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United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

MAXINE WATERS, CA, RANKING MEMBER

M E M O R A N D U M

To: Members of the Committee on Financial Services

From: FSC Majority Committee Staff

Date: October 21, 2013

Subject: October 24, 2013 Subcommittee on Capital Markets hearing on "Legislative Proposals to Reduce Barriers to Capital Formation"

The Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing on "Legislative Proposals to Reduce Barriers to Capital Formation" at 2:00 pm on Thursday, October 24, 2013, in Room 2128 of the Rayburn House Office Building. This will be a one-panel hearing with the following witnesses:

- Heath Abshure, Arkansas Securities Commissioner, on behalf of the North American Securities Administrators Association
- Michael Arougheti, Chief Executive Officer, Ares Capital Corporation
- J. Michael Ertel, Legacy M&A Advisors, LLC
- Alexander C. Frank, Chief Financial Officer, FIFTHSTREET
- Patrick O'Shea, Senior Managing Director, BB&T, on behalf of SIFMA
- Tom Quaadman, Vice President, Center For Capital Markets Competitiveness, U.S. Chamber of Commerce
- David Weild, Chairman & CEO, IssuWorks

This hearing will examine seven legislative proposals:

- H.R. 31, the Next Steps for Credit Availability Act
- H.R. 1800, the Small Business Credit Availability Act
- H.R. 1973, the Business Development Company Modernization Act
- H.R. 2274, Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act
- H.R. ___, To direct the Securities and Exchange Commission to revise its regulations relating to requiring the use eXtensible Business Reporting Language for periodic reporting to exempt smaller public companies from such requirements
- H.R. ___, To amend the Securities Exchange Act of 1934 to provide for an optional pilot program allowing certain emerging growth companies to increase the tick sizes of their stocks

- H.R. ___, To amend certain provisions of the securities laws relating to the treatment of emerging growth companies

Modernizing the Regulation of Business Development Companies

Business development companies (BDCs) are closed-end investment companies that invest in small- and medium-sized private companies rather than large public companies. Not only do BDCs invest in small- and medium-sized companies, they also lend to these companies, filling a market niche that some commercial banks have abandoned. As a result, many small and medium-sized American businesses have been able to obtain financing that might not otherwise have been available, which has permitted them to grow.

In 1980, Congress authorized the creation of BDCs by amending the Investment Company Act of 1940 (15 U.S.C. § 80a-1 et seq.) (the Investment Company Act). Congress has not updated the statute since 1980. The existing regulatory framework has created challenges for BDCs seeking to raise and deploy capital and, in turn, to satisfy Congressional mandate to lend to small and medium-sized companies. This hearing will examine three proposals to modernize and streamline the regulatory regime governing BDCs: H.R. 31, the Next Steps for Credit Availability Act; H.R. 1800, the Small Business Credit Availability Act; and H.R. 1973, the Business Development Company Modernization Act.

Introduced by Rep. Michael Grimm, H.R. 1800, the Small Business Credit Availability Act, would amend Section 60 of the Investment Company Act to allow BDCs to purchase, acquire, hold securities of or other interests in an investment advisers or advisors to investment companies and allow BDCs to issue more than one class of senior security which is a stock. H.R. 1800 would also amend Section 61(a) of the Investment Company Act to reduce the ratio of assets to debt from 200% to 150%. Finally, H.R. 1800 would direct the Securities and Exchange Commission (SEC) to revise its rules and forms to allow BDCs to use the streamlined securities offering provisions available to other registrants under the Securities Act of 1933 (15 U.S.C. 77a et seq.) (the Securities Act). Among these revisions, H.R. 1800 directs the SEC to revise Rules 418 and 14a-101 under the Securities Act, and Rule 103 under Regulation FD, which are not explicitly included in H.R. 31 (Rep. Velazquez). H.R. 31, the Next Steps for Credit Availability Act, introduced by Rep. Nydia Velazquez, is substantially similar to H.R. 1800 except that it does not direct the SEC to revise Rules 418 and 14a-101 under the Securities Act and Regulation FD Rule 103.

Introduced by Rep. Mick Mulvaney, H.R. 1973, the Business Development Company Modernization Act, amends Section 2(a)(46)(B) and Section 60 of the Investment Company Act to allow BDCs to purchase, acquire, or hold securities or other interests in the business of registered investment advisers, advisors to investment companies, and other "eligible portfolio companies" as defined in the Investment Company Act, including certain financial services companies. On June 12, 2013, Joseph Ferraro of Prospect Capital testified that by eliminating outdated limitations, H.R. 1973 would bring small- to medium-sized American financial services businesses into the family of "eligible assets," thus removing an obstacle to their growth and increasing the flow of BDC dollars into these new and expanding American businesses.

H.R. 2274, the Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act

Mergers and Acquisitions (M&A) brokers perform services in connection with the transfer of ownership of smaller, privately held companies. M&A brokers are subject to costly and burdensome regulatory requirements, which adversely impacts and unnecessarily increases the costs that business owners incur when they buy or sell their businesses. The SEC's Forum on Small Business Capital Formation ("Forum") recommended from 2006-2011 that the SEC should modernize and streamline the regulation of M&A brokers but the SEC has never acted on these recommendations.

