REDUCING BARRIERS TO CAPITAL FORMATION

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

JUNE 12, 2013

Printed for the use of the Committee on Financial Services

Serial No. 113–29

U.S. GOVERNMENT PRINTING OFFICE

81–764 PDF WASHINGTON : 2013

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

JEB HENSARLING, Texas, *Chairman*

GARY G. MILLER, California, *Vice Chairman*
SPENCER BACHUS, Alabama, *Chairman Emeritus*
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
SHELLEY MOORE CAPITO, West Virginia
SCOTT GARRETT, New Jersey
RANDY NEUGEBAUER, Texas
PATRICK T. McHENRY, North Carolina
JOHN CAMPBELL, California
MICHELE BACHMANN, Minnesota
KEVIN McCARTHY, California
STEVAN PEARCE, New Mexico
BILL POSEY, Florida
MICHAEL G. FITZPATRICK, Pennsylvania
LYNN A. WESTMORELAND, Georgia
BLAINE LUETKEMEYER, Missouri
BILL HUIZENGA, Michigan
SEAN P. DUFFY, Wisconsin
ROBERT HURT, Virginia
MICHAEL G. GRIMM, New York
STEVE STIVERS, Ohio
STEPHEN LEE FINCHER, Tennessee
MARLIN A. STUTZMAN, Indiana
MICK MULVANEY, South Carolina
RANDY HULTGREN, Illinois
DENNIS A. ROSS, Florida
ROBERT PITTENGER, North Carolina
ANN WAGNER, Missouri
ANDY BARR, Kentucky
TOM COTTON, Arkansas
KEITH J. ROTHFUS, Pennsylvania

MAXINE WATERS, California, *Ranking Member*
CAROLYN B. MALONEY, New York
NYDIA M. VELÁZQUEZ, New York
MELVIN L. WATT, North Carolina
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
MICHAEL E. CAPUANO, Massachusetts
RUBÉN HINOJOSA, Texas
WM. LACY CLAY, Missouri
CAROLYN McCARTHY, New York
STEPHEN F. LYNCH, Massachusetts
DAVID SCOTT, Georgia
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
GWEN MOORE, Wisconsin
KEITH ELLISON, Minnesota
ED PERLMUTTER, Colorado
JAMES A. HIMES, Connecticut
GARY C. PETERS, Michigan
JOHN C. CARNEY, JR., Delaware
TERRI A. SEWELL, Alabama
BILL FOSTER, Illinois
DANIEL T. KILDEE, Michigan
PATRICK MURPHY, Florida
JOHN K. DELANEY, Maryland
KYRSTEN SINEMA, Arizona
JOYCE BEATTY, Ohio
DENNY HECK, Washington

SHANNON McGAHN, *Staff Director*
JAMES H. CLINGER, *Chief Counsel*

SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

SCOTT GARRETT, New Jersey, *Chairman*

ROBERT HURT, Virginia, *Vice Chairman*
SPENCER BACHUS, Alabama
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
RANDY NEUGEBAUER, Texas
MICHELE BACHMANN, Minnesota
KEVIN McCARTHY, California
LYNN A. WESTMORELAND, Georgia
BILL HUIZENGA, Michigan
MICHAEL G. GRIMM, New York
STEVE STIVERS, Ohio
STEPHEN LEE FINCHER, Tennessee
MICK MULVANEY, South Carolina
RANDY HULTGREN, Illinois
DENNIS A. ROSS, Florida
ANN WAGNER, Missouri

CAROLYN B. MALONEY, New York, *Ranking Member*
BRAD SHERMAN, California
RUBÉN HINOJOSA, Texas
STEPHEN F. LYNCH, Massachusetts
GWEN MOORE, Wisconsin
ED PERLMUTTER, Colorado
DAVID SCOTT, Georgia
JAMES A. HIMES, Connecticut
GARY C. PETERS, Michigan
KEITH ELLISON, Minnesota
MELVIN L. WATT, North Carolina
BILL FOSTER, Illinois
JOHN C. CARNEY, JR., Delaware
TERRI A. SEWELL, Alabama
DANIEL T. KILDEE, Michigan

CONTENTS

Page

Hearing held on:
June 12, 2013 1
Appendix:
June 12, 2013 35

WITNESSES

WEDNESDAY, JUNE 12, 2013

Coulson, R. Cromwell, President and Chief Executive Officer, OTC Markets Group 4
Ferraro, Joseph, General Counsel, Prospect Capital Corporation 6
Hansen, Shane B., Partner, Warner Norcross & Judd LLP 8
Langevoort, Donald C., Thomas Aquinas Reynolds Professor of Law, Georgetown University Law Center 11
Weild, David, Senior Advisor, Grant Thornton LLP 10

APPENDIX

Prepared statements:
Huizenga, Hon. Bill 36
Coulson, R. Cromwell 37
Ferraro, Joseph 67
Hansen, Shane B. 75
Langevoort, Donald C. 93
Weild, David 97

REDUCING BARRIERS TO CAPITAL FORMATION

Wednesday, June 12, 2013

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 1:10 p.m., in room 2128, Rayburn House Office Building, Hon. Scott Garrett [chairman of the subcommittee] presiding.

Members present: Representatives Garrett, Hurt, Huizenga, Grimm, Stivers, Fincher, Mulvaney, Hultgren, Ross; Maloney, Sherman, Himes, and Carney.

Ex officio present: Representative Hensarling.

Also present: Representative Duffy.

Chairman Garrett. This hearing of the Subcommittee on Capital Markets and Government Sponsored Enterprises will come to order. The hearing is entitled, "Reducing Barriers to Capital Formation."

I welcome the esteemed panelists for your testimony. But before we do that, I will recognize myself for 5 minutes.

Today, we are here to discuss the important topic of reducing barriers to capital formation for America's small businesses. Startup companies and small businesses are literally the backbone of our economy, generating literally millions of jobs in the United States every year. Yet, these companies often find it difficult to raise the capital they need to successfully launch and grow their businesses.

So last spring, Congress passed the bipartisan Jumpstart Our Business Startups Act, the JOBS Act, for short, to enhance capital formation and reduce regulatory burdens for American startups and small businesses. And although it is far too early to judge the ultimate success of the JOBS Act, early indications are that the law is working.

First, since April 2012, around 600 companies have elected Emerging Growth Company (EGC) status under the Act, with about a third of these companies listed or pending a listing on NASDAQ or the New York Stock Exchange market. IPOs got a strong start in 2013.

Second, more than 90 percent of EGCs that publicly filed their first registration statements since 2012 elected to use at least one accommodation under the JOBS Act, with certain IPO on-ramp accommodations being particularly popular.

Third, according to an April 2012, Small Business Access to Capital Survey, one in five respondents indicated that they are more likely to seek outside investors as a result of the JOBS Act.

And, fourth, with the short-term interest rates near zero, the JOBS Act has benefited investors, providing more options to put their money to work. Many companies have gone public under the JOBS Act to outperform peer companies that did not.

But notwithstanding these positive trends, the full potential of the JOBS Act remains largely unrealized today, as the SEC continues, unfortunately, to delay mandatory rulemaking to implement many of the law's most important and beneficial provisions. Of course, this delay really comes as no surprise to those of us who have followed the SEC's priorities in the past. Indeed, year after year, the SEC seems to place promoting capital formation, which is a key component of the agency's mission, near the bottom of its agenda.

For example, last year the SEC tabled the JOBS Act rulemaking to prioritize issues and rules under the Dodd-Frank Act for companies to disclose their use of conflict minerals as well as rules requiring the disclosure of payment of government entities by companies engaged in resource extraction. While these rules may have commendable goals, they fall outside of the SEC's core expertise, and they appear to do very little, if anything, to protect investors, make the U.S. markets more fair and efficient, and promote capital formation. At worst, they do the opposite.

While the SEC has for years received valuable recommendations on how to promote access to capital for small businesses from its own Government-Business Forum on Small Business Capital Formation, and its Advisory Committee, the agency so far has acted on only a small number of these recommendations.

So with all this in mind, I was pleased to hear Chairman White reaffirm to this committee last month that she is committed to prioritizing the completion of mandatory JOBS Act rulemaking as soon as possible, and I hope that her commitment carries over to other efforts to facilitate small business capital formation.

Today, America's startups and small businesses continue to encounter difficulties accessing U.S. capital markets to finance their business, and the cost of these companies going and staying public remains very high.

On top of this, over the past 5 years the Obama Administration has unleashed a record amount of burdensome red tape that has disproportionately increased the cost of doing business for smaller companies compared to their larger peers. As a result, many small businesses have been forced to do what? Cut back on hiring and employee benefits at a time when our economy and those employees can least support it.

And so as our country continues to go down a path of slow economic growth and persistently high unemployment, it is more important than ever that we continue to reduce burdensome government regulations on small businesses and enhance our ability to obtain capital at a reasonable cost.

So I look forward to hearing from our panel this afternoon on ways that Congress and the regulators, as well as market participants, can continue to build on the JOBS Act, including, among other things, efforts to modernize the regulatory regime governing business development companies, to increase liquidity in the shares of publicly traded small and mid-cap companies, and to promote more research analyst coverage for small cap companies.

With that, I yield back my time, and I recognize the gentleman from California for 5 minutes.

Mr. SHERMAN. Mr. Chairman, thanks for holding these hearings.

For most of what the average American would call a small business, getting expansion capital means getting a loan. And that is the purview, chiefly, of another subcommittee, but I should address it for a minute.

First, we should commend the Fed for keeping interest rates low at this critical time in our economy. Because if you are trying to get enough money to open a second restaurant, you are trying to get a loan, and if you are able to get the loan, it will be a lower interest rate than it would be otherwise, and your customers now think that their home is worth more than their mortgage, and they are actually able to come to that restaurant. Whereas, a few years ago, my constituents wouldn't go to a restaurant unless there were golden arches in front of it.

Second, we ought to pass the bill to allow credit unions to make small business loans, and we ought to be pushing the regulators of commercial banks to not turn up their noses at small business loans.

We had, in this room, Jamie Dimon come in and say he had to send tens of billions of dollars to London where, as you will remember, it was eaten by a whale, because he couldn't find businesses here in the United States to lend it to. One of the very few things just about all sides of all aisles agree on here is that we all know of 100 small businesses which need capital. I am talking about the really small businesses that aren't even thinking of going public.

As to those thinking of who are going public, a key thing is whatever we can do to minimize legal and accounting fees and the other costs of going public, one of those things would be not to require audit rotation beyond the standards already found in the accounting profession because that can, in some cases, double the audit fee, which is a significant portion of the cost of being a small publicly traded company.

Finally, as to the SEC prioritization of regulations, I think we ought to give the regulators a break here. They cannot look at one statute and say, "That is a good one, I will do that one first," and look at another statute and say, "That is a bad one."

It is possible the Chair believes that minimizing legal and accounting fees for businesses going public is more important than saving lives in Eastern Africa, where they are beset with conflict mineral issues. Others would reach the other conclusion. And the regulators simply have to follow the laws we pass. I don't think the SEC should refuse to enact regulations to implement laws just because the chairman voted for them and I voted against them or vice versa.

With that, I yield back.

Chairman GARRETT. The gentleman from Virginia is recognized for 2 minutes.

Mr. HURT. Thank you, Mr. Chairman.

Thank you for holding today's hearing on Reducing Barriers to Capital Formation. One of the most important functions of this committee is to promote initiatives to increase access to capital for our small businesses and startups. Last Congress, this subcommittee led the way in the enactment of the JOBS Act. Among other things, the JOBS Act allowed emerging companies to tap capital in the public markets without enduring some of the most burdensome regulations which inhibit their ability to grow.

