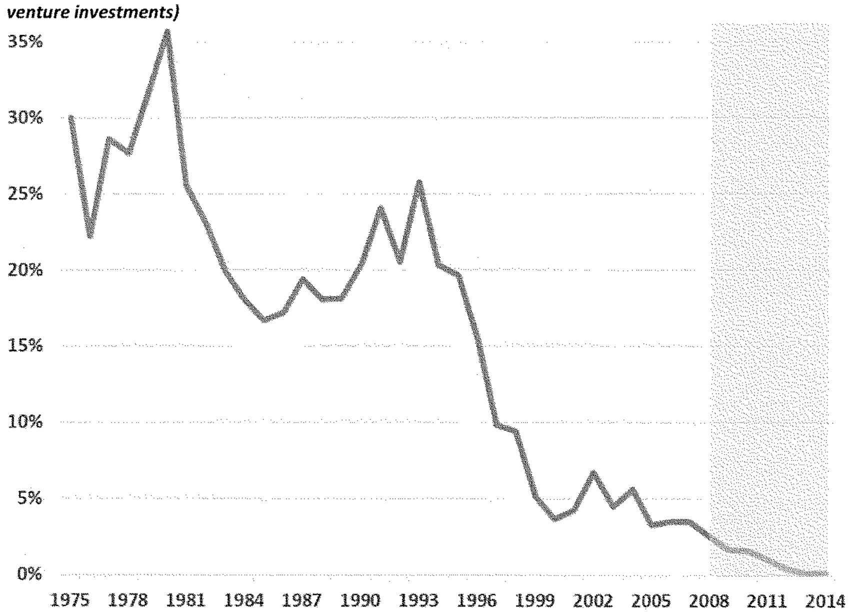
[4] Chair Mary Jo White, "...the U.S. markets are the envy of the world..." from *Testimony on SEC Budget,* Before the Subcommittee on Financial Services and General Government, Committee on Appropriations, United States Senate, on June 25, 2013 see http://www.sec.gov/News/Testimony/Detail/Testimony/1365171606059#.VLwM29g5A5s

Percentage of Venture-Funded Companies that have Gone Public
(Note-shaded area highlights those years that are understated given the relative youth of those venture investments)



Source: National Venture Capital Association, based on number of first venture fundings each year

Large Cap Bias Everywhere We Look

Because of the decline in the small cap ecosystem and the shift to for-profit, stock-held exchanges, U.S. markets are dominated by thought leaders, institutions and regulatory bodies with experience, expertise and economic incentives derived disproportionately from large cap stocks and the firms that focus on them.

In our view, large-cap bias permeates the SEC (Securities & Exchange Commission), FINRA (Financial Industry Regulatory Authority), the NYSE, NASDAQ, SIFMA (Securities Industry Financial Markets Association) and DTCC (Depositary Trust Company) – every institution that has a voice. Small cap companies (and their investors and their intermediaries) by contrast, are inadequately represented, and their voices are drowned amid the preponderance of large cap trading-oriented investors. Regulators have pursued an ideology that low-cost trade execution is the only measure that matters. Even that measure is perversely off the mark: Best execution is defined as the price of trade execution relative to the NBBO (National Best Bid and Offer) at the time of execution when in reality it should be measured from the time at which the order is received (not executed). Large orders take time and care to execute and information leakage can cause the stock to move adversely in one direction or the other. This is known as "slippage." Small orders are sold (payment for order flow) and sometimes shopped across venues looking for the "best return" (not "best execution") to the originating broker dealer.

The most recent example of domination by large capitalization interests is revealed in an examination of the SEC's much trumpeted "Market Structure Advisory Committee"[5] – announced just this January 13, 2014:

Members of the Equity Market Structure Advisory Committee are:

- **Matthew Andresen**, Co-Chief Executive Officer, Headlands Technologies LLC
- **Reginald Browne**, Senior Managing Director & Global Co-Head, ETF Group, Cantor Fitzgerald & Co.
- **Kevin Cronin**, Global Head of Trading, Invesco Ltd.
- **Brad Katsuyama**, President and CEO, IEX Group Inc.
- **Ted Kaufman**, Professor, Duke University Law School and former U.S. Senator from Delaware
- **Richard Ketchum**, Chairman and CEO, FINRA
- **Manisha Kimmel**, Managing Director, Financial Information Forum
- **Mehmet Kinak**, Vice President and Head of Global Equity Market Structure and Electronic Trading, T.Rowe Price Group
- **Andrew Lo**, Charles E. and Susan T. Harris Professor of Finance and Director, Laboratory for Financial Engineering, MIT Sloan School of Management and Chairman and Chief Investment Strategist, AlphaSimplex Group
- **Joseph Mecane**, Managing Director, Barclays PLC
- **Jamil Nazarali**, Senior Managing Director & Head of Execution Services, Citadel Securities
- **Eric Noll**, President & CEO, Convergex Group
- **Maureen O'Hara**, Robert W. Purcell Professor of Finance, Johnson Graduate School of Management, Cornell University and Chairman of the Board, Investment Technology Group Inc.

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[5] See SEC Press Release at http://www.sec.gov/news/pressrelease/2015-5.html#.VLmjuNg5A5s entitled, *SEC Announces Members of New Equity Market Structure Advisory Committee: Committee Comprised of Experts with Diverse Backgrounds and Viewpoints*

- **Joe Ratterman**, CEO, BATS Global Markets Inc.
- **Nancy Smith**, Corporate Secretary & Chief Integration Officer, AARP
- **Chester Spatt**, Kenneth B. and Pamela R. Dunn Professor of Finance, Tepper School of Business, Carnegie Mellon University and Director of its Center for Financial Markets
- **Gary Stone**, Chief Strategy Officer, Bloomberg Tradebook LLC

We applaud the inclusion of institutional investors who have knowledge of small cap investing, namely Kevin Cronin of Invesco and Mehmet Kinak of T. Rowe Price.