Introduced by Rep. Bill Huizenga, H.R. 2274, the Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act, would amend Section 15(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78a et seq.) (the Exchange Act) to create a simplified SEC registration system for M&A brokers. Specifically, H.R. 2274 would allow M&A brokers to register with the SEC by filing an electronic notice which would be made publicly available on the SEC's website. A properly completed electronic notice of registration would become effective immediately upon receipt by the SEC, except that SEC approval of such notice would be required if the M&A broker, or a person associated with the M&A broker, is subject to suspension or revocation of registration, a statutory disqualification, or a disqualification under SEC rules pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. No. 111-203). H.R. 2274 would also require M&A brokers to make certain disclosures to clients as may be required by the SEC including, but not limited to, a description of the M&A broker and its affiliates, associated persons, fees, and any conflicts of interest.

In addition, H.R. 2274 would direct the SEC to tailor its rules governing M&A brokers by taking into account the nature of the transactions in which M&A brokers are involved, the involvement of the parties to such transactions, and the limited scope of the activities of M&A brokers. Under H.R. 2274, an M&A broker would be prohibited from receiving, holding, transferring, or having custody of client funds or securities in connection with the transfer of an eligible privately held company and would not to be able to engage on behalf of an issuer in a public securities offering. H.R. 2274 would require the SEC to work with the states to establish uniform and consistent standards of training, experience, competence, and other qualifications for M&A brokers, as well as to develop the form and content of the electronic notice of registration. On June 12, 2013, Shane Hansen on behalf of the Alliance of Merger & Acquisition Advisors testified that H.R. 2274 would "reduce the regulatory costs incurred by sellers and buyers of small and midsized privately held companies for professional business brokerage services, while enhancing their protection through well defined, appropriately scaled, and cost effective federal securities regulation."

H.R. _____, To amend the Securities Exchange Act of 1934 to provide for an optional pilot program allowing certain emerging growth companies to increase the tick sizes of their stocks.

Rep. Sean Duffy has circulated a discussion draft of legislation to amend Section 11A(c)(6) of the Exchange Act to provide for an optional pilot program administered by the SEC allowing certain "Emerging Growth Companies" (EGCs), a category of issuers recently established in Title I of the Jumpstart Our Business Startups (JOBS) Act (P.L. 112-106), with a stock price above $1.00 to increase the "tick size" at which their stocks are quoted and traded

from $.01 to $.05, or, if the EGC's board of directors so elects, $.10. The discussion draft would allow covered EGCs to change the tick size of their stock from $.05 to $.10 or from $.10 to $.05 one time during the pilot program, as it would also allow EGCs to opt out of the program. On July 10, 2013, Kenneth Moch from Chimex testified that '[t]he current one-size-fits-all approach to tick size does not reflect the realities of the market and subjects smaller issuers to the same trading framework as large, multinational companies with exponentially higher trading volumes and market caps. I support flexibility in tick size for smaller issuers in order to address the needs of small companies hamstrung by decimalization. A pilot program to allow small issuers to choose larger trading increments (either $0.05 or $0.10) would spur trading activity in emerging company stock."

H.R. _____, To direct the Securities and Exchange Commission to revise its regulations relating to requiring the use eXtensible Business Reporting Language for periodic reporting to exempt smaller public companies from such requirements.

Rep. Robert Hurt has circulated a discussion draft to provide an optional exemption for EGCs and non-accelerated filers from SEC rules requiring registrants to file their financial statements in an interactive data format known as eXtensible Business Reporting Language (XBRL). The discussion draft would direct the SEC to revise its rules in accordance with the XBRL exemption. On July 10, 2013, Kenneth Moch from Chimex testified that because "XBRL reporting does not provide much insight for potential investors in small companies, the high cost of compliance far outweighs its benefits." Mr. Moch expressed support for "an exemption from XBRL compliance for smaller issuers (or modified compliance, with exemptions from onerous detailed tagging), freeing them from a costly regulatory burden that does more harm than good."

H.R._____, To amend certain provisions of the securities laws relating to the treatment of emerging growth companies.

Rep. Stephen Fincher has circulated a discussion draft of legislation to change registration requirements for EGCs. The discussion draft reduces from 21 to five the number of days that an EGC must have a confidential registration statement on file with the SEC before the EGC may conduct a road show. The discussion draft also clarifies that an issuer that had been an EGC when it filed its confidential registration statement but ceased to be an EGC before its initial public offering (IPO) will be treated as an EGC through the date of its IPO. The discussion draft requires the SEC to revise its general instructions on Form S-1 to indicate that a registration statement filed (or submitted for confidential review) by an issuer before its IPO may omit financial information for historical periods otherwise required by regulation S–X. Finally, the discussion draft allows EGCs to submit a confidential draft registration statement to the SEC for any follow-on securities offerings after its IPO.