Despite the SEC's ability to fully implement the JOBS Act in a timely fashion, we are already seeing the positive impact of the law, as 83 percent of IPOs after the JOBS Act's passage were emerging growth companies. We, however, can still do more to remove costly and unnecessary regulatory impediments that are restricting companies from accessing capital in the public and private markets.

I have heard from innovative biotech companies in my district, Virginia's Fifth District, that the overall regulatory burden which disproportionately impacts small or public companies is the primary motivator in their decision to stay private. We must look at solutions to eliminate and streamline regulations to create an environment that is more efficient and conducive for long-term economic growth.

I appreciate this committee's continued focus on ensuring that our small businesses and startups have the ability to access the necessary capital in order to innovate, expand, and create the jobs that our local communities need, that my Virginia's Fifth District needs. I look forward to the testimony of our distinguished witnesses, and I thank them for their appearance today.

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

Chairman GARRETT. The gentleman yields back.

In looking around, I think that is the end of opening statements, which is great, because it means we can talk to the experts now and hear your opinions.

Without objection your full written statements will be made a part of the record. You will be recognized for 5 minutes for a summary. The lights in front of you, of course, advise you as to 5 minutes, 1 minute, and your time is up.

With that, I will begin on the left here.

Mr. Coulson, you are recognized for 5 minutes.

STATEMENT OF R. CROMWELL COULSON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, OTC MARKETS GROUP

Mr. COULSON. Thank you, Chairman Garrett, Ranking Member Maloney, and members of the subcommittee. My name is Cromwell Coulson, and I am CEO of OTC Markets Group. I appreciate the opportunity to testify.

As an operator of public marketplaces for smaller companies, and being a smaller publicly traded company ourselves, in our own right, I hope I can provide the committee with greater insights into barriers to capital formation that should be removed.

We are all here because we recognize the value of public trading to small growing companies and the U.S. economy. The visibility, valuation, liquidity, capital, and trust that public trading provides can create some of the most successful and sustainable companies in the capitalist system.

We have provided 15 concrete suggestions in our written testimony that together will make our public markets more open, more transparent, and more connected for smaller public companies, while reducing the complexity and cost.

Our marketplaces, like all public markets, are better informed and more efficient when there is transparency of trading activity and availability of company information. We work with broker-dealers in the trading process, and we have completely changed what was once an opaque marketplace. Now, the broker-dealers trading out of our markets are the same electronic broker-dealers trading NASDAQ and New York Stock Exchange Securities.

But we also work with a wide range of companies. We need to engage them to provide better information for investors. And we have designed a system of tiered marketplaces to separate the highest quality companies from the lowest, and also to clearly warn investors when there is less information.

The JOBS Act, particularly through ending the ban on general solicitation and new, more inclusive capital raising, takes great strides towards achieving the type of transparency our markets need to thrive. We can do more, though, to reduce barriers to capital formation by thoughtfully enhancing our public secondary markets.

Capital has greater value if it is liquid and transferable. A carefully crafted tick size pilot program applicable to quotes and orders but not trades could provide a much-needed improvement to small company liquidity and value. Equity markets in the United States are the most regulated of all our financial markets. Our antifraud provisions already give regulators a broad sword when they see wrongdoing. But regulators should think like investors. Give investors the information they need to make intelligent decisions, but let them make choices.

Our limited resources should be used to protect investors by driving transparency and smartly targeting the biggest problems, not just creating the longest regulatory filings or the largest number of enforcement cases. We urgently need more transparency of the people behind SEC reporting companies that are being widely promoted on the Internet. These advertisements of penny stocks, without any information about the people promoting them, makes a mockery of our regulatory system.

Our promotion disclosure regulations were written for an era when promotion was done through the mail. It needs to be updated, because we have interesting biotech companies, smaller manufacturing companies, and community banks that are traded on our markets which are drowned out by these other companies.

We want equality of regulation. There should be margin eligibility for all higher quality public companies, not just exchange-traded companies. This will help the community banks, giving them greater access to capital. We also want consistent disclosure of institutional holdings and insider trading in non-exchange-listed securities.

With market structure, we should be careful not to be governed by fear. Markets, like all U.S. industries, need diverse choice and healthy competition to promote growth and innovation. Some use the term "fragmentation" to paint a picture of a broken marketplace in need of repair. "Fragmentation" may sound dark and dangerous, but it is just a spin doctor's word used by those losing market share to more dynamic competitors.

When NASDAQ was a market for small companies, it was not a centralized stock exchange, but an automated quotation system with fragmented trading connected by transparency. Promoting competition efficiency is what drives a successful small company marketplace. It would be a step in the wrong direction to create monopoly stock exchanges or any attempt to create a trade-out rule or regulation that would mandate centralized trading on stock exchanges.

Thank you, again, for inviting me to testify. While the issues I discuss may seem diverse, each is a vital component to reducing barriers to capital formation by creating better informed and more efficient financial marketplaces. I look forward to discussing these and other ideas with you.

[The prepared statement of Mr. Coulson can be found on page 37 of the appendix.]

Chairman GARRETT. Likewise. Thank you.

Next, Mr. Ferraro is recognized for 5 minutes.

STATEMENT OF JOSEPH FERRARO, GENERAL COUNSEL, PROSPECT CAPITAL CORPORATION

Mr. FERRARO. Chairman Garrett, Ranking Member Maloney, and members of the subcommittee, thank you for the opportunity to testify today.

My name is Joseph Ferraro, and I am general counsel to Prospect Capital, a leading provider of capital to job-creating small and medium-sized companies in the United States. Prospect is a publicly traded business development company, or BDC. Our company completed its initial public offering in July 2004, and since then we have invested more than $5.5 billion in over 175 small and medium-sized companies to expand their businesses, hire workers, construct factories, and achieve other important objectives.

Our capital has helped create thousands of American jobs over the years, and our capital is much needed in this critical period of high unemployment and economic uncertainty.

In 1980, Congress enacted amendments to the Investment Company Act of 1940, authorizing BDCs to facilitate financing of small and medium-sized businesses. Financing these companies requires significant and time-consuming due diligence activities and rigorous credit analysis that has become uneconomical for traditional banks, and involves transaction sizes too small for many other capital providers. Put simply, a BDC is a lender to, and an investor in, small and medium-sized businesses that might not otherwise receive financing.

Today, our industry is composed of about 40 publicly traded BDCs, collectively managing $39.1 billion in assets. Our industry believes that modest changes to our securities laws can greatly enhance the ability of BDCs to serve the capital needs of small and medium-sized companies without undermining investor protections.

These changes have been recommended by bills introduced by Representatives Mulvaney, Velazquez, and Grimm.

First, a BDC must invest at least 70 percent of its assets in so-called eligible assets, namely public micro-cap and private companies. But current law excludes financial services companies from qualifying as eligible portfolio companies. Thus, no more than 30 percent of a BDC's assets can be invested in financial services companies.

This outdated limitation makes no sense. Financial services is a sector that encompasses a wide array of companies, including community banks, leasing companies, factoring firms, and automobile financing companies. These companies have a capital magnifying effect that results in more capital flowing into small and medium-sized businesses. How? Because such companies themselves frequently serve the needs of other smaller companies.

Further, BDC investments in small to medium-sized American financial services businesses are consistent with the principal purpose for which Congress created BDCs—to provide capital and assistance to small, developing businesses that are seeking to expand and create American jobs. The law should not artificially limit a BDC's ability to provide capital to such companies.

Second, current law limits a BDC's investment in investment advisors. Although the SEC routinely provides administrative relief from this prohibition though exemptive relief orders, the process is very time-consuming and expensive. The pending bills would repeal this prohibition, in essence codifying existing practice and ending the needless spending of shareholder resources to seek administrative relief.

Third, BDCs, like other companies that regularly raise capital through security issuances, rely on pre-filed shelf registrations—filings that allow a company to be pre-positioned to issue additional securities. Because shelf registrations contain financial information that becomes outdated, companies are allowed to incorporate by reference in their shelf registrations subsequent financial reports. However, BDCs are not allowed to take advantage of this commonsense approach and instead must annually update shelf registrations each time new quarterly information is reported. This should be changed.

Fourth, in 2005 the SEC modernized the issuance process especially for frequent securities issuers, reducing costs and making the process more efficient. However, BDCs were excluded from these commonsense reforms. Our industry is a frequent issuer of securities. For example, Prospect has raised some $2.5 billion since our IPO in 2004 through more than 26 public offerings. There is no public policy justification for BDCs being left behind when the SEC modernized these rules.

Fifth, the pending bills offer other reforms that can assist BDCs in raising and deploying capital. For example, these bills allow some easing of the leverage limits imposed by current law on BDCs to allow more flexibility on how a BDC constructs its own balance sheet.

In conclusion, business development companies are an important source of capital for small and medium-sized companies. With some commonsense reforms, it is possible to increase the capacity of

BDCs to support job-creating American businesses without in any way undermining the strong investor protections or costing taxpayers a dime. We applaud the efforts of Representatives Mulvaney, Grimm, and Velazquez, and urge the committee to act favorably on BDC reform legislation.

I would be pleased to answer any questions you may have.

[The prepared statement of Mr. Ferraro can be found on page 67 of the appendix.]

Chairman GARRETT. I thank you.

Next, from Warner Norcross, Mr. Hansen, you are recognized for 5 minutes. Good afternoon.

STATEMENT OF SHANE B. HANSEN, PARTNER, WARNER NORCROSS & JUDD LLP

Mr. HANSEN. Thank you, Chairman Garrett, Ranking Member Maloney, and members of the Capital Markets Subcommittee. Thank you for this opportunity to explain how and why today's one-size-fits-all system of securities broker-dealer regulation adversely impacts and unnecessarily increases the costs incurred by business owners for professional and business brokerage services to sell, buy, or grow their small and medium-sized businesses in privately negotiated transactions.

My comments today are primarily focused on H.R. 2274, the Small Business Mergers, Acquisition, Sales, and Brokerage Simplification Act of 2013, a bipartisan bill introduced by Congressman Huizenga, with Congressmen Higgins and Posey.

The public policy considerations supporting this legislation go back to 2005, with the publication by the American Bar Association of a report and recommendations of the Private Placement Broker-Dealer Task Force which is available on the SEC's Web site. A similar recommendation was made by the final report of the SEC Advisory Committee on Smaller Public Companies in 2006, which is also available on the SEC's Web site.

Appropriately scaling Federal regulation of merger and acquisition brokers has been among the top recommendations in the 2006, 2007, 2008, 2009, 2010, and 2011 SEC Government-Business Forums on Small Business Capital Formation. Indeed, in January 2012, then-SEC Chairman Mary Schapiro acknowledged these concerns in a response to a bipartisan congressional letter and a Senate committee's question for the record, both attached to my written statement. Despite this, in more than 6 years the SEC has not made this small business issue a rulemaking priority and is unlikely to do so in the absence of a congressional directive.

Let me describe for you the business context of this issue. Each of you has in your districts likely hundreds, perhaps thousands, of small and medium-sized business owners who sooner or later will want to prepare for and sell their business. They will want professional business brokerage services to help them. Similarly, back in your districts you likely have hundreds, perhaps thousands, of entrepreneurs committed to owning their own businesses, or larger companies wanting to grow their businesses through acquisitions. These potential buyers want professional assistance finding and screening potential sellers. These buyers and sellers are represented by counsel and often assisted by accountants. They rely upon written representations, warranties, covenants, and remedies in their negotiated contracts for their protection.

Capital formation, business growth, jobs creation, and preservation by small and medium-sized businesses are all facilitated with business brokerage services. For example, the acquisition of one business by another enables the combined business to expand and to accumulate investor capital in more diversified, often financially stronger business enterprises. Small business sellers and buyers simply cannot afford to hire a registered investment banking firm, whose fees typically start at $500,000. And there are no registered investment bankers in most small communities.