We applaud as well the inclusion of Ted Kaufman who, in his December 16, 2009, speech on the floor of the United States Senate asked,

> *"How can we create a market structure that works for a USD 25 million IPO — both in the offering and the secondary aftermarket? If we can answer that question, Mr. President, this country will be back in business.[6]"*

We are extremely concerned, however, by the absence of participation by middle market investment banks including such firms as Piper Jaffray, Cowen & Company, William Blair, Leerink Partners, Robert W. Baird, Pacific Crest Securities (recently acquired by KeyCorp) and Stifel Financial. Middle market investment banks, whose numbers were once great, are now an endangered species. These firms reflect and are emblematic of the dwindling infrastructure (ecosystem) that the United States depends upon to support a robust small IPO and aftermarket. Their decline dates back to the disappearance of the Four Horsemen and has continued unabated into recent years with the sale (some would say collapse) of firms like Keefe Bruyette & Woods and Think Equity as well as the January 8, 2015, announcement that Standard Chartered Bank would close its equity sales and research business.[7]

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[6] See University of Delaware Library, Ted Kaufman, United States Senator for Delaware, *Kaufman Calls Decline in IPOs "Choke Point" to Job Creation, Economic Recovery* : "The failure of Wall Street to provide capital to small companies may be costing our economy millions of foregone jobs," December 16, 2009 at http://green.lib.udel.edu/webarchives/kaufman.senate.gov/press/press_releases/release/-id=352c7e34-1cad-4ad3-b31c-c267bd492d1a.htm

[7] New York Times Deal Book, January 8, 2015, *Standard Chartered to Close Equity Sales and Research Business*, by Neil Gough. See http://dealbook.nytimes.com/2015/01/08/standard-chartered-will-close-equity-sales-and-research-business/

The Early NASDAQ, London AIM and Toronto TSX Venture Exchanges

A number of small-cap or Venture Exchanges have been successful in the past. Today, all have converted to for-profit public shareholder models contributing to the deterioration in the small cap ecosystem in each of the US, U.K. and Canada. As the small-cap ecosystem shrinks, so do research, sales and marketing support and capital available to support liquidity. When the "aftermarket" declines, IPO production declines.

The Early NASDAQ – Nasdaq was established in 1971 as a member-owned trade reporting facility. It was not a "stock exchange" in the legal sense (not an SRO or Self-Regulatory Organization) but was a facility of the NASD (National Association of Securities Dealers) which itself was "Member-owned" (no public shareholders). Trades did not occur on Nasdaq in its infancy but occurred in the over-the-counter market between and within broker-dealers (its member firms). The primary innovation of Nasdaq in the early years was to create price transparency and to allow members to advertise their activity (volume) in any given Nasdaq stock.

The Intel Corporation went public on Nasdaq in 1971. It did not meet the qualifications of the listed stock exchanges at the time. The early Nasdaq was in essence a Small-Cap Exchange. It was the original U.S. Venture Exchange.

Notably, in the early years of NASDAQ, market makers could advertise their markets but they were not formally obligated to buy significant amounts of stock. The market was a telephone "quoted" market where dealers could back away from orders and thus manage their risk. Their quotes were not live orders that anyone could "hit" electronically, as they can today. When companies had poor results, dealers would short or back away and stock prices would decline. When companies had good results, dealers would get on the phone and "talk the stock up." Wide quoted spreads which created "effective"[8] tick sizes of as much as 25 cents per share, provided ample incentives for market makers to commit capital – whether to short stock to provide an institution with an initial position (to "get the investor going"), or to buy a block of stock from an investor at or below the "bid" side of the market and offer it to brokers to make sales calls "net" with 25 cents per share to the stockbroker as a maximum incentive. Liquidity in small-cap stocks was thus "manufactured" by the dealers and their salesforces.

Admittedly, there was quite a bit of conflict here. Salesmen (brokers) were motivated by money. Firms tried to control for this by investing in equity research and the so-called "Competition of ideas" – the fact that the typical firm had many stocks from which to choose under research coverage, caused them to disproportionately market their "buy" rated ideas while shying away from "hold" or "sell" recommendations.

Reg. ATS came in 1998 and represents the dawn of widespread electronic order book markets in the United States. These caused the effective tick size, the smallest increment in which a stock can trade, to drop from 25 cents per share to 3.125 cents per share – at the same time that the internet enabled

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[8] While the actual permissible minimum "tick" size was in the pre-decimalization period 3.125 cents (1/32nd), the markets of the 70s and 80s were quoted and the convention was to quote in 25 cent increments. Thus, while an institution might be able to negotiate less than a 25 cent increment (usually 1/8 or 1/16), many orders would be marked up a ¼ point or 25 cents which was thus the "effective" tick size.

widespread self-directed discount retail investing collapsing the commissions charged by retail brokers. While many micromarket economists will argue cause-and-effect here, for those of us that ran these businesses (David Weild co-chaired strategy for investment banking, equity research, institutional sales and equity trading at Prudential Securities), we reacted to the changes by cutting research commitments, capital commitments, and investment banking support of small capitalization companies. The profitability of $50 million IPOs was suddenly one-third of what it had been pre-Reg. ATS. The collapse of the ecosystem accelerated while a series of new trading-focused for-profit competitors to Nasdaq forced Nasdaq to convert to a for-profit company itself with public shareholders in order to raise adequate capital to remain competitive.

Today, small capitalization companies are frequently seen to announce good news but not enjoy the benefit of a positive reaction by the stock. Why? Because intermediaries are needed to market small cap stocks to investors, and under the current system, no one can earn a living bringing new buyers into smaller stocks.

LSE's AIM (London Stock Exchange's Alternative Investment Market) – AIM was founded in 1995 as a submarket of the London Stock Exchange. As of December 2014, there was a total of 1,104 companies listed on the AIM market including 885 from the U.K. and another 219 International.[9] The U.K. population is one fifth that of the United States so on the domestic side alone, this would be the equivalent, in U.S. terms, of contributing 4,425 (885 x 5) listed companies to the U.S. markets. An AIM-type market thus has the potential to nearly double the current population (approximately 5,000) of publicly listed companies in the United States. The AIM peaked in 2007, before the Financial Crisis, at 1,694 public companies – nearly twice the current number of listed companies. On a population-weighted basis, this would be the equivalent of adding 8,470 publicly listed companies to the U.S. listed markets – a number not seen in the United States since before the introduction of Reg. ATS in 1998.

