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On behalf of the Securities Industry and Financial Markets Association

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Chairman Garrett, Ranking Member Maloney and members of the Subcommittee, thank you for the opportunity to appear before you today to discuss various legislative proposals to promote capital formation and job creation. My name is Gary Wunderlich, CEO of Wunderlich Securities, and I am testifying today on behalf of the Securities Industry and Financial Markets Association[1]. Wunderlich Securities is an independent investment firm and full service broker/dealer headquartered in Memphis with 28 offices in 16 states. We provide a full range of financial services to retail and institutional clients including investment banking, institutional sales and trading and research.

SIFMA and its member firms appreciate this Committee's dedication to a review of the environment for capital formation, and we are committed to working with you to evaluate and offer constructive recommendations to improve the wide-range of proposals that you are considering. America's success depends on a vibrant financial system that provides access to capital and credit at a reasonable price. The capital markets provide funding to people across America allowing them to build on their dreams of opening a small business, saving to send their children to college, buying their first home or saving for retirement. Our capital markets have changed dramatically in just the past few years so it is wholly appropriate for extensive public debate about what is working or not working in today's marketplace.

Changes in our economy and markets warrant evaluation and modernization of securities regulation in a manner that continues to protect investors, ensures the competitiveness of our markets and provides the efficient flow of capital to the many corners of our changing economy. In that regard, we welcome the opportunity to be here today.

[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. 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.

Tick-Size Pilot Discussion Draft (Rep. Duffy)

One area of capital formation that has been frequently debated over the past few years is the impact of decimalization on liquidity of small-cap and mid-cap issuers. Some have suggested that the move to decimalization has contributed to lower levels of liquidity in those stocks and that along with other factors, has impeded capital formation for those companies. Congress brought this issue into focus last year in passing the "JOBs Act". Section 106 of the "JOBS Act" directed the Securities and Exchange Commission (SEC) to conduct a study examining the effects of decimalization on initial public offerings (IPOs) and the liquidity of small and middle capitalization companies. The SEC submitted its report to Congress last July and included a literature review of a number of studies that had been conducted on the issue. The SEC recommended not proceeding with specific rulemaking to increase tick sizes, but rather considering additional steps that may be needed to determine whether rulemaking should be undertaken in the future. Since then, the topic has been discussed in a number of public forums, including Chairman Garrett's Equity Market Structure Roundtable this past May and an SEC Roundtable in February.

SIFMA and its members have also been engaged in an active dialogue about the impact of decimalization on small and mid cap issuers, and we generally believe that a pilot program which widens quote increments for small and mid cap securities could increase trading liquidity in those securities. Increased liquidity in the small and mid cap market will create a more fertile environment for small and emerging growth companies to tap the public markets, with broader market participation in the sector and the potential for increased research coverage to better inform and educate investors on both the opportunities and risks. We know that these companies can be an engine for economic growth, and the sponsors of these proposals are right to consider additional ways to ensure entrepreneurs have access to the capital they need.

While SIFMA is supportive of a pilot that explores how a wider tick size could benefit to small cap issuers, we oppose any pilot program that would prohibit trading within the wider quoting increments, as the current Discussion Draft contemplates. A prohibition on trading inside the quoting increment would be an unprecedented alteration of market practice and would prevent broker-dealers from providing price improvement to retail investors.

With respect to market practice, trading within the quoted spread has always been permitted. Before Regulation NMS and before the establishment of the stock exchanges themselves, market participants have always been able to meet in the middle on a negotiation over price. This includes periods when stocks were still traded in fractions instead of decimals (*e.g.,* 1/8ths of a dollar, instead of the current penny pricing). It is difficult to understand how such an alteration in market practice would facilitate the goal of increasing

liquidity for small-cap and mid-cap issuers. To our knowledge, there is no evidence to suggest that the goal of a tick size pilot to increase liquidity would be advanced by prohibiting trading within the wider quoting increments.

Perhaps more importantly, a trading restriction would have a negative impact on Main Street savers and retail investors. A consensus of most every market structure panel discussion or roundtable in recent months is that it has never been better to be a retail investor, as the options for routing trades have increased and as a result, trading costs have substantially decreased. Trading inside the spread allows broker-dealers to provide price substantial improvement at pricing increments within the established quoting increments. This happens routinely today when investors' trades are executed in non-exchange venues, allowing investors to "buy lower" and "sell higher" than they would otherwise. Just a few years ago, the SEC considered and rejected a trading restriction when it adopted the current penny-wide quoting increment, concluding that such price improvement benefits retail investors and is in the public interest. At that time, the SEC determined that trading in sub-penny increments does not raise the same concerns as sub-penny quoting, that sub-penny executions do not decrease depth at the posted quote (*i.e.,* do not reduce liquidity), and that sub-penny executions due to price improvement are generally beneficial to retail investors. The SEC's conclusion that it is in the public interest to allow trading within the spread is as relevant in 2013 as it was in 2005.