So today, Federal securities laws and rules regulate Main Street M&A brokers the same way as they regulate Wall Street investment banks handling public company transactions. Compliance costs are necessarily passed on to the business buyers and sellers in order for the M&A broker to stay in business, and small firms only handle a few transactions each year but must maintain ongoing regulatory compliance at all times.

H.R. 2274 would direct the SEC to create a simplified system of M&A broker registration through a public notice filing, and would require delivery to clients of disclosures about M&A brokers similar to those requirements applicable today to investment advisors. The bill would direct the SEC to review and tailor applicable rules to fit this smaller business context.

In conclusion, regulatory reengineering is urgently needed, even as recognized by the SEC. The perception of public protection through today's broker-dealer regulation is illusory because in fact thousands of small, unregistered M&A firms do business across the country. The rules are simply not clear in how they apply to them and do not fit. Today's one-size-fits-all broker-dealer regulation is simply too costly for small and medium-sized businesses to afford, so they either go without professional advice or hire cheaper unregistered firms. This congressional directive to adopt a regulatory solution will ultimately free up the SEC's resources to better protect our public markets and passive investors.

I urge you to support H.R. 2274, and I look forward to your questions.

[The prepared statement of Mr. Hansen can be found on page 75 of the appendix.]

Chairman GARRETT. Thank you.

At this point, I will yield to Mr. Huizenga.

Mr. HUIZENGA. Thank you, Mr. Chairman.

I appreciate that. I came in from the House Floor—where we were moving along our package of derivatives bills—just as Mr. Shane Hansen was starting. Important things are happening here in the Financial Services Committee.

But I want to thank Shane for bringing this issue to my attention a while ago, now, and it was a great meeting and a great opportunity for us to begin to work together. I think, as he has aptly pointed out, the proposal that is before us is going to significantly reduce the regulatory compliance costs, which currently exceed $150,000 initially and $75,000 annually. The SEC has not taken this recommendation in the past. And I think it is time that we do this legislatively.

As we know, approximately $10 trillion of privately owned Main Street, mom-and-pop type businesses will be sold or closed as Baby Boomers age. That is a tremendous amount of transfer of wealth that is going to be happening. I think how we handle that is very important for our future generations. I appreciate everything that this committee is doing to help ease that.

So thank you, Mr. Chairman.

With that, I yield back.

Chairman GARRETT. Thank you. I appreciate that.

Mr. Weild, you are now recognized for 5 minutes. Thank you for being with us this afternoon.

STATEMENT OF DAVID WEILD, SENIOR ADVISOR, GRANT THORNTON LLP

Mr. WEILD. Thank you. Chairman Garrett, Ranking Member Maloney, and members of the subcommittee, thank you for inviting me to speak today about an issue of great importance to America, how to reduce barriers to capital formation, particularly for small companies, which are the growth engine of the U.S. economy.

My name is David Weild. I oversee Capital Markets at Grant Thornton, LLP, one of the six global audit, tax, and advisory organizations. I was formally vice chairman of the NASDAQ stock market, with responsibility for all of the listed companies. I also ran the equity new issues business of a major investment bank for many years.

U.S. capital markets, once the envy of the rest of the world, have undergone a profound transformation in less than a generation, leaving small business investors and the U.S. economy much worse off. I will quickly share several shocking statistics confirmed by a study that I recently coauthored for the Organization for Economic Cooperation and Development (OECD). U.S. markets have lost nearly half of all listed companies from their peak in 1997. The United States has suffered 15 years of consecutive lost listings from the U.S. stock markets. The U.S. small IPO market has suffered a catastrophic failure, falling from first place in small IPOs to 12th among the 26 largest IPO markets. On a GDP-weighted basis, we are now 24th, ahead of only Mexico and Brazil.

The U.S. IPO market should be producing 5 to 10 times the number of IPOs it has produced over the past 13 years. We estimate 10 million additional U.S. jobs would have been created during this timeframe. Notably, in our work for the OECD comparing the top 26 IPO markets, low-cost electronic markets with inadequate tick sizes are harming IPO markets in other areas of the world as well.

After-market support is the biggest single obstacle to resurgence in the U.S. IPO market for small companies. The collapse in tick sizes from 25 cents to 1 cent, a result of regulatory and structural changes since 1997, is gutting the infrastructure of smaller broker-dealers, research analysts, and capital support that is essential to take small companies public and support them in the aftermarket once they are public.

Ultimately, while lower tick sizes have benefited short-term, high-turnover traders through lower transaction costs, long-term fundamental investors in small cap stocks have lost liquidity and investment opportunities and are thus much worse off today. The

U.S. stock markets are now essentially governed by a one-size-fits-all framework, with 1 cent tick sizes for every stock, regardless of share price, market capitalization, or liquidity. Only big brands and large companies can sustain adequate visibility with investors in today's market. Small cap stocks need broker-dealers to support their liquidity, sales, and equity research in order to sustain active markets.

U.S. capital markets have lost their way, but as my written testimony elaborates, we can take proactive and immediate steps to overcome the structural challenges faced by the U.S. stock markets and promote capital formation for small companies.

First, we applaud passage of H.R. 701 by an overwhelming vote of 416–6, and we encourage swift Senate adoption of this bipartisan bill that requires the SEC to finalize Regulation A-plus rulemaking by October 31, 2013. Reg A-plus will provide a less complex registration process, a higher offering limit of $50 million, and increase investor protections. This is an important catalyst by which small companies can now go public, grow, and contribute to job creation. However, we urge Congress to also consider the need for Blue Sky exemptions, or we fear this Regulation A-plus will not be utilized.

Second, we strongly urge an immediate SEC pilot program of at least 5 years in length to let emerging growth companies and small cap companies trade with higher tick size increments. Higher tick size increments will increase liquidity and capital formation for small companies by increasing the incentives required to fuel investments in equity distribution sales and aftermarket support. As markets realign, share performance and returns on investment will improve, all while laying the foundation for increased IPOs, economic growth, and job creation.

Third, we encourage the creation of a new parallel stock market exempt from Regulation NMS for public companies under $2 billion in value. Adequate aftermarket support is a continuing challenge for small companies. This new market would give issuers a choice in markets, proper balance between intermediaries, issuers, and their investors, and usher in a return to the business of underwriting and supporting small cap companies.

Thank you for the opportunity to present information on such an essential topic. I am pleased to answer any questions. Thank you.

[The prepared statement of Mr. Weild can be found on page 97 of the appendix.]

Chairman GARRETT. Thank you very much.

Finally, from Georgetown University Law Center, Professor Langevoort, you are recognized for 5 minutes.

STATEMENT OF DONALD C. LANGEVOORT, THOMAS AQUINAS REYNOLDS PROFESSOR OF LAW, GEORGETOWN UNIVERSITY LAW CENTER

Mr. LANGEVOORT. Chairman Garrett, Ranking Member Maloney, I am pleased to testify today on the vitally important topic of capital formation and investor protection. With the JOBS Act more than a year old, we still await rulemaking by the SEC on many of its key provisions.

However, the JOBS Act does not exhaust the possibilities for innovations in capital raising and secondary trading that can make our financial markets more robust and opportunities for honest entrepreneurship more compelling.

The SEC's Advisory Committee on Small and Emerging Companies has made a number of recommendations for additional changes that, if appropriately crafted, could be a positive step forward, including a more sensible disclosure regime for small and emerging issuers, those companies with a smaller footprint in our markets, our economy, and our society.

While I do not agree with all of their suggested exemptions, there is much room for adjustment. As the Advisory Committee also recommends, we can also do more to facilitate the evolution of fair and efficient secondary trading markets for both nonpublic companies and smaller public companies, recognizing, however, that if that evolution turns sharply in the direction of larger and more robust accredited investor-only markets, the adverse implication for our public markets could be profound.

Regulatory reform efforts should continue, but it is essential that this be done with due regard for investment protection. No amount of regulatory reform can eliminate the uncomfortable truth that small business capital formation is difficult because small business is very risky and the cost of capital high.

While inefficient regulation raises the cost of capital, good regulation lowers it. Investor trust is closely tied to capital formation and economic growth. Although that trust has proven resilient over time, it is not something that can be taken for granted. If it hits some tipping point and recedes because there is too much perceived risk of opportunism and abuse, capital formation will be damaged by poorly crafted innovations, not enhanced.

For all the honest entrepreneurs who deserve a better shot at marketplace funding, there are opportunists who not only threaten the financial well-being of targeted, sometimes vulnerable investors but take funds away from legitimate enterprise, pollute the reputation of our markets generally, and create no jobs except for perhaps in boiler room operations. No innovations in capital raising will work unless the help investors tell the difference between good promoters and bad, as well as between good business plans and dubious business plans. Otherwise, this is just gambling, from which smart investors know to stay away.

I would commend to you the SEC's Investor Advisory Committee as another bipartisan voice worth listening to as its members reach consensus. Although there are many imperatives in crafting good rules to promote entrepreneurship and capital formation, two are paramount. One is that we recognize the role of retirement savings as an at-risk target, the threat to which neither aging Americans nor our economy generally can afford. The other imperative is the need for greater transparency in so-called private markets so that there can be better oversight and surveillance in the otherwise dark spaces where investments are aggressively promoted and sold.

I commend members of the subcommittee for their attention to these important challenges.

Thank you.

[The prepared statement of Professor Langevoort can be found on page 93 of the appendix.]

Chairman GARRETT. Thank you.

Again, I thank the panel for their testimony. At this time, we will go to questioning, and I will recognize myself for 5 minutes.

Let's begin with one area, and that is the area of research analysts. I will throw it out to maybe Mr. Weild and Mr. Coulson, I guess.

First of all, would you agree on the basic premise that when it comes to research analysts—I think you will agree, there is less availability of research analysts for small businesses than there are for large businesses.

Mr. WEILD. Absolutely.

Mr. COULSON. Yes.

Chairman GARRETT. If that is the case, it makes it harder for smaller cap companies to grow and be able to sell and get into the equity markets and sell their shares.

Mr. WEILD. Yes.

Mr. COULSON. Absolutely.

Chairman GARRETT. I will set the premise here, and maybe I will give you the answer. Do you think this came about due to the SEC's 2003 global research analyst settlement agreement?

Mr. WEILD. I believe that it was already in process, dating back to the Order-Handling Rules and Reg-ATS and the collapse of the economic incentives to support small cap companies and have a way to pay for that research.

Chairman GARRETT. Give me a date, then.

Mr. WEILD. That was 1997 and 1998. But I think it was obfuscated by the bubble. The dot.com bubble was in full form at that point in time. When you fast-forward to decimalization in 2001, people were already starting to shed research analysts, research compensation.

Chairman GARRETT. Mr. Coulson?

Mr. COULSON. From what I hear from investment bankers, they are very nervous about having banking related to the research process. And it creates a dynamic, even for big companies, because we have some of the largest ADRs in our marketplace, globally, and they say the large banks, because equity trading is funding research now, restrict which institutions they send it to. So tier two and tier three institutions don't even see some research from big banks because you have to send it to the ones who pay for the trading. And if it is driven by investment banking, paid for or equally funded with proper oversight and controls, it is used more broadly to support the knowledge of the firm in that space. I think on Wall Street, we have always had conflicts. We have ways of dealing with conflicts, rather than just ban an activity and cut off the funding for it.

Chairman GARRETT. I am getting slightly different things here.