Students of stock market history will note that most of AIM trading is based on a clone of the original NASDAQ dealer system called SEAQ. "NASDAQ" stands for "National Association of Securities Dealers Automated Quotation" system while "SEAQ" stands for "Stock Exchange Automated Quotation" system. Ironically , representatives of the London Stock Exchange now travel to the United States to solicit U.S. companies to list on the AIM.[10] U.S. companies cite the lack of Sarbanes-Oxley in the U.K., lower ongoing reporting costs on AIM, and market making as attractants. However, the company review process skips the FSA (the U.K. equivalent of the SEC) and is outsourced to underwriters who are known as NOMADs or Nominated Advisors. These NOMADS are responsible for due diligence and disclosure but critics say that the process is uneven and stigmatizing. For this reason, we would prefer to keep the SEC in this role in the United States.

Actual Invitation to an Upcoming AIM New Business Event to be Held in Miami, Florida on March 10, 2015.

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[9] See http://www.londonstockexchange.com/statistics/historic/aim/aim-statistics-archive-2014/dec-14.pdf
[10] *London Stock Exchange officials recruit businesses in Denver*, January 19, 2015, by Aldo Svaldi, The Denver Post, see http://www.denverpost.com/business/ci_27351789/lodon-stock-exchange-officials-recruit-businesses-denver

Hello,

You are invited to the following event:

THINK BIG, AIM HIGHER: RAISING CAPITAL THROUGH LONDON'S INTL GROWTH MARKET

Event to be held at the following time, date, and location:

Tuesday, March 10, 2015 from 8:00 AM to 10:00 AM (EDT)

The Beacon Council
80 Southwest 8th Street
#2400
Miami, FL 33130

View Map

Attend Event

Share this event:

For more details please contact: Rebecca Mowat HM Consul & Head UKTI Southeast rebecca.mowat@fco.gov.uk / (786 223 3713) Twitter @UKTIUSA

Criticisms of AIM – In 2007, The Guardian reported that SEC Commissioner Roel Campos created a stir in London when he likened AIM to a casino saying, "I'm concerned that 30% of issuers that list on AIM are gone in a year." The article[11] went on to say that "The LSE, which controls AIM, retorted that the number of companies that go into liquidation or administration in a year is actually fewer than 2%." What people generally don't understand is that the "expected life" of a listing, even in the United States, where companies are more mature, is only approximately 7 years. It stands to reason that smaller companies will be merged and delisted from exchanges at higher rates than larger companies. From a public policy perspective, however, they also represent materially less risk exposure to the public exactly because they are smaller: On February 27, 2015, the market value of Apple Computer was approaching $750 billion. This is the equivalent of the combined values of 7,500 companies of $100 million in market value (the United States only has 5,000 listed companies). Clearly, the bigger systemic threat to the U.S. economy is not the churn in small companies, but in not providing a suitable "Venture Exchange" for them to list. Intel Corporation, which went public in 1971 in an $8 million IPO, was only three years old and unprofitable on an operating basis. It missed delivery of its first product and the stock price was cut more than fifty percent. Intel listed on the early Nasdaq – the original U.S. Venture

[11] The Guardian, *City hits out over US 'casino' jibe at Aim*, by Jill Treanor, March 10, 2007 See http://www.theguardian.com/business/2007/mar/10/1

Exchange – that inspired President Jiang Jemin in 1998 to call the NASDAQ Stock Market, "...the crown jewel of the U.S. economy."

One of the authors of this study conducted a series of meetings several years ago with the then-head of the AIM market in London, AIM market makers and institutional investors on AIM. Dealers and institutional investors both said that dealers were feeling pressure as the LSE, in pursuit of its own profits, moved the largest AIM stocks from the dealer trading platform to the electronic bulletin board or CLOB (central limit order book). These more liquid AIM stocks were said to be still "AIM Listed" but now trading on the same platform as stocks in the Major Market (the LSE version of the "Big Board" in the United States). The impact was said to be greater profits for the LSE and lower profits for the dealer (market maker) community.

TSX Venture Exchange (TMX Group's small cap exchange) – The TSX Venture Exchange traces its roots to the merger of the Vancouver Stock Exchange and the Alberta Stock Exchange in 1999 to form the Canadian Venture Exchange. In 2001, the TSX Group (Toronto Stock Exchange, now known as TMX Group) purchased the Canadian Venture Exchange, converting it at some point from a dealer market to an auction-style electronic stock market. We believe that, while this move was in the best economic interests of TMX Group, it likely siphoned off economics from the dealers (market makers) and put pressure on the Canadian small cap ecosystem. In a recent article[12] in the Financial Post, "Can the once mighty TSX Venture Exchange be saved?" it is clear that the cumulative market value of the exchange is less than in 2001 when it was acquired by TMX Group, and market participants are voicing concern that access to capital and liquidity are extremely poor. Despite this, the TSX Venture Exchange still has over 2,100 listed companies with an aggregate value of approximately CAD$33.1 billion (U.S.$26.5 billion). 2,100 listings is astonishing when one considers that the Canadian economy is one ninth the size of the U.S. economy, making it a 19,000 U.S.-listed-company weighted equivalent, and yet the entire U.S. listed stock market (NASDAQ plus NYSE) consists of only 5,000 listed operating companies.

We believe that the member-owned model was and would be superior to balancing interests and that stock exchanges with public shareholders will inevitably be tempted to siphon economics in ways that undermine the ecosystem required to support a vibrant small cap marketplace.

[12] Financial Post, December 27, 2014, *Can the once mighty TSX Venture Exchange be saved?*, by Peter Koven, see http://business.financialpost.com/2014/12/27/can-the-once-mighty-tsx-venture-exchange-be-saved/

Recommendations for Venture Exchanges

RECOMMENDATIONS FOR PUBLIC MARKET VENTURE EXCHANGES – Our discussion of Small-Cap or "Venture Exchanges" generally presupposes public markets (e.g., the Nasdaq Stock Market of the '70s and '80s, the London AIM and the Toronto TSX Venture). Public Venture Exchanges are essential to restore higher economic growth rates. Moreover, Private Market Venture Exchanges may also fill another void in the U.S. arsenal of infrastructure required to support the entrepreneurial economy. As a result, we are also making recommendations for Private Market Venture Exchanges (see "Recommendation for Private Market Venture Exchanges" below).