As with any market, free and open competition among trading venues has created pricing efficiencies for the end user – here, the retail investor – who benefits directly from lower trading costs. We are concerned that a restriction on trading increments would tilt the playing field in favor of certain venues over others, impair the robust competitiveness of this market, and accordingly, eliminate those price improvement opportunities that broker-dealers currently give their customers.

In addition, for any possible pilot program to be a success, it is critical to establish clearly stated metrics for use in evaluating the results of the pilot. And while SIFMA generally supports a pilot for widening quoting increments in small and mid cap securities, ideally we would like to see such a study take place as part of a broader review of U.S. market structure. Such a review should include the regulatory structure around exchange and off-exchange trading venues, the future of self-regulation, and a consideration of whether the comparative regulatory benefits and obligations facing exchanges and broker-dealers should be adjusted to reflect today's market realities. As SEC Commissioner Gallagher has noted at SIFMA's previous two market structure conferences, this review should have "no sacred cows."

Business Development Company Regulation (H.R. 31, H.R.1800 and H.R. 1973)

SIFMA supports efforts to modernize regulation of Business Development Companies (BDCs) as contemplated in the three bills we are discussing today. Since their creation, BDCs have been subject to

regulation under the Investment Company Act of 1940 subjecting them to certain statutory safeguards covering such areas as diversification, leverage, compliance and valuation. The BDC structure was created to promote public vehicles as a means to bring capital to small and medium sized businesses and by regulation, 70% of BDCs investments must be in private or small cap companies.

The JOBs Act provided for an onramp for Emerging Growth Companies (EGCs) to access the IPO market and has also created a framework for crowdfunding to bring capital to early stage entrepreneurs in much smaller increments. More can be done, however, to promote the flow of capital to private companies that are big enough to need larger amounts of capital to reach the next stage of their development but are still years away from an IPO. BDCs offer one such critical source of capital to eligible companies. BDC's have been active issuers in the last few years as they see opportunity to bring funds to attractive companies that are struggling to find capital at a reasonable cost from other sources.

Unfortunately much of the modernization of securities regulation that occurred in 2005 by way of Securities Offering Reform largely did not apply to BDCs. As a result, SIFMA believes that many unnecessary obstacles remain in place today so that BDCs are unable to efficiently access the markets and, in turn, provide much needed capital to middle market companies. We support efforts to align regulation for BDCs more closely with that of other public companies.

Since most BDCs are tax RICs (Regulated Investment Companies) and as a result are required to dividend out substantially all of their net income for tax purposes, BDCs are required to come to the public markets more regularly to raise capital in order to grow. The inability to utilize some of the built- in efficiencies in securities regulation for frequent corporate issuers, such as incorporating previously filed information by reference, creates unnecessary burdens. Moreover, since BDCs are generally unable to sell their shares below NAV (absent a shareholder vote among other things), they are even more sensitive to the need to access markets when conditions are favorable and so the inability for larger BDCs to qualify as Well-known Seasoned Issuer (WKSIs) and realize the benefits of automatically effective registration statements is also harmful. These types of hurdles impede BDCs in their mission to bringing much needed capital to the middle markets in a cost effective and efficient manner.

Lastly, SIFMA believes some incremental flexibility in the asset coverage ratio should be provided to BDCs to allow them to better fulfill their mission while at the same time maintaining sufficient safeguards to protect investors such as enhanced disclosure requirements, capital structure limitations, corporate governance and compliance requirements, affiliate transaction limitations and restrictions on leverage, all of which are applicable to BDCs by virtue of their being subject to compliance with the '40 Act and which are incremental to the safeguards applicable to other public companies.

Emerging Growth Company Discussion Draft (Rep. Fincher)

Congressman Fincher's discussion draft which would modify existing regulation of EGCs is also laudable and SIFMA supports each of the four provisions in the discussion draft.

Section 1 amends the Securities Act of 1933 to reduce the quiet period requirements from 21 days to 5 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 a significant reduction in the quiet period as contemplated in the bill.

Sections 2 and 3 of the Discussion Draft 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.

Conclusion

SIFMA welcomes your continued interest in supporting capital formation through appropriate regulatory relief. Many in government often try to distinguish Main Street from Wall Street but the capital allocation function provided by my Memphis, Tennessee firm and thousands of others across this country supports the creation and expansion of tens of thousands of small businesses who are truly the backbone of our economy and the best hope we have for robust job creation moving forward. Again referring to Commissioner Gallagher's quote that there should be no sacred cows as we evaluate how our markets have evolved and what more can be done to improve their function, SIFMA strongly supports the work of this Committee to facilitate capital formation and create jobs and we look forward to continued constructive engagement throughout this process.