Mr. WEILD. They are both accurate. Excuse me. When we study actually—about 80 percent of commissions are generated by the top 100 institutional investors in the market, which are skewed very large cap and high turnovers. So, consequently, that small cap research product really doesn't have a home because it tends to be consumed by smaller and smaller institutions that don't have the liquidity constraints of the big firms. That is all a product of this hyper-efficient, low-cost penny tick size market, which means there is really no way to make money as an investment bank from supporting specialists in investment in small cap companies.

Mr. COULSON. The smaller investment banks do not have the trading business today. It has gone to the more electronic, larger transaction firms. So the business relationship they have with smaller companies is based on investment banking.

Chairman GARRETT. So, even if we solve the conflict issue somehow or other—you used words like "proper regulation" or something like that—that the settlement agreement tried to address or did address, are both of you saying that in and of itself—I hear your points on the tick size and what have you. Is that not enough to try to address this problem?

Mr. COULSON. No.

Chairman GARRETT. Okay.

Mr. COULSON. I think it is a great start, but I also think we need to solve the liquidity issue for smaller companies by—the tick study is one approach.

Chairman GARRETT. So maybe the question should be this, then: Is this conflict issue in addressing the settlement issue an essential part of it? In other words, we have to address the tick size, and there are a couple of other things we are going to pull out of this panel, although all my time is focused on this one issue. This, though, has to be addressed as part of that process, is that correct?

Mr. WEILD. It is an important part of that process, yes.

Mr. COULSON. It is one of the key things that needs to be done.

Mr. WEILD. Chairman Garrett, I believe that the key part is liquidity. It is not necessarily even research. It is capital commitment to small cap stocks to facilitate liquidity and having a mechanism whereby brokers can actually earn a return on facilitating institutional liquidity. Because institutions have increasingly cut allocations to small cap stocks because of the loss of liquidity. And that is not necessarily related to the research problem. It is related to market making.

Chairman GARRETT. I get that. I will close on this: That is why we had the panel up in New York to try to begin the overall discussion on market structure reform similar to what this panel has talked about there. So, that goes to the larger issue.

Thank you for your testimony.

The gentleman from Connecticut is recognized for 5 minutes.

Mr. HIMES. Thank you, Mr. Chairman, and thank you to all the witnesses for coming in front of this robust committee today to talk about this topic, which clearly has drawn the interest, at least on my side of the aisle.

I, for one, have been following the IPO market pretty closely prior to the creation of the JOBS Act. And I think it is a really important topic of conversation.

Of course, over the last couple of years, people have made every argument conceivable for why the IPO market over the years has declined. Some people say it is Sarbanes-Oxley. Some people say it is NMS. Other people say it is order handling rules. Other people point to the economy.

There is actually some pretty dramatic data coming out about the U.S. IPO market in the year 2012. IPOs—this is by dollar volume—in the Asia-Pacific were down 40 percent. In Europe, they were down 64 percent. In the United States, they were up by 17 percent, such that the United States IPO volume represented just less than half—43 percent—of global IPO issuance. That would suggest perhaps that the story we hear from the other side of the aisle that overwhelming U.S. regulation is going to crush our markets is perhaps not entirely factual. But it is also intriguing. What drove that? Was this in fact a difference of regulation relative to Europe and Asia Pacific? Was this in fact different order handling rules? Can somebody explain to me the incredible sort of volatility in issuance volumes and the out-performance of the United States IPO market?

Mr. WEILD. Yes, sir. We interact with international companies because we have 1,500 ADRs on our marketplace. So we see the largest and the smallest. In Europe, the economy is what is driving that dynamic right now. The financial markets there are very depressed. We talked to the IROs of the largest companies. That said, the dynamic when I meet an interesting small public company, it is most likely listed in Toronto or London or on the Australian stock exchange because they have created processes which are a lot more friendly. And that is what I keep hearing from companies—from smaller companies especially—and we will see U.S. companies. We had a company that is in the payment business that went public on the Aim to Raise Capital, came back to our marketplace to re-enter the U.S. markets, and then they upgraded to NASDAQ at the turn of the year. Small companies find it friendlier to go overseas from the United States. And international companies—

Mr. HIMES. Let me stop you there, because I have limited time, and I have two other categories of questions. One is, as public policymakers, how do we know when we have that balance right? I used to do IPOs many, many years ago, and I know they are darn expensive things to do. Gross spread is still 7.5 percent. By the way, I would like to talk about that. For 20 years, I have been paying attention, and gross spread for an IPO is 7.5 percent. I am sort of fascinated by that consistency. But it is an expensive thing to do. That doesn't include lawyers' fees. Pretty soon, you are getting up to 10 percent of your volume of issuance.

How do we know that our system is set up such that the companies that go public via IPO, set aside these are risky companies we are talking about and what that implies for retail investors, how do we know when we have struck the right optimal balance? Do we just look at Canada and Europe and say, we are doing less $50 million IPOs than they are? How do we know?

Mr. WEILD. Congressman Himes, those markets—I am going to recommend to you the paper that we wrote for the OECD. I think it is entitled, "Making Stock Markets Work for Economic Growth." But we looked at, say, 26 IPO markets. The ones that Cromwell ticked off all have higher tick sizes to the percentage of share price for smaller capitalization stocks. There are aftermarket incentives. And the multiple regression that we ran actually explains, based on economic incentives, about 70 percent of IPO production globally.

Mr. HIMES. Can I stop you there? Because I am going to run out of time. That was my third category of questions. Maybe I will have a chance to come back for some others.

Can you, in the 45 seconds remaining, give us a sense for why increasing the tick size would in fact promote more smaller IPOs? This is not a regulatory thing. This would essentially be moving money from one group of third parties to the other. Can you sort of explain that and why that would be helpful?

Mr. COULSON. Market-structured penny tick size creates a market structure that competes almost exclusively on cost of trading. And in microcap markets, you need value creation, which is sales, promotion, marketing of stories, telling of the stories. You need to capital to facilitate institutional-size liquidity. Those are primary ingredients. You need research. That is value creation. There is no economic model to support value creation. So, as a consequence, we go to the lowest common denominator and compete on price alone. That is catastrophic for stocks that trade episodically: big buyer, no seller. It works fine for large cap stocks. So this is the reason we take this model and we apply it to everything, and it disenfranchises the entire small company ecosystem.

Mr. HIMES. Thank you. I note my time is up. Maybe I will get a chance to ask more questions later. But I appreciate the answer. Thank you.

And thank you, Mr. Chairman.

Mr. COULSON. Just one quick point is, because talking about the structure of what, hopefully, tick size would incentivize is more displayed liquidity by intermediaries. If you have a small company stock that trades 30 times a day—that is once every 1,000 seconds—you need intermediaries.

We have a world where, yes, we have displayed prices. And the average community bank in my marketplace has a spread of 19 cents, trades at $17. But it is kind of like stores in Cuba. The prices are low, but you can't buy anything. How do we fill the shelves up with liquidity again? How do we reignite liquidity, so an inventor says, "Hey, I can buy something in here." Instead of, "If I buy something, the price yo-yos up. When I am filled, it goes back down."

And the tick study is a good start. But I can't explain it to you in 15 seconds because I need to sit down with you and your staff and go through the market structures and go through some of the things we have seen. We used to have increments in our market. We saw more displayed liquidity by intermediaries. I think it is a great experiment.

Chairman GARRETT. Thank you.

Mr. Fincher is recognized for 5 minutes.

Mr. FINCHER. Thank you, Mr. Chairman.

I thank the panel for being with us today. Something we have been focused on in my short time of being here in the second term is jobs, jobs, jobs—trying to get more people into the workplace to get our economy moving. Mr. Carney and I, last year or I guess the year before, sponsored the JOBS Act. And this was something that has been very good.

I have a couple of questions, but I am going to read a statement first: "Since April 2012, shares of U.S. companies that have gone public under the JOBS Act are generally outperforming those that did not; a 28.9 percent average stock price appreciation from offered price for JOBS Act companies compared to 13.1 percent for non-JOBS Act companies. From April 2012, to January 2013, U.S. companies that have gone public under the JOBS Act have outperformed the Russell 2000 Growth Index, which is up 11 percent over that period."

Just a couple of questions, and I will end with a simple one: Why have small company IPOs, under the $250 million market cap, declined since 2004? And the second question, aside from the SEC's failure to fully implement the JOBS Act, what do you believe are the largest factors explaining why many companies are still sitting on the sidelines and not going public? If you could answer the second one first?

Mr. Coulson, I will start with you.

Mr. COULSON. So on why are companies sitting on the sidelines? Because they are scared of the cost and complexity. It is not just when you go in today. They think it gets raised every time you are a public company and some big company does something wrong from corporate governance, you need to hire more consultants.

There is a dynamic. Big companies are owned by index funds. We have to have a different corporate governance system for them. Small companies, we should design our markets to fit intelligent investors, so there is information availability, because investors aren't forced to own them. They get to buy and sell them. And how do we get that efficient information out, but not creating this compliance?

One of our recommendations is that we wait on XBRL for smaller public companies because we are hearing from SEC reporting companies it is going to $35,000 to a vendor every year and take up their finance committee time. So, those are things we can do reduce the complexity. And XBRL is a great idea. Everybody thought it was smart. But we have created this cost on smaller companies.

Number two, why are we seeing fewer IPO's and smaller companies? One, we have a very successful private capital-raising marketplace. And the JOBS Act, when the SEC votes—and I have heard they are going to vote rather soon on removing general solicitation—we are going to really change this wall between private capital raising and public capital raising. We are changing the check-at-point-of-sale rather than blocking out all this transparency about capital-raising activity in the markets. And this is going to make going public be more of a continuum. Companies suddenly aren't dark everything because they are scared of breaking their capital raising because they put their annual report on their Web site, and that we start seeing more disclosure and companies start trading. That is how it used to be, but our markets got broken up.

The second piece, which I am not sure we can fix that easily, is some of the numbers from when the IPOs were higher, were smaller, riskier IPOs on NASDAQ; the Stratton Oakmont, the boiler room movie guys. Those were NASDAQ securities, which most people don't remember. But those raised the numbers. What happened was, the firms got overloaded with regulation on sales practices. So they said, "We don't really want to sell to individual investors any-more. We just want to sell privately to accrediteds who are more sophisticated." And that dynamic is even if you do a private placement, those securities, if you make them tradeable after they have come to rest, after they have been seasoned for a year, that capital becomes more valuable and thus companies will have a lower cost of capital if you make a security tradable. Because securities are based. They are property.

Mr. FINCHER. One final question, Mr. Hansen, for you and anybody else who wants to respond in 40 seconds, in your opinion, what regulation or law has inhibited capital formation for businesses the most? What one?

Mr. HANSEN. I would say, in the context of raising capital, it would be limitations on the ability to generally solicit investments, but which needs to be carefully constructed to protect investors. On the M&A side, I would tell you that formation of capital comes from mergers and acquisitions of businesses, and the broker-dealer regulation inhibits that by forcing very small firms into a very expensive system of regulation.

Mr. FINCHER. Thank you very much.

I yield back, Mr. Chairman.

Chairman GARRETT. I now recognize Mr. Ross.

Mr. ROSS. Thank you, Mr. Chairman.

I appreciate that.

Back when the Advisory Committee on Small and Emerging Companies did their recommendations, on January 6, 2012, they recommended the Commission take immediate action to relax or modify the restrictions on general solicitation, as you referred to, Mr. Coulson. We passed the JOBS Act and required it to be done by July 4th. Unfortunately, the SEC missed that deadline. Unfortunately, this becomes endemic, not only with the SEC but with any agency under the jurisdiction of Dodd-Frank, that we are having these deadlines just lapse.

I guess my question is, to what extent has this impacted not only capital markets but also just some sense of certainty in business planning for the business environment out there, when the JOBS Act, under the Regulation D of general solicitation restrictions being removed, not being done?

Mr. Coulson?