Governance – "Venture Exchanges" should be chartered separately by the SEC. A distinct set of rules – apart from traditional stock exchanges and ATSs (Alternative Trading Systems) – For example, "Reg. Venture Exchange," would be enacted – either in Congress with the support of the White House, or through the SEC's broad exemptive authority (which they have historically been reticent to use without clear signals from Congress).[13] In order to sustain and nurture small-cap liquidity:

- **Venture-Exchanges Should be Member-Owned Exchanges –** As seen from our preceding discussion of early Nasdaq, the LSE AIM and the TSX Venture Exchange, the for-profit, stock-held ownership structure of the U.S. stock exchanges puts stock exchanges in competition with value providers[14] (broker/dealers that provide research, sales and capital to support liquidity). As a result, the for-profit shareholder model puts shareholders' needs for profits ahead of the health and well-being of the ecosystem and the well-being of small cap companies that generate very little trading profit. As a result, we believe that Venture-Exchanges should be Member-Owned and that members should be Broker-Dealers who can receive capital calls in line with their size – broken into three tiers – Large, Medium and Small – to provide balanced representation on the Board of Directors. There should also be an Investor Advisory Committee and a Corporate Issuer Advisory Committee, each with the right to review all material rule changes and make recommendations to the Board.
- **Creation of a Separate Venture Exchange Division at the SEC –** A separate Venture Exchange Division of the SEC should be established to put focus on the specialized and distinct needs of the small-cap marketplace. It should be staffed with financial professionals (and not simply lawyers) and should be tasked to nurture a revival in small IPOs. The division would ensure a balancing of interests among the Venture Exchanges themselves, corporate issuers, intermediaries (the broker-dealers who provide research, sales and marketing and liquidity) and investors. It would horizontally integrate disciplines in:
    - **Listings rules, disclosure, and use of shelf registrations to facilitate lower cost capital formation** (currently within the Division of Corporation Finance) – We need lower cost disclosure (possibly along the lines of Reg. A+) for the smallest companies and broad allowance of shelf registrations for any issuer that is current with disclosure.

[13] Congress appropriates the SEC's budget. The SEC is naturally hesitant to take controversial positions where the SEC Chair is called to defend the SEC's actions and risk cuts to the SEC's budget.

[14] See "SIFMA Calls For Review of SRO Structure" at http://www.sifma.org/newsroom/2013/sifma-calls-for-review-of-sro-structure/ "**Exchanges Compete with the Broker-Dealers they Regulate.** Combined with the transformation of exchanges into for-profit enterprises in search of ways to expand their businesses, exchanges and broker-dealers have become direct competitors in many aspects of their businesses. Most prominent is the competition for order flow between exchanges and broker-dealers."

- SEC review of disclosure will support confidence.
- The disclosure regime should be scaled – Reg. A+ disclosure adopted at the low end. Something stronger for larger listed companies.
- State regulation should be pre-empted by an "Exchange Listing" exemption for all Venture Exchange listed securities.

- **Trading rules** (currently within the Division of Trading & Markets) - Trading in U.S. equities markets is "one-size-fits all" optimized for the trading of large-cap stocks - a description that was first coined[15] by us and has subsequently been repeated in Congress and at the SEC. Why is this important? Because small cap markets are "asymmetrical" order-book markets with no "network effect." They lack the natural visibility and liquidity of large cap stocks. By applying a highly price-competitive market structure to small cap trading, the U.S. has experienced a deterioration in large-buyer (and seller) liquidity and a contraction in the small-cap ecosystem (IPO on-ramps). In addition, because well more than 90% of stock trading occurs in stocks that are larger than $2 billion in market value, we find that many regulators bring large cap bias in their approach to small cap stocks. Venture Exchanges should be:
  - **Exempt from the Order Handing Rules (but not the Manning Rule).**
  - **Exempt from Reg. ATS and Reg. NMS.**
  - **Exempt from UTP (Unlisted Trading Privileges – Rule 12f-2).**
  - **Exempt from Decimalization.**

  Venture Exchange listed companies should be:
  - **Exempt from Sarbanes-Oxley.**
  - **Exempt from State Blue Sky.**
- **Enforcement** (currently within the Division of Enforcement) – Small cap markets need to prioritize enforcement over prevention. In our dealings with former SEC Commissioners, it became apparent that high cost regulation and low-cost trading may have been intended by some at the SEC and FINRA to prevent sales practice abuses. However, this cure was worse than the disease because it gutted the capital formation engine and source of economic renewal for the entire U.S. economy. When policymakers incentivize more research, sales and trading, there will undoubtedly be more sales abuses - including so-called "pump and dump" schemes. The SEC and FINRA must not be shy about putting flagrant offenders out of business and, for this reason, we think that a special Enforcement Group within a Venture Exchange Division and at FINRA, may be needed.
- **ETFs and Index Funds** (currently within the Division of Investment Management) – ETFs and Index Funds are harmful especially to progressively smaller capitalization stocks. By taking a supply of securities off the market, they undermine liquidity in already less liquid stocks. They also cause consumers to take short-cuts in investing by buying "themes" and "baskets" in lieu of understanding company fundamentals. This likely undermines the "entrepreneurial IQ" of the American populace, dulling the appetite for education about business and entrepreneurship. Worse, most ETFs and Index Funds are market cap weighted. While they purport to invest in indices,

[15] *A wake-up call for America*, by Weild & Kim, p. 20, November 2009, "In an epic case of unintended consequences, one-size-fits-all market structure added liquidity to large cap stocks, but…created a black hole for small cap listed companies. In addition, public companies find themselves in a market environment with a lack of research support, greater systemic risk and volatility, and structural impediments that block them from going private."

for a variety of liquidity and cost issues, most intentionally avoid investment in the smallest stocks, thus further siphoning capital away from this market segment. Finally, ETFs and Index Funds don't buy new issue stock offerings. The more ETFs and Index Funds grow, the more capital is taken away from capital formation and job growth. Policymakers, at a minimum, should require that all ETFs and Index Funds place standing orders on all offerings.