Mr. COULSON. I was speaking to a CEO who has a publicly traded company. They are not SEC-reporting, but they have $100 million in revenues and they own restaurants. And he was reaching out to me, saying, "I have been raising capital privately from friends and family. We have been growing the business. But we have an opportunity to expand. When is the JOBS Act going to take place? When is Reg A-plus going to come? Because I want to use that."

I keep hearing about it. That is the story I keep hearing, that this is going to change capital raising for small companies.

Mr. ROSS. So, they are sitting on the sidelines. In other words, investment capital is waiting.

Mr. COULSON. They are constrained.

Mr. ROSS. Let me ask you this, then. Do you feel that there is sufficient capacity of investment capital out there to meet what hopefully is a pent-up demand for those who are entrepreneurs or businesses that want to put it to use?

Mr. COULSON. It is going to change and open up capital raising because now the rules of privacy for private capital raises, you can only talk to pre-existing relationships. You can't have any publicity around it. So much capital is stuck, sitting there. There will be some dumb ideas financed because of the transparency.

Mr. ROSS. But isn't that what the market does?

Mr. COULSON. And it will be so much better if we, not only investors, but the press and the public see what is going on in capital markets. If we stop having this one tier of markets, where things take place publicly, and then you have everything else taking place in private. Unless you are Dr. Evil, you would really like to finance your company publicly.

Mr. ROSS. I am going to poll each one of you on this, because I only have 2 minutes left. Mr. Sherman from California referred to this. Put it down on my level. When I go back home and I see mom-and-pop investors, and see my developers that are looking for investment capital in order to expand their business or to start their development, and they go to the banks and because of their restrictions, there is nothing in the equity markets. So, they go to a credit union.

What is your opinion, if I would just poll you, we have this issue of whether we should raise the commercial lending capacity for credit unions. How do I tell my people back home, "Just wait, the JOBS Act will pass? We will have more investment capital out there for you. You don't need to go to a credit union." But in the meantime, they are waiting. So what is your opinion on expanding the commercial credit limit for credit unions?

Mr. COULSON. It is another great access to capital. But debt is different than equity. And they should all be there and companies should decide. Equity has a lot of advantages because it is perpetual. You don't go bankrupt issuing equity.

Mr. ROSS. But entrepreneurs have to act. They don't have the luxury of waiting for equity financing. And they need the liquidity so they will go to debt financing.

Mr. COULSON. The JOBS Act was filled with great ideas for all levels of creating equity. But it just hasn't happened. We are all waiting.

Mr. ROSS. Mr. Ferraro, anything to add?

Mr. FERRARO. Congressman, I look at that issue in the context of my own company because business development companies are in the business of providing that debt. We do both debt and equity. But really, being a lender is the bread and butter. We are here today promoting legislation that is all about increasing opportunity, increasing the category of investments in financial services companies that we can freely invest in. Some of the legislation concerns leverage limits, a lot of registration parity and reform. So getting to your question, essentially, those kinds of reforms that we are in favor of, that is the other avenue. I hope you tell them to visit a BDC.

Mr. ROSS. Message delivered. I believe my time has expired, so I will yield back.

Chairman GARRETT. Mr. Stivers is recognized for 5 minutes.

Mr. STIVERS. Thank you, Mr. Chairman.

My first question is for Mr. Coulson. You listed 15 recommendations in your testimony. Do you know, are there proposals out there for—I know for several of them, there are, but there were a bunch that I wrote question marks next to. Are there folks working on many of these ideas or any of these ideas that you know of? I know a couple of folks who are working on some of these ideas.

Mr. COULSON. They are working on some of the proposals. The SEC has a draft rule filing—I haven't seen it, so I don't know if it is good or bad—to better regulate SEC transfer agents. We proposed that the SEC have better disclosure around promotion on the Internet, which hurts all capital raisers. We did it 7 years ago. There were 200 comments in favor of it, but there has been nothing but silence.

So these are areas where getting them to act—and I am a plumber of electronic markets. My goal is to connect broker-dealers so they trade things efficiently. My goal is to connect companies to putting information on the Internet so it is freely available and the market can make informed choices. But I can't if these pieces of plumbing from broad ranges of the JOBS Act to small things such as marginability for a community bank shares—we have 600 community banks. When one of them leaves NASDAQ, there is no change in that company. Why shouldn't that security be marginable? It is an asset in our economy.

Mr. STIVERS. That makes a lot of sense. I did appreciate in your testimony where you talked about benefits of publicly traded markets, visibility liquidity, valuation capital and trust. And the fact that now we are basically encouraging, by how complicated we are making things, capital to go other directions. And I think that is the gist of this hearing.

Mr. Weild, I wanted to talk about your proposal for the change in the tick size. I believe Mr. Duffy may be working on something like that. I don't want to preempt him. But it seems like that would help a lot of small companies.

Mr. WEILD. It will help not just public companies, companies going public, but it will help the private markets as well because this is the equity food chain or the supply chain, if you will. And by having a hole blown out of the IPO market, we don't have capital then coming back into the private markets and then reinforcing itself. All of these rules which allow us to get out and promote or, if you will, market stocks, what they will do is they will help with the reallocation of assets from larger capitalization companies into smaller capitalization companies, which is where the job formation lives. And innovation lives. So it is a very healthy thing in the aggregate if you look at it in macro terms.

Mr. STIVERS. I used to work for a securities firm, and one of the things I did was IPOs. I worked there for 5 years. The IPO market is very cyclical. And when somebody comes out and has a successful offering, either two or three lookalikes come out after it. I also know in the conversation with Mr. Himes earlier, he was trying to get at that issue. That seems to me to be part of the issue as well. But clearly, you need a few successful offerings for other people to then come behind them. And I think that is part of the problem with some of the smaller companies right now, too, because somebody has to be first. And nobody—a lot of people don't want to be first in the marketplace.

Mr. WEILD. And IPO markets are always cyclical. They still are. They always were. But the new cycles, the new highs—

Mr. STIVERS. Are not as high.

Mr. WEILD. —are lower than the old lows. That should tell you something. Banks are losing money in the aftermarket for small companies, so they don't support the companies. The deals break issue price at higher rates because they are not getting supported, which shuts the IPO window. And somebody had asked the question before, why do these sub-$250 million market value companies not go public? And they are rational. It is because the success rates of IPOs have gone lower and lower, even for larger capitalization companies that been cut in half over the last 15 years, because of the lack of support.

Mr. STIVERS. So your proposal for a secondary market system for some of those smaller companies that serve as alternative exchange, would that be similar to kind of what the pink sheets have been? Or tell me how you—

Mr. WEILD. No. I think actually increasingly everything has been subject to the same sort of trading regulation. And what we were really encouraging was a governance structure that put investment banks, institutional investors, and issuers, they gave them all a seat at the table and actually focused exclusively on the needs of small cap markets and small cap investors, small cap issuers, just so that you created that core discipline, which I think is generally lacking, because if you go to the SEC and you listen to a lot of the debate, it is totally overwhelmed by large cap data, S&P 500 data. And that I think is really leading us astray.

Mr. STIVERS. It overwhelms the small companies for sure.

Mr. WEILD. Absolutely.

Mr. COULSON. And just a point, we bought and killed the pink sheets with technology and transparency. So that old opaque phone-base is—and we have changed that. So it is not a pink sheets type market. Our marketplace looks a lot more like NASDAQ.

Mr. STIVERS. I understand it is a lot more transparent, and it is realtime.

Mr. COULSON. Like NASDAQ, when it was a marketplace for small companies.

Mr. STIVERS. I am out of time.

Thank you, Mr. Chairman, for your indulgence.

Chairman GARRETT. The gentleman is welcome. And the gentleman yields back.

The gentleman from California.

Mr. SHERMAN. I think, Mr. Weild, it was you talking about the greater tick sizes. A company could decide to make sure that its shares were worth $5 rather than $50, just by issuing 10 times as many. Would that in effect give them a higher tick, because the 1 cent would be on a $5 rather than a $50 per share basis?

Mr. WEILD. It is an excellent point. And the answer is it would, except that in the United States, because the practice of Wall Street is to prohibit solicitation on stocks under $5 a share and keeping those stocks on margin, every issuer wants to keep their stock above $5 a share. So, unlike other foreign markets where people will actually trade their stocks or split them down to 50 cents or $1 so that 1 penny on a dollar share price would be 1 percent incentive, in the United States, that option is effectively eliminated by the practice of the market from issuers. So, it doesn't work in the United States.

Mr. SHERMAN. So you could do it at $10 a share, but you have to keep your shares at well above $5, because they could always go down. You could do a stock split to go from 50 down to about 10 as long as you are confident—

Mr. WEILD. Right. And that has why a 10 cent tick size on a $10 share price would be the equivalent of what we see in foreign markets that makes them work with a dollar share price with a penny tick size. That is why having higher tick sizes is the easiest way to fix this problem in the United States.

Mr. COULSON. So if you are the CEO of a community bank, are you going to say, "Oh, I need a higher tick size, so I am going to have my stock be at $3, and then my depositors will think I am economically distressed?" We should have proper tick sizes based—

Mr. SHERMAN. I realize there is some belief that if the share is selling for $50 per share, the company is stronger than if it is selling for $8 or $5 per share. That is just psychological. There is no basis for it. But we all can't have shares with the value of Berkshire Hathaway.

Is there anyone here on the panel who thinks that the greater tick size would be harmful to investors? At first blush, it would seem to, since it is in effect, more cost. Jack wants to sell the shares. Bob wants to buy them. And the transactions cost is greater.

Yes?

Mr. COULSON. If you are looking at cost based on where was the inside quote at the time of trade, it would look like it is more cost, because the way markets work now is intermediaries use what is called a tail trading strategy. They move the price the bid offer up and down as investors come in and out. So if you thicken it up a little bit—and we don't agree with having tick sizes as widely spread as they are today. We just think you should organize them. If a community bank has a 19 cent spread today at $17, the debate is whether it is a nickel or dime increment, not a 25 cent increment. I have seen when we had increments—we used to have increments of below a dollar of half a penny—we saw much more proprietary liquidity stack up. And, that was a good thing for investors.

Mr. SHERMAN. So, it is counterintuitive. But you think investors do better with a 5 or 10 cent tick rather than a 1 cent tick—minimally, or incrementally?

Mr. COULSON. It is based on price and velocity. We really shouldn't care if it is a $1 stock or a $100 stock, just to have increments that organize. They don't sell Picassos at Sotheby's in penny increments—

Mr. SHERMAN. Let me try to get in one more question, because we are all focused here on publicly traded companies, which most businesses aren't and don't even aspire to be.

Mr. Ferraro, you are investing in companies that are smaller. What is missing, in my area at least, are loans that yield 6 to 12 percent. In other words, if you are creditworthy enough to get yourself a 5 percent loan, I have four bankers out there in the hallway who will make a loan to you right now. But if you are not quite that creditworthy, nobody will make you the loan. What is the typical rate of interest that you charge when you are not getting an equity kicker?

Mr. FERRARO. Typical rates of interest—our rates can range anywhere from 8 to 12 to 14 percent. It really all depends on the opportunity at hand, the health of the company involved.

Mr. SHERMAN. Do you insist on full collateralization?

Mr. FERRARO. I'm sorry?

Mr. SHERMAN. Do you have to have as much collateral as you borrow? Or do you borrow against A, it is a good company or here is the hard asset?

Mr. FERRARO. All different levels. Collateralized loans. Whatever is appropriate in the situation.

Mr. SHERMAN. If you set up an office in the San Fernando Valley, make sure it is in the west or southern portion of that valley. I yield back.

Mr. FERRARO. That is what we like to do.

Chairman GARRETT. Mr. Huizenga is now recognized.