- **Creation of Separate Venture Exchange Groups within FINRA and DTCC** – Again, we need to keep the focus on the needs of this ecosystem. Smaller FINRA member firms complain that FINRA and DTCC are creating unnecessary cost and friction in the small cap ecosystem. Broker-Dealers complain, for example, that they are searching for compliance vendors to improve compliance, but FINRA, as a matter of policy, refuses to share its knowledge of outside compliance service providers. As a consequence, well-intended broker-dealers make completely avoidable mistakes in compliance. This is not in the best interests of anyone. Most in the industry understand that FINRA and DTCC's revenues are largely derived from the big Wall Street firms and that the big Wall Street firms' business is disproportionately large-cap. Most in the industry also understand that SIFMA (the major industry trade association) is dominated by the big Wall Street firms. Clearly, Congress and the SEC must come up with a construct that institutionalizes and perpetuates a discipline in small-capitalization stocks and the care and feeding of the small-capitalization ecosystem. It should be mandated that:
  - **DTCC is required to provide electronic settlement to Venture Exchange listed stocks.**
  - **Broker-dealers with equity powers are required to allow stock brokers to solicit all Venture-Exchange listed stocks.**
  - **Broker-dealers are required to allow customers to buy Venture-Exchange listed stocks on margin.**
  - **Broker-dealers and investors are required to "Hard locate" shares to borrow before shorting any common stock.**
  - **Market Makers are given an exemption whereby any investor that fails-to-deliver securities must be issued a "buy-in" 24 hours after the failure-to-deliver and cut off from further activity with the broker-dealer until such time as the failure is rectified.**
- **Adequate Ecosystem Economics** – Intermediaries and service providers are essential to providing support for small cap companies. That support comes in three forms – sales and marketing support, equity research coverage and market making that employs capital to shoulder risk (drive large buyer liquidity – more liquidity drives more institutional investment in these stocks). Unlike large-cap markets where liquidity is naturally occuring due to the so-called "network effect," small-, micro- and nano-cap liquidity has always needed to be supported. That support must be paid for through some combination of higher commissions, higher tick sizes and trading spreads, or direct subsidies (the old specialist system on the NYSE required specialists to subsidize liquidity in small cap stocks in exchange for making excess profits in large cap, naturally liquid stocks) and affirmative obligations on market makers. As a result: Venture Exchanges must be:
  - **Allowed to list stocks up to $2 billion in market value – $2 billion is still considered small-cap by most institutional investors. A population of larger than $250 million market value stocks (the ceiling for the SEC Advisory Committee on Small and Emerging Companies) will be essential to generate enough economics to grow**

the ecosystem and create sufficient on-ramps to drive IPO production and support.

- **Allowed to compete for listings up to $2 billion in market value (with a CPI escalator) and larger (higher profits in larger stocks creates higher economics to build bigger IPO on-ramps) – Venture Exchanges must be allowed to recruit listings from other stock exchanges and vice versa. This will enable the Venture Exchange ecoystem to obtain critical mass much sooner than if it was dependent on the IPO market.**
- **Given the authority to set minimum commissions charged by participating brokers.**
- **Given the authority to set minimum tick sizes and trading spreads by market makers.**
- **Given the authority to set affirmative requirements of market makers.**

Ultimately, the success of Venture Exchanges hinges more on the profitability of the Ecosystem (Intermediaries and value providers) than it does on the profitability of the Venture Exchange itself. This is why public-shareholder based stock exchanges are poor custodians of venture-exchanges because they are naturally more interested in shareholder profitability than in ecosystem profitability. ***As a practical matter, this will require an absolute exemption from such pro-price competition rules as OHR and Regulations ATS, NMS, Decimalization and Unlisted Trading Privileges (UTP).***

- **Extension of Title 1 JOBS Act Research Rules to All Venture Exchange Listed Companies –** The JOBS Act improved the ability and lowered the cost, of sell-side equity research analysts, to work with investment bankers. These liberalizations should be extended to all Venture Exchange listed companies – not just on the IPO. Specifically,
  - **Investment bankers should be able to arrange analyst communications with investors.**
  - **Analysts should be able to join investment bankers in meetings with company management.**
  - **Analysts should be able to participate in road shows (this would go beyond the JOBS Act)**
  - **Research on Venture Exchange listed companies should be permissible before and after any IPO or follow-on offering.**
  - **Congress should limit liability for research published before an IPO - We understand that the reason why EGC (Emerging Growth Company) IPO research has not been published before the IPO, as is the case in Europe, is because of concerns over liability.**
- **Clarity On What Constitutes Equity Research –** Congress or the SEC should specifically exempt published materials that do not include securities price targets or recommendations (e.g., Buy, Sell, Hold) from the definition of "Research." FINRA rule 2711 is ambiguous as to what constitutes equity research, thereby restricting the flow of information in support of smaller market capitalization stocks.
- **Disclosure of Investor Long Positions –** SEC Form 13F ownership information and transparency breaks down in small-cap stocks because quarterly reporting is limited to investors with more than $100 million in qualifying assets. Most micro- and nano-cap investors manage less than $100 million in assets because of liquidity constraints. We believe that managed portfolios all the way down to $10 million in size, including family offices, should disclose all long (and short) positions on a quarterly basis.

- **Disclosure of Investor Short Positions –** We continue to be disturbed that the SEC does not require the disclosure of short positions on the same basis as long positions. Corporate issuers have the right to decline a meeting with an investor who has established a short position in the stock. Corporate issuers have the right to spend their time in ways that are not contrary to the interests of the Company's owners (investors). However, without the disclosure of which investors short stock and the types of stock that they short, management's limited and valuable time – time that would be better put to use managing the Company and creating jobs – is squandered. Worse, some short sellers spread rumors, knowing that it is virtually impossible for the public to attribute the source. Just as there is information value to the rest of the market in who is long a stock (high quality investors attract other long investors), there would also be information value to the rest of the market in who is short a stock. We believe that the lack of disclosure around short-selling undermines investor confidence and the rights of corporate issuers.

RECOMMENDATIONS FOR PRIVATE MARKET VENTURE EXCHANGES - While most students of stock market structure will view "Venture Exchanges" as a public market construct, enhancements to the regulatory framework for private markets are also needed. However, we view Private Market Venture Exchanges, open to only accredited investors and institutional buyers, to represent a partial remedy to the collapse in the small IPO market. "Private Market" Venture Exchanges should not be seen as a substitute for a well-thought out "Public Market" Venture Exchange construct. Private markets would benefit from the inclusion of:

- **Basic disclosure** – The requirement of annual financial statements (not audited) for any company that has raised over $1 million from outside investors.
- **A consolidated tape** – Activity in all secondary markets should be reported centrally by all market participants, and this information feed should be broadly distributed. The simple distribution of pricing information broadly should not be deemed a "solicitation."
- **Freedom to solicit accredited investors** – States' regulations should be pre-empted and brokers should be free to solicit in the private aftermarket any accredited or institutional investor. Non-accredited investors should be off limits.