Mr. HUIZENGA. Thank you, Mr. Chairman.

Mr. Hansen, I do appreciate you for staying on message about H.R. 2274, when my colleague Mr. Fincher had asked what your one thing is. And I do want to get to that. I want to ask everybody. But if you could, really quickly, this has been a recommendation from the SEC working group and forum for a number of years. I think 2006 was the first time it came up. Why has the SEC not taken this recommendation? Why do we find ourselves at a point now where we need to use a legislative tool?

Mr. HANSEN. I think that is a great question. I think the answer is essentially that the SEC has a long to-do list that is directed by Congress. And so, it is focused on those types of priorities, which to some extent reflect national crises with which they have had to deal. In the area of M&A brokers, small businesses, medium-sized businesses, this is not an area where there have historically been issues. There haven't been frauds. The parties rely upon their lawyers. They negotiate transactions. And they are not relying upon Federal securities laws for those protections.

So I think it is not perceived as an urgent issue, except it is because there are estimated to be $10 trillion of privately held companies in the process of being sold as Baby Boomers retire. And as a result of that, these sellers and buyers each need professional advice. It is an urgent issue. So, I think it does necessitate Congress stepping in to say, "We need to simplify this."

Mr. HUIZENGA. All right. Thank you. Here is what I would like to do in the remaining 3 minutes. I would like to quickly hear from each one of you. What do we need to do next? We have one piece of legislation that we are talking about. I think, Mr. Ferraro, you have talked about a couple of other pieces.

And I know, Professor Langevoort—it takes a Dutch guy to know a Dutch name—you had said in your testimony that the JOBS Act, we need to have some more patience, we don't want to rush this, is kind of how I am interpreting what was there. But I am curious, what can we do next, to have a next step so that we can continue some momentum here? And I would like to have everybody try to give us a quick—

Mr. LANGEVOORT. Sure. I think you have heard actually from a number of people. We need to transition to a much more open and efficient market for small companies, which is going to take a large number of steps, much longer than we have today; that we are going to have to rearticulate what disclosure demands be put on smaller and medium-sized companies. I think if we can get competing platforms for smaller companies, get it fair and open so that investors are attracted to it, it is probably the next best step. I think we have to see what the JOBS Act will bring when the SEC acts. I think that will be soon. But I think that new market is our next—

Mr. HUIZENGA. There are a lot of us hoping they will act soon on that.

Mr. Weild?

Mr. WEILD. It is essential to get tick sizes up, and it is essential to get the JOBS Act implemented and to worry about what can go right and come back and fix it around the edges if you have to course-correct. But the paralysis is just killing people. We have 20 percent of kids in the United States living below the poverty line. And if you read Professor—I am trying to think of his name—Moretti's book, "The New Geography of Jobs," there are five service sector jobs created for every technology job. There is a multiplier effect at stake here. So, we have to get moving.

Mr. HANSEN. I would add that while you were looking at issuer-related questions on capital formation, you should not overlook the fact that the service providers, the broker-dealers, the M&A brokers, the private placement type brokers or finders who are raising capital or need to raise capital, would want to be compensated for raising capital. They don't enjoy any type of exemption that the issuers do. An issuer may have an exempted registration, but it is still a security. It still takes a registered broker-dealer, if they are going to get paid, to raise the capital or to sell the business. So I think that what you need to look at is the fact that the service providers in this marketplace, private as well as public, also have concerns that need to be addressed.

Mr. FERRARO. Congressman, I think you need to bring BDCs from 1980 into 2013. And the suite of legislation that is currently on the table does that. Predominantly, we are removing arbitrary barriers to investment in certain kinds of investment areas to financial services. It is a much different universe today than it was back then. On top of that, I would also highlight from our legislative agenda the offering reform. Items, simple items such as incorporation by reference, which most every other public company in America can do, saving money on attorneys, money on accountants, all costs that get passed on either in the form of the percentage on the loans that we are charging or less of a dividend that can be distributed to our shareholders. There is no need for any of that. And it is an area where I think having legislation is the most effective and efficient means forward.

Mr. HUIZENGA. I know my time has expired, so it is up to the chairman here.

Chairman GARRETT. The gentleman yields back.

I now recognize the gentlelady from New York.

Mrs. MALONEY. I thank the chairman for yielding, and I apologize to my colleagues and the chairman; there were three bills out of the Financial Services Committee that were on the Floor being debated, and I wanted to be part of that debate.

Chairman GARRETT. So, you wanted to be down there to support those?

Mrs. MALONEY. I was. I did support them. I want to welcome all the panelists today, particularly Joe Ferraro, who is from the great City of New York. And my colleague, Mr. Sherman, said he wanted him to open up an office in California. I am very pleased that Mr. Grimm and I have him in the great City of New York.

Welcome, and thank you for being here.

Mr. FERRARO. Thank you.

Mrs. MALONEY. Regarding the business development companies, has the BDC community asked the SEC to modify any of its rules to accommodate the concerns that you have expressed here today? And if so, which ones?

Mr. FERRARO. It has. Colleagues at Ares and Apollo have already talked to the SEC about some of their legislation. Our legislation is relatively new, and we are planning to talk to the SEC in the next couple of weeks about those pieces. And there is a lot in there where—going back to comments I had made previously, there is much that would benefit by congressional action versus anything like the SEC rulemaking. For example, the reforms that we are proposing to open up what is called the 30 percent basket in the business and basically make investments in financial services not captive to that limitation is something that really needs congressional action more than SEC action.

On the SEC action side, there have been in particular offering reform ideas on the table. Incorporation by reference, electronic road shows, just simple things from which many other companies in the public space already benefit. And there is something where the rulemaking hasn't happened, and if we are at the table now to further reform BDCs both in those areas and others that are mentioned in the written testimony, it just makes sense and it is more efficient to get it all done now in this process.

Mrs. MALONEY. Some of the changes that you have mentioned can be done by SEC action, correct?

Mr. FERRARO. They can. I point to the offering reform for that. I think the SEC has always been very responsive to us. I think what happens is the particular division of the SEC that deals with business development companies also oversees hundreds of mutual funds. And there are just constraints on resources and time. So it just makes more sense to do it this way.

Mrs. MALONEY. And is it necessary—aside from the time constraints on the SEC—for Congress to legislate these changes?

Mr. FERRARO. I believe it is, yes.

Mrs. MALONEY. So they cannot be done by the SEC? They have to be done by Congress?

Mr. FERRARO. Many of them cannot be done by the SEC alone.

Mrs. MALONEY. Would anybody else like to comment on some of the really salient barriers to small business growth that you feel are there?

Mr. COULSON. Just two quick points. The promotion proposal of transparency of the people behind it; if we don't fix this, the JOBS Act, the advertising general solicitation of securities under the JOBS Act, these same people will be hiding out and doing that. So transparency of who are the people behind offerings is really one of the most important things for investors, knowing who it is.

Second, it is not this committee but taxes for smaller public companies, the easiest way to attract investors is to pay a dividend on your shares. But small corporate companies don't have the efficiency of the REIT structure. And if we did that, it would be the silver bullet to bringing more profitable public companies and ones where investors could track by income rather than just future potential. And that is something to talk to your colleagues about because that really would change the dynamics for smaller public companies because they are squeezed between the debt bias for interest with private equity firms. And larger global companies having much lower tax rates. My company pays a 39 percent tax rate.

We also pay more for our tax accountants like Grant Thornton than we do for our auditor at Deloitte. We don't get a great rate, and that is something that needs to be worked on, because the New York Times says large, large S&P 500 companies pay a 29 percent rate. And IT companies pay a 22 percent rate, so we are at a capital disadvantage. And we are also at a disadvantage of providing returns to our investors.

Mrs. MALONEY. So why are you paying 39 percent when larger companies are only paying 29 percent? Why is that happening?

Mr. COULSON. Sadly, we are in New York State. And I love New York. It has a great community of people. We are also—unlike the New York Stock Exchange, which developed software in Ireland, we develop our software in our offices in New York City, and our office is in Washington, D.C. So we are at a disadvantage for capital. And that is a point. It is like the REIT business has been hugely successful in bringing income-producing companies public. So why aren't we taking that known process to smaller public companies and having a process to bring in, not only companies that are needing a lot of capital for growth, but companies which are creating income, because it flows through to the other side of the equation. If investors own dividend-paying securities in their retirement, they beat inflation. Debt eventually gets beat by inflation. So we should be incentivizing equity. It makes our system more stable. It makes our financial statements more true because you can tell the income a company is paying. It makes our marketplaces more efficient. And it opens the door for smaller companies being public.

Mrs. MALONEY. Thank you.

My time has expired.

Chairman GARRETT. Thank you.

The other Representative from New York, Mr. Grimm.

Mr. GRIMM. Thank you, Mr. Chairman. I appreciate it. Thanks for holding this hearing.

I want to thank everyone on the panel today for your testimony.

Welcome to the committee. We appreciate your input.

I would like to try to keep it a little bit cogent. We were discussing BDCs, so, Mr. Ferraro, if I could go to you to discuss a little bit more. I have legislation, H.R. 1800, the Small Business Credit Availability Act—fancy terminology—to somewhat modernize the way small development companies with BDCs are regulated. I believe BDCs provide an important service for providing financing to the small and medium-sized firms that we just spoke about. And they often have difficulty obtaining traditional bank financing. So I see the value in that. And these are the exact kinds of firms that are responsible for a lot of the new job creation.

So it is apropos, since we have discussed so much about the unemployment rate. This bill would allow BDCs to borrow more than they do now: $2 for every $1 of assets that they hold versus the current one-to-one structure. In addition, it would streamline the forms of procedures by the BDCs for securities offerings. I think you are familiar with that. And bringing them more in line with some of the publicly traded companies. As the VP of a BDC, what kind of an impact do you think that would have if implemented on job creation just as a whole?

Mr. FERRARO. I think it would have a tremendous impact. Everything that you are talking about I think the entire suite of BDC legislation essentially says to business investment companies, go out, raise capital, pass that capital on to small and medium-sized businesses. And when you do that, not only a lot of times are you helping those businesses to grow when you are talking about, in my estimation, financial services businesses in particular, they then go on and help additional businesses to grow. The typical company that comes to us is looking for that level of investment that results in the creation of a factory, a new expansion of a warehouse, a new line of business. And because of that and the rigorous due diligence process that we have, we kick the tires. We say, okay, is this the kind of company that we believe can get there, that we would put our shareholders' money behind and in turn earn our shareholders a good return?

Mr. GRIMM. On that exact point, could I just expand on another question, since you brought it up, the companies that your company finances, what is their ability in general to access capital to grow their business via bank loans or capital markets?

Mr. FERRARO. It is generally limited. I think as a lot of my colleagues have mentioned, when you are talking about small and medium-sized businesses, your traditional banks can be more hesitant to lend, and the sad fact is, after what we have experienced in the past few years, a lot of the banks just aren't there and lined up to provide that kind of capital. So we service a very critical and important area of financing for these companies because they really can't get the money elsewhere.

Mr. GRIMM. I feel that a two-to-one leverage ratio is conservative by any standard. But can you just tell us, how does that compare with ratios used by other financial firms?

Mr. FERRARO. Oh, it is very, very low. When you talk about a traditional bank, you might see a 12-to-1 leverage. I know people at different times in this hearing have talked about multiples way beyond that, that are just stunning. Anything we are talking about in the reform is still highly, highly conservative.

Mr. GRIMM. And on that note, for those who think, wow it seems like you are doubling. It seems like a lot of leverage, in comparison, I would say it is not even close to what other financial institutions have. It is extremely conservative. But for those naysayers, what level of losses would a BDC need to experience to wipe out its equity at these ratios?