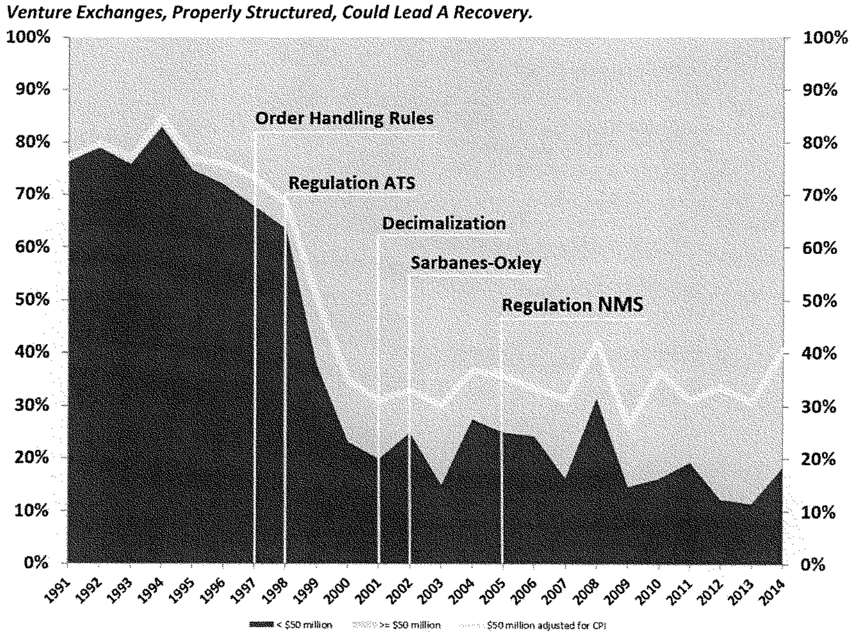
Conclusion

In our work for the Organization of Economic Cooperation and Development (OECD), we examined IPO markets throughout the world. It became obvious to us that the incentives and disincentives created by governments and regulators are the major determinant of the success (or lack thereof) of small IPO markets (and the aftermarket). The inescapable conclusion is that the collapse of the small IPO market in the United States was caused by ill-conceived and nearsighted public policy and that it can be rectified by improved and farsighted public policy that includes the creation of a regime designed to meet the very different needs of small-cap public companies. Intelligently designed "Venture Exchanges" would create a foundation for a resurgence in entrepreneurship, innovation and job creation. We believe that, once established and after perhaps a decade of operation, Venture Exchanges would lead to the creation directly (by companies accessing and investing capital) and indirectly ("muliplier effect" of jobs being created in the service sector of the economy because of the money spent by these companies and their employees) of 10 million jobs for the U.S. economy.

The ability of the United States to sustain itself as a world leader may rest on our ability to reverse the decades long trend of lower company start-up rates and lower IPO rates. Higher levels of entrepreneurship are the bedrock of a vibrant economy. The creation of Venture Exchanges, and the natural advocacy for entrepreneurship that would emerge from these exchanges, is one of the single most important actions that policy leaders can take to reignite the American Dream and restore America's position as the "Capital market envied by capital markets throughout the world."

Appendix

The Small IPO Collapse Coincided With The Policy-Driven Shift To Low-Cost Electronic Trading. Venture Exchanges, Properly Structured, Could Lead A Recovery.



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WEILD&CO.

About Weild & Co.

Weild & Co. is the brainchild of noted Wall Street executives, including David Weild and Ed Kim, whose work is credited with having led to The JOBS Act. Weild & Co. uses technology, data and people to improve the marketing and distribution of new issues for corporate issuers and investment banks. This leads to a better aftermarket and performance for public companies and their investors. The mission of Weild & Co. is improve capital formation. We are pioneering equity distribution and marketing platforms to complement traditional investment banks. Our clients include both corporate issuers and investment banks.

About Weild Capital

Weild Capital is the investment banking arm of Weild & Co. Weild Capital represents companies and investment banks with a securities distribution approach that allows managements and investment banks to reach longer-term and smaller institutional investors. Weild Capital also provides advisory and placement services but does not accept commissions from investors.

WEILD&CO.

About the Authors

David Weild is Chairman and CEO of Weild & Co. He is a Former Vice Chairman of The NASDAQ Stock Market who ran its listings businesses in the U.S., Europe, Asia and Latin America. The studies that David co-authored with Ed Kim documented the long-term decline in equity capital formation in the United States and provided the core arguments that gave rise to the JOBS Act and many of the specific provisions contained in the JOBS Act. For these reasons, he has been called "The father of the JOBS Act" (Forbes). David has worked on over 1,000 public equity offerings during the course of his career in senior management at a major Wall Street firm where he oversaw equity capital markets, corporate finance, online brokerage and technology investment banking. He has a BA in Biology from Wesleyan University and an MBA from the Stern School of Business.

Edward Kim is COO of Weild & Co. Ed has over 25 years of capital markets, finance, product development, and operations experience. Prior to helping form Weild & Co., he ran financial communications at Stern And Company, a strategic communications and public relations firm. Ed was formerly head of new products for the corporate client group at The NASDAQ Stock Market. Ed has worked in investment banking, trading, research and equity capital markets at firms including Lehman Brothers, Prudential Securities, and Robertson Stephens. He has a BS in Materials Science and Engineering from the Massachusetts Institute of Technology.

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May 19, 2015

The Honorable Scott Garrett
Chairman
Subcommittee on Capital Markets and Government Sponsored Enterprises
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Carolyn Maloney
Ranking Member
Subcommittee on Capital Markets and Government Sponsored Enterprises
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Re: Venture Exchanges

Dear Chairman Garrett and Ranking Member Maloney,

The undersigned, all of which are companies in science and technology related disciplines that have successfully graduated to a listing on a national securities exchange, write to provide insight on the topic of Venture Exchanges, which was discussed at your subcommittee's May 13, 2015 hearing entitled "Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens, Part II."

Each of us traded on the OTCQX Best and/or OTCQB Venture marketplaces operated by OTC Markets Group before graduating to a national securities exchange listing. We benefited from trading in these markets, and also have a specific understanding of some of the key issues facing smaller SEC reporting companies.

With our shared positive experiences on the OTCQX and OTCQB marketplaces, we strongly believe that any successful venture exchange legislation must be inclusive of organized over-the-counter markets and Alternative Trading Systems (ATSs) as well as traditional stock exchanges. Historically, the U.S. equity markets benefited from the over-the-counter market model competing with the national securities exchanges for trading smaller companies. Limiting trading to one type of listing or trading platform, or one predetermined business model, would trample the innovation and competition that allowed our companies to develop and thrive.

The path to successful venture company growth and capital raising would be eased significantly by updating current law and regulations to provide for the following:

- Blue Sky preemption for all offerings of securities registered with the Securities and Exchange Commission (SEC).

- Blue Sky preemption for secondary trading of securities trading on an ATS or other venture market that requires companies to provide adequate current information to investors.
- Margin eligibility for all companies meeting the qualitative thresholds of a "ready market," as that term is defined by the SEC. The SEC should have the discretion to determine which non-exchange securities qualify as margin eligible.
- Modernize the definition of a "Penny Stock" in Rule 3a51-1 under the Securities Act. Many companies dependent on research and development fall into the Penny Stock definition due to their business model. The definition of a Penny Stock should be updated to:
    - Account for the effect of bona fide research and development costs, and
    - Consider SEC registered and exempt capital raises at interim periods in the calculation of Net Tangible Assets under the Penny Stock definition.
- Additional oversight of the on-ramp to venture companies beginning public trading via the Financial Industry Regulatory Authority, Inc.'s Form 211 process and the Depository Trust Clearing Corporation's eligibility process.

We believe Congress should have the SEC carefully study the potential impact of all of these proposals and examine the impact of lifting other restrictions on smaller companies raising capital and the broker-dealers trading their securities. The study should consider the operation of venture markets here and abroad to develop concrete recommendations that support efficient capital formation for smaller and growing companies wherever their securities are listed or traded.

We ask that any venture marketplace legislation be inclusive of organized over-the-counter markets and ATSs as well as national securities exchanges, and that such legislation address the vital issues set forth above.

We unequivocally support facilitating more opportunities for companies raising capital and fewer restrictions on the broker-dealers trading their securities. Removing unnecessary regulatory restrictions on capital and fostering competition among exchanges, ATSs and broker-dealers with diverse business models are the best long term solutions for helping venture companies grow and develop.

Signed,

Cancer Genetics, Inc.

Corbus Pharmaceuticals Holdings, Inc.

CymaBay Therapeutics Inc.

Lipocine Inc.

NanoViricides, Inc.

Provectus Biopharmaceuticals, Inc.

RXi Pharmaceuticals Corporation

Cancer Genetics, Inc. (NASDAQCM: CGIX) is an emerging leader in the field of personalized medicine, offering diagnostic products and services that enable precision medicine in the field of oncology. Products and services being developed at CGI are poised to transform cancer patient management, increase treatment efficacy, and reduce healthcare costs. CGI's cutting-edge proprietary tests and state-of-the-art reference laboratory provide critical genomic information where patients and their physicians need it most – to diagnose, monitor and inform cancer treatment. CGI is committed to maintaining the standard of clinical excellence through its investment in outstanding facilities, a culture of excellence and state of the art equipment. With locations in the US, India, and China, CGI is helping to empower personalized cancer treatment around the globe.
http://www.cancergenetics.com/

Corbus Pharmaceuticals Holdings, Inc. (NASDAQCM: CRBP) is a pharmaceutical company focused on the development and commercialization of novel therapeutics to treat rare, life-threatening inflammatory and fibrotic diseases with clear unmet needs. The Company's lead product candidate, Resunab™, is a first-in-class, oral anti-inflammatory drug that acts to resolve inflammation through an endogenous pathway. Resunab is scheduled to commence two Phase 2 clinical trials in 2015 for the treatment of cystic fibrosis and diffuse systemic sclerosis ("scleroderma") two diseases in which inflammation contributes to disease progression. Resunab also has the potential to treat additional rare, inflammatory diseases.
http://www.corbuspharma.com/

CymaBay Therapeutics Inc. (NASDAQCM: CBAY) CymaBay Therapeutics is a clinical-stage biopharmaceutical company located in the San Francisco Bay Area focused on developing therapies to treat metabolic diseases with high unmet medical need or serious rare and orphan diseases. We are committed to developing breakthrough medicines that improve the lives of patients and their families. CymaBay was seeded with the assets from an earlier metabolic disease company in which more than $120M was invested to produce a robust pipeline.
http://www.cymabay.com/

Lipocine Inc. (NASDAQCM: LPCN) Lipocine is a specialty pharmaceutical company focused on developing innovative oral treatment alternatives for use in men's and women's health using its proprietary drug delivery technologies. Lipocine product development pipeline entails repositioning of established drugs with significantly improved patient compliance through an efficient 505(b) (2) regulatory pathway strategy. http://www.lipocine.com/

NanoViricides, Inc. (NYSEMKT: NNVC) NanoViricides, Inc. is a development stage company with a unique nanomedicine technology. The Company is developing nanotechnology-based biomimetic anti-viral medicines, "nanoviricides®". Virus-specific nanoviricide drug candidates against five commercially important viral diseases, viz. seasonal and potentially-epidemic influenzas and bird flu, HIV/AIDS, cold sores and genital herpes infection, viral eye diseases, as well as dengue viruses, have demonstrated very high levels of effectiveness.
http://www.nanoviricides.com/

Provectus Biopharmaceuticals, Inc. (NYSEMKT: PVCT) Provectus Biopharmaceuticals, Inc., a development-stage biopharmaceutical company, engages in developing ethical pharmaceuticals for oncology and dermatology indications. Its product line includes PV-10, which has completed Phase II study for metastatic melanoma; completed a Phase I study for breast cancer; and is in Phase I protocol expansion for liver metastasis, as well as initiated a

Phase I feasibility study to detect immune cell infiltration into melanomas. The company is also developing PH-10 that is in Phase IIc randomized study for the treatment of psoriasis; and has completed Phase II study for the treatment of atopic dermatitis. In addition, it develops PH-10 for the treatment of actinic keratosis and severe acne vulgaris. Further, the company is developing over-the-counter pharmaceuticals, including GloveAid, a hand cream with antiperspirant and antibacterial properties; Pure-ific line of products to prevent the spread of germs on skin; and Pure-Stick and Pure N Clear acne products. Additionally, it develops medical device technologies for markets comprising cosmetic treatments, such as reduction of wrinkles and elimination of spider veins, and other cosmetic blemishes; and therapeutic uses, including photoactivation of PH-10, other prescription drugs, and non-surgical destruction of various skin cancers.
http://www.pvct.com/