Mr. FERRARO. At those ratios, I don't really have the numbers with me.

Mr. GRIMM. Just ballpark, though, just to give an idea.

Mr. FERRARO. I don't want to guesstimate, but at the same time, it would have to be a substantial degradation of the book to quite a significant level.

Mr. GRIMM. As far as you know, have we ever seen losses like that—

Mr. FERRARO. No.

Mr. GRIMM. —experienced by BDCs, even during the height of the financial crisis?

Mr. FERRARO. Not to that extent, no.

Mr. GRIMM. Okay. I see my time is just about out. Thank you very, very much. And thank you all on the panel.

I yield back.

Chairman GARRETT. Thank you.

The gentleman yields back.

Mr. Carney, you are recognized for 5 minutes.

Mr. CARNEY. Thank you, Mr. Chairman. And thank you for having this hearing today. I apologize for arriving late. I realize I may have missed your opening statements and a lot of the discussion and debate. Professor Langevoort, if I am pronouncing your name correctly or at least close enough, I have just a couple of questions. You mentioned at the beginning of your testimony a reference to the JOBS Act, and that some of the rules are still being completed. You also say in the first paragraph that all good policymaking takes time and can't be rushed if it is to be done well. So it may be a little bit premature to ask this question.

But I was one of the sponsors of the IPO onramp part of the JOBS Act. And I wonder if you could comment on what you have seen on that aspect of the Act itself, and whether we have any results there, recognizing that it may be too early to judge.

Mr. LANGEVOORT. Yes. Obviously, that was self-executing, so we saw the first effects right away. Ernst & Young just issued a report on the first 12 months of onramp. So we have seen data. Perhaps due to our economy, factors that have nothing to do with the JOBS Act, you are not seeing a larger number of IPOs than you saw previously. The growth is not necessarily in emerging growth companies, even though 80-some odd percent of all of the IPOs are emerging growth companies. So I am going to play right into your hands. We will know a lot more.

Mr. CARNEY. It is too early to tell. Sir, are you familiar with some of the discussion that led up to some of the provisions in that Act? It is my understanding, again, as part of the team that with my colleague, the prime sponsor, Mr. Fincher from Tennessee, it started out of a conference that the Treasury Department had of people in the high-tech, primarily Silicon Valley world, Silicon Valley bank. From that, interest was generated, and there was a working group that met several times. And they came up with a list of ideas. What do you think, are there other ideas that didn't become part of the IPO Act that we might think about now? Or what do you think about the ideas that became the provisions in that Act?

Mr. LANGEVOORT. As I indicate in my testimony, I think with more time—and this is not, by any means, pointing any fingers—there could be a much more rational, comprehensive articulation of what we should expect in terms of governance and disclosure from emerging companies. I have a list of things I would have added to the exemptions that aren't there. There are a couple on the list.

Mr. CARNEY. Could we get that list? It is not in your testimony. Could we get a list of those?

Mr. LANGEVOORT. I would be happy to give you a list, but I think they are fairly predictable.

Mr. CARNEY. You referenced the SEC's Advisory Committee on Small and Emerging Companies and a number of recommendations. I haven't seen that. I assume that we could get our hands on that as well. Are they similar kinds of recommendations to what you have on your list?

Mr. LANGEVOORT. There are a number of recommendations. One is to conform the disclosures for relatively smaller companies to the list that was put in the JOBS Act for emerging growth companies. So to some extent, it piggybacks on what you all wrote. But there is also a call for a more comprehensive look at what we ask for from smaller companies, and that goes beyond the JOBS Act.

Mr. CARNEY. And one last question: Is there anything that gives you pause? At the end of your testimony, you talk about investor protections that give you pause in terms of—there is a balance to be struck here, but for sure in terms of what is required and reporting and the like as we move forward.

Mr. LANGEVOORT. We are waiting for the rules on general solicitation. I think it was 25 years ago that I first wrote calling for the end on the ban on general solicitation. So, I completely support the effort. It is, however, going to be new territory. And there are going to be abuses. So we are going to find out whether the SEC has the capacity, the resources, whether FINRA has the capacity, the resources, to be watching this space, because for all the good that is going to be done, there are going to be people at risk.

Mr. CARNEY. Thank you very much. My time has expired. I apologize that I don't have enough time for questions for the rest of the panel, but thank you all for coming, and for your ideas and advice.

Chairman GARRETT. Mr. Mulvaney, you are recognized for 5 minutes.

Mr. MULVANEY. Thank you, Mr. Chairman.

Mr. Ferraro, I want to go back to some of your original testimony and expand a little bit on that, and some of your written testimony and talk about H.R. 1973, not the least of which because it is my piece of legislation. But I know you and I have talked about it. I have spoken with folks in your industry about it. Very briefly, if we set the stage here, you go back to the current rules, you go back a couple of decades, and you are limited in your ability to invest in financial services companies, small banks, community banks, those types of things. My bill would seek to remove that restriction. Tell me why that is important. Tell me what that means to the BDC industry. Tell me what opportunities that creates. Tell me what you could do in the future that you can't do now. If you have examples of things that you have tried to do in the past, but you can't do because of that rule. Help us understand the practical realities of why those rules need to be changed.

Mr. FERRARO. Sure. It will be my pleasure. What has happened over the past 33 years in the existence of BDCs is that the area of potential investment in financial services type businesses has itself expanded. When the BDC rules were originally enacted, there was just an arbitrary line put that said 30 percent of your assets can only be invested in certain kinds of companies. Typically, they are foreign or they are other types of investment companies, and we are not interested in changing that. But there is one area where there is limitation on financial services companies. I still can't find the policy justifications or reasons behind it, even if you go back to the legislative history. The practical reality for businesses in the BDC space is that we have these kinds of companies that come to us.

A good example is Nationwide Acceptance out of Chicago. It is an auto lender. A wonderful company. It creates jobs. It helps families get autos. They can take their kids to school. They can go to work and so on. We would like to invest in more companies like that. Depending upon our asset balance at a particular time, if we had another attractive Nationwide come to us, we may not be able to do that simply because that investment may be slightly over 30 percent of our assets. And so when I have that valuable company, when I have that potential great investment before me, and I am being asked by that company, why can't you provide capital to us, all I can say is, well, there is a line set that tells me that I can't. And beyond that, I don't have a great explanation as to why.

Mr. MULVANEY. Mr. Coulson, do you want to comment on that? You look like you have a comment.

Mr. COULSON. No. It is the constant regulation away of capital, which is frustrating, because I hear it from the community banks that they are always constrained on going to their best markets for capital, their best seekers and it is a more personal frustration that—

Mr. MULVANEY. So the strong argument actually helps the community-based financial institutions as well?

Mr. COULSON. Yes.

Mr. MULVANEY. Does anybody know, by the way, why the rule was there? Does anybody have any insight? I think you are right. It sounds like it is random. It sounds like it is just an arbitrary number. Does anybody have any background on why that is? In fact, it strikes me—and to get back to the bill—Mr. Sherman was here a while ago and he wants you to come to California into his district and start offering your services. And knowing the little bit I know about his district, that might be the best way to get there.

Mr. FERRARO. It absolutely would be, yes.

Mr. MULVANEY. Thank you. I will yield back the balance of my time to the chairman. Thank you.

Chairman GARRETT. Okay. On that note, we will now turn to Mr. Duffy for maybe the last word.

Mr. DUFFY. Thank you, Mr. Chairman.

Unemployment right now stands at 7.6 percent. This has been one of the longest and toughest recoveries since the Great Depression. We are having a jobs issue in America, and it is affecting our families. Many of them want to get back to work. They want to make a better living. They want to get more dollars into their family coffers.

The greatest way to generate jobs in America is to make sure that our small businesses and our startups are growing and expanding and creating those jobs, the small businesses that are the best generators. If our small businesses don't grow, neither do our American jobs. Recently, our small cap companies have had a difficult time accessing capital and, therefore, growing their businesses. Capital issues for small cap companies, I would argue, have coincided with decimalization. If we want a vibrant job market and job growth, we need to have a vibrant market for our small cap companies.

So, I want to ask the panel as a whole kind of a two-part question. One, do you all agree with the SEC Chairman that one tick size doesn't fit all? And do you agree that we should implement a tick size pilot program to determine if wider trading spreads would improve liquidity for small cap companies and increase economic incentive for investors? We have held a long conversation about this. But I would like everyone to weigh in on what you think about those issues. Mr. Coulson?

Mr. COULSON. I completely agree. We need liquidity. We have changed our marketplace into a series of orders instead of intermediaries. And the idea that marketplaces should just be these nice investors lining up and matching and never have a liquidity provider is a mistake. We need broker-dealer participation in the marketplace providing liquidity, and we need to incentivize it, but we also need to make sure that the tick sizes are not too wide. We can't artificially widen spreads. That would be a step backwards. But if we organize the marketplace, and we have increments that reflect the trading velocity.

We have Fannie Mae and Freddie Mac trades on our marketplace. Fannie Mae trades 78,000 times in one day. It doesn't need tick sizes. That would be bad. But for companies that trade 100 times a day, they need organization. They need liquidity. And if we start seeing—because we also have a little different viewpoint. With tick sizes, because it will give a little more profitability to market makers, we should have them show larger sizes. And that way, we get a multiplier effect of more liquidity displayed. And if we do that, we are guaranteed the tick sizes will succeed. FINRA lowered our displayed sizes in our marketplace. And we saw liquidity go away.

Mr. DUFFY. I want to make sure I get to everyone. So, I will go down the line.

Mr. FERRARO. Congressman, I will respectfully defer to my colleagues. I don't believe the BDC community has established an opinion on this one.

Mr. DUFFY. Fair enough.

Mr. HANSEN. I would generally defer to them, too, except to observe the fact that small business issuers as well as small investors rely upon there being available research about these companies. And you would need have a way of funding that. I think the unintended consequence, as described by the other witnesses, has been—

Mr. DUFFY. Do you believe that the tick size would address that issue?

Mr. HANSEN. It could. And on that, I will defer to the other experts in the markets.

Mr. DUFFY. Mr. Weild, I think I know where you stand on this, but—

Mr. WEILD. Clearly. But I will tell you that everybody understands that at zero tick size, the entire stock market implodes. So at a penny tick size, one size fits all is idiotic. When we had quarter points for large cap stocks, it charged investors too much money. Now we have 1 penny tick sizes, one-size-fits-all. It is a disaster. It is catastrophic for the small cap markets. So I couldn't agree more with the Chairman of the SEC or with your views on getting higher tick sizes into smaller capitalization companies to jump-start the U.S. economy.

Mr. DUFFY. Mr. Langevoort?

Mr. LANGEVOORT. Yes. Interference with free market is to be preferred, again. But we do need to incentivize this activity. Finding the right balance is the key, and a pilot program is the right way to do that.

Mr. DUFFY. Thank you all for the answers. I want to go to an issue that the gentleman from California brought up, Mr. Sherman. He was talking about how the higher cost of these transactions might affect our investors and traders. But isn't it fair to say that if there is no liquidity, these trades aren't happening, and therefore, there are no investors to be heard? And illiquid stocks don't help investors. They don't help the companies. They don't help the economy, and therefore, if we can improve the liquidity, we are improving the market for our investors' companies and the economy.

Mr. COULSON. Liquidity is a virtuous circle, and we now have an incentive for—if you are a liquidity provider and intermediary, you don't provide the liquidity on the bid offer. You provide the liquidity at the tail end of an investor coming into the market. So we would be changing the liquidity provider model so there is more displayed liquidity on the bid offer. And what you would see is, if you see a bid offer with liquidity on both sizes, you are much more likely to take the offer or hit the bid, because you see enough liquidity to do what you want to do. And that creates the virtuous circle. And also, if there is displayed liquidity in my marketplaces, other broker-dealers, if there are 2,000 shared offered, other broker-dealers will compete and sell 5,000 shares at that price point. So we have competition with displayed liquidity, which again multiplies the liquidity. So if we only have 100 shares there, there is nothing to multiply.