RXi Pharmaceuticals Corporation (NASDAQ: RXII) is a biotechnology company focused on discovering and developing innovative therapeutics, primarily in the area of dermatology and ophthalmology, addressing high-unmet medical needs. RXi discovery and clinical development programs are based on siRNA technology as well as immunotherapy agents. These compounds include, but are not limited to, their proprietary, self-delivering RNAi (sd-rxRNA®) compounds for the treatment of dermal and retinal scarring. It also includes an immunomodulator, Samcyprone™, a proprietary gel formulation of diphenylcyclopropenone (DPCP), for the treatment of such disorders as alopecia areata, warts, and cutaneous metastases of melanoma. RXi's robust pipeline, coupled with an extensive patent portfolio, provides for product and business development opportunities across a broad spectrum. RXi is committed to being a partner of choice for academia, small companies, and large multinationals.
http://www.rxipharma.com/

New York Times

The Opinion Pages | Editorial

The Title Insurance Scam

By THE EDITORIAL BOARDMAY 12, 2015

When you buy or refinance a home, you have to get title insurance, which protects both you and the lender if ownership of the property is ever challenged. Shopping around for title insurance is rare; if you are like most people, you buy the insurance from a title agent referred to you by the loan officer or someone else involved in the transaction. All of which makes buyers of title insurance sitting ducks for abuse. Congress is aware of the situation — and is determined to keep things just as they are.

It is no secret, for instance, that many borrowers are overcharged for title insurance. In 2007, the Government Accountability Office warned that the price of title policies was inflated by lack of competition in the title-insurance market, as well as apparently illegal kickbacks paid by title agents to realtors, mortgage brokers, loan officers and others who sent business their way.

The 2010 Dodd-Frank law called for cleaning up title insurance, and, in 2014, regulators from the Consumer Financial Protection Bureau issued a rule to carry out the law. Basically, the rule created a safe harbor from liability for regulatory violations, but only for loans with closing costs of less than 3 percent of the total loan, including fees to title companies affiliated with lenders. In effect, the rule uses market incentives to limit title costs by offering lighter regulation in exchange for keeping costs down.

Congress is resisting. A bipartisan majority in the House recently passed a Republican bill to exclude title fees from the calculation that determines the level of regulatory scrutiny. The White House has threatened a veto. But, in the Senate, Republicans could add the bill to other legislation that Democrats may want.

The bill ignores evidence of kickbacks unearthed by the consumer bureau and by New York's Department of Financial Services. The public corruption case against Dean Skelos, who stepped down Monday as majority leader of the New York State Senate, and his son Adam, involves title insurance. The elder Mr. Skelos is alleged to have pressed a real estate executive to send title-related business to his son, who had worked in insurance. The executive had a title company pay the son a "commission" of $20,000 for no work — which is another way of inflating the price paid by consumers for title insurance.

http://www.nytimes.com/2015/05/12/opinion/the-title-insurance-scam.html

Questions for the Record
"Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens, Part II"
Hearing Date: May 13, 2015
Questions for Mr. Tom Quaadman

Response from Mr. Tom Quaadman

The U.S. Chamber of Commerce shares your concerns about EU regulatory developments that might impact the availability of research coverage, especially for smaller firms, and the detrimental effect this will have for capital formation in the United States. In particular, we fear that the European Securities and Markets Authority's ("ESMA") recent technical advice on the Markets in Financial Instruments Directive ("MiFID II") will severely limit investment firms from accessing research reports for firms which are smaller or lightly traded. It will also discourage European investment in American companies, potentially limiting a key source of funding for the U.S. capital markets.

ESMA's technical advice regulates fees related to research reports. The technical advice requires "unbundling" of research fees from commissions paid by clients to investment managers, both for equity research and for fixed income, currency and commodities research. The advice imposes significant operational constraints on investment managers and severely reduces clients' capacity to finance research. Currently, investment managers often use commissions as a method of paying for third-party research reports. These research reports are important for investment managers and allow them to make more informed investment decisions for their clients. They are especially critical for clients of smaller investment managers, which may not have the ability to conduct in-house research on behalf of their clients.

Moreover, even though these are EU regulations, firms that provide research reports to EU clients will need to comply with ESMA's technical advice. If the European Commission decides to follow the ESMA advice, the regulation of dealing commissions within the EU will have a global impact. Investment managers that operate globally will also be forced to comply with the technical advice and may begin charging research report fees directly to clients, driving up the cost of investing.

Consequently, we agree that there may be a potentially large impact on capital formation for smaller firms as a result of ESMA's technical advice. Smaller investment managers may decide to turn away EU clients given the logistical difficulties of charging research report fees to individual clients. They may also be forced to pay increased prices for research from external providers. These consequences could impact research coverage for lightly traded and less liquid securities, impacting Congress' current legislative priorities to promote capital formation.

Questions for the Record

Hearing: May 13, 2015 - Capital Markets and Government Sponsored Enterprises Subcommittee hearing entitled "Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens, Part II"

Requesting Member: Rep. Dennis A. Ross

- Witnesses:

  1. David Burton (Senior Fellow, Economic Policy, The Heritage Foundation,
  2. Tom Quaadman (Vice President, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce),
  3. David Weild (Chairman & CEO, Weild & Co.),
  4. Ronald J. Kruszewski (Chairman and CEO, Stifel Financial Corp., on behalf of the Securities Industry and Financial Markets Association (SIFMA))

I have a question about European Union (EU) regulations and how they relate to new limitations on how firms may pay for research. As I read the concerns raised in industry reports about how these European regulations could impact U.S. based research providers because of the global nature of our financial system.

It seems that the EU regulations, if enacted as currently contemplated, would limit an investment funds' ability to pay for research, and that the economics of this regulation would likely cause smaller research firms to curtail the amount of research that they publish, particularly on smaller, less liquid securities.

This may undercut all we are doing in the United States to cultivate capital formation for smaller firms. This may impact the tick size pilot program, the Venture Exchange Bill before us today and many other small changes we are making to ease the burden of capital formation.

Do you know of these regulations and Is it fair to say that they would have a significantly deleterious impact on capital raising in the U.S.?