Mr. DUFFY. My time has expired. But just quickly, stay tuned. We are going to draw up a bipartisan bill that will provide us a pilot program to expand our tick sizes. And hopefully, we will see the end result as an end positive. I yield back the remainder of my time.

Chairman GARRETT. On that bipartisan note, we bring this hearing to an end. I want to thank all the witnesses once again for not only your testimony today, but for your written testimony as well, which has already been reviewed by our staff.

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.

With that, this hearing is adjourned.

[Whereupon, at 2:55 p.m., the hearing was adjourned.]

A P P E N D I X

June 12, 2013

OPENING STATEMENT OF REP. BILL HUIZENGA

House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises

Hearing on Reducing Barriers to Capital Formation

June 12, 2013

Chairman Garrett and Ranking Member Maloney, thank you for holding this important hearing to discuss ways to reduce barriers to capital formation.

The mission of the Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. As part of that mission, the SEC was mandated by law to conduct an annual forum focusing on small business capital formation.

The SEC Government-Business Forum on Small Business Capital Formation has held an annual gathering since in 1982. The purpose of the Forum is to "provide a platform to highlight perceived unnecessary impediments to small business capital formation and address whether they can be eliminated or reduced."

Since 2006, the SEC's Forum has highlighted the merger and acquisition broker (MAB) proposal as one of its top recommendations to help small businesses. The MAB proposal would address securities regulation of business brokers and merger and acquisition advisors who are in the business of facilitating the purchase and sale of privately held companies. This proposal would significantly reduce their federal regulation compliance costs, which can initially exceed $150,000 and after that, cost $75,000 per additional year. However, the SEC has not acted on this recommendation.

That is why I, along with Reps. Brian Higgins and Bill Posey, introduced H.R. 2274, the Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act. This bipartisan bill would reduce the regulatory costs incurred by the buyers and sellers of smaller privately held companies for professional business brokerage services.

It has been estimated that approximately $10 trillion of privately owned, main-street mom and pop type businesses will be sold or closed as baby boomers retire. Business brokers play a critical role in facilitating private business mergers, acquisitions, and sales of these main-street companies. By simplifying the regulation and reducing the cost of these business brokerage services, these privately-owned companies would be able to safely, efficiently and effectively be able to sell their company while preserving and protecting jobs at these companies.

Mr. Chairman, I look forward to hearing from our distinguished panel.

OTC Markets

TESTIMONY OF R. CROMWELL COULSON

PRESIDENT AND CEO OF OTC MARKETS GROUP INC.

BEFORE THE SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

COMMITTEE ON FINANCIAL SERVICES

HEARING ENTITLED "REDUCING BARRIERS TO CAPITAL FORMATION"

JUNE 12, 2013

INTRODUCTION

Chairman Garrett, Ranking Member Maloney and members of the Capital Markets and Government Sponsored Enterprises subcommittee, my name is R. Cromwell Coulson, president, CEO and director of OTC Markets Group Inc., operator of the OTCQX®, OTCQB® and OTC Pink® marketplaces where 10,000 U.S. and global securities trade.[1] I appreciate the opportunity to testify before the subcommittee today on the topic of "reducing barriers to capital formation." As an operator of public marketplaces for small companies and a publicly traded small company in our own right, I hope I can provide the committee with greater insight into barriers to capital formation that should be removed.

Our self-interest in changes to regulation is very clear. We want more openness so our public markets are more inclusive, we want better transparency so our public markets are better informed, and we want more connectivity so our public markets are more efficient. Finally, we want to remove unneeded regulatory burdens in order to reduce the cost and complexity imposed on smaller public companies.

We have the following recommendations to members that will help accomplish these goals:

[1] OTC Markets Group Inc. (OTCQX: OTCM) operates Open, Transparent and Connected financial marketplaces for 10,000 U.S. and global securities. Through our OTC Link® ATS we directly link a diverse network of broker-dealers that provide liquidity and execution services for a wide spectrum of securities. We organize these securities into marketplaces to better inform investors of opportunities and risks – OTCQX®, The Best Marketplace with Qualified Companies; OTCQB®, The Venture Stage Marketplace with U.S. Reporting Companies; and OTC Pink®, The Open Marketplace with Variable Reporting Companies.

Our data-driven platform enables investors to easily trade through the broker of their choice at the best possible price and empowers a broad range of companies to improve the quality and availability of information for their investors. To learn more about how we create better informed and more efficient financial marketplaces, visit www.otcmarkets.com.

OTC Link® ATS is operated by OTC Link® LLC, member FINRA/SIPC and SEC regulated alternative trading system.

1) Demand that the SEC complete rulemaking on Title II, Title III and Title IV of the Jobs Act in a timely manner, without overly complicated or costly barriers to companies raising capital under these new regulations.

2) Update Securities Act Section 17(b) to require increased disclosure of stock promotion activity and greater transparency into the people behind it.

3) Improve the share issuance process through better regulation of transfer agents and more thoughtful information exchange between transfer agents, broker-dealers and the Depository Trust Company (DTC).

4) Require that insiders and affiliates that buy or sell non-SEC reporting companies publicly disclose transaction information in a manner similar to SEC Forms 3, 4 and 5.

5) Bring more transparency to holders of non-exchange traded securities by expanding Section 13(f) of the Exchange Act to require that institutional investment managers disclose their holdings of all publicly traded equity securities.

6) Implement a quote and order price increment (tick size) pilot for all publicly traded small companies. The pilot should include increased minimum displayed size requirements for broker-dealer proprietary quotes and orders.

7) Reject any attempt to create a "trade-at rule" that would require orders to be routed to the best publicly displayed price. Such a rule would effectively reduce choice and innovation, decrease competition between market centers and impose increased and unnecessary costs on investors.

8) Support diverse choice and healthy competition among trading venues, and reject any regulation or policy that would lead to giving a "centralized trading monopoly" to the listed stock exchanges or any other trading venue.

9) Make margin-eligible all non-penny stocks that are actively traded on “established public markets” and make the SEC responsible for determining the margin eligibility of all equity securities.

10) Make all non-penny stocks that are actively traded on “established public markets” exempt from state Blue Sky secondary trading restrictions.

11) Update the SEC definition of penny stocks to take into account interim capital raises.

12) Allow companies to transparently pay market makers in order to initiate quotations in securities, provide tighter spreads and make more liquid markets.

13) Allow smaller SEC reporting companies to opt out of XBRL filings until the cost is vastly reduced.

14) Remove antiquated Section 17B of the Exchange Act.

15) Institute a 25% corporate tax rate and deductibility of dividends for publicly traded smaller companies.

Of course, we need our marketplaces to be well regulated, but it is important to acknowledge that the U.S. equity markets have the most regulated trading of all our financial markets. The broad anti-fraud provisions in Section 10(b) of the Exchange Act and its related rules already give regulators a broad sword against those who seek to commit fraud and other crimes in the securities markets.

Before I begin, I would like to give some background on the history of our company as it will provide context to our testimony. In 1997, I led a group of investors to acquire OTC Markets Group's predecessor business, the National Quotation Bureau. At the time, trading was a largely phone-based process with little price transparency, electronic connectivity or information availability on the companies that traded. This made for an opaque and inefficient market with high transaction costs and little liquidity.

It is easy to forget that less than twenty five years ago there was no consumer Internet brimming with information about companies and people, no Yahoo! Finance with a wealth of information and no online brokers for investors to trade electronically. Company brochures, financial statements and investment advice were distributed in paper through the mail, and stock prices were obtained through a phone call or visit to a broker. Clearly, times have changed, and we must update our securities laws to reflect these changes so investors and markets are empowered with more information when they analyze, value or trade securities.

OPENING PUBLIC MARKETS TO MORE COMPANIES AND INVESTORS

At OTC Markets Group we operate Open, Transparent and Connected marketplaces, and our mission is to create better informed and more efficient financial marketplaces. We started transforming our marketplaces with a real-time quotation service for broker-dealers to provide price transparency and best execution in off-exchange securities. We also developed the website that became www.otcmarkets.com, to give investors around the world instant access to high-quality financial data.

In 2003, we launched our electronic trade messaging platform, which later became OTC Link® ATS, operated by OTC Link LLC, our wholly-owned subsidiary and an SEC registered alternative trading system and FINRA/SIPC member broker-dealer. The launch of electronic trading in 2003 kicked off a series of changes in technology, transparency and regulation that has transformed trading into our modern, efficient electronic system with transparent and well-regulated[2] broker-dealer trading. We have a diverse community of broker-dealer liquidity and execution providers showing their best quotes and orders and directly interacting with each other across our network. In short, we create the data technology plumbing for securities trading by market makers and agency brokers.

Ten years later, our marketplaces are home to 10,000 U.S. and global securities that traded a combined dollar volume of $135 billion in 2012, including over 3,000 ADRS and ordinary shares of global companies that are also listed overseas and primarily follow SEC Rule 12g3-2b by providing their home country disclosure in English, over 3,000 SEC registered companies current in their reporting, and over 600 community banks that report to their U.S. banking regulator. We also have hundreds of smaller U.S. companies that are exempt from SEC

[2] See attached Regulation of Trading Summary

reporting because of their smaller number of shareholders but use our services to publicly distribute their disclosure to investors. OTCQX, our best marketplace with qualified companies, had a dollar volume of $22.9 billion last year and an aggregate market capitalization of $1.3 trillion.

The leading electronic broker-dealers that trade NYSE and Nasdaq securities also use their technology to trade OTCQX, OTCQB and OTC Pink securities, with the result that the investor trading experience is now almost identical. The extensive market data, company data and security information provided by our platform and our Issuer Services business can be found at most of the major online brokers, market data vendors and financial portals, including Bloomberg, Reuters, Schwab, E*Trade, TD Ameritrade, Scottrade and Yahoo! Finance.

Since our OTC Link ATS serves broker-dealer subscribers that need to deliver best execution to investors in a wide spectrum of securities, we see companies along a continuum, ranging from those that act private or have financial reporting difficulties to those that provide the highest level of public disclosure. We help identify these companies based on the quality of their financial disclosure by segmenting them into three marketplaces – OTCQX, our best marketplace with qualified companies; OTCQB, our venture stage marketplace with U.S. reporting companies; and OTC Pink, our open marketplace with variable reporting companies.

Our marketplaces, like all public markets, are better informed and more efficient when there is transparency of trading activity and company information. We work with broker-dealers on the trading process, but need to engage companies to provide better information for investors. Smaller companies are not owned by big institutions or index funds. Stock pickers own small company's shares, and stock pickers are looking for quality companies, with quality managements and quality disclosure so they can make intelligent investment decisions. Transparency builds trust, and we have designed our tiered marketplaces to encourage companies to make more current information publicly available. As companies climb to their highest achievable marketplace and take advantage of services that enable them to provide more information to their investors, whether it be our OTC Disclosure and News Service or our access to our Real-Time Level 2 (OTCQX, OTCQB and OTC Pink) market data, their public trading becomes more informed and efficient, their shares more liquid, and they experience improved access to capital.

We have created alternative reporting standards that provide a disclosure framework for non-SEC reporting companies seeking to make adequate current information publicly available[3]. With our OTCQX U.S. Disclosure Guidelines and our OTC Pink Basic Disclosure Guidelines, we provide a structure and format for a wide variety of companies to publish and distribute their disclosure and make it freely available on the internet.[4] Our services ensure company data is disseminated to market data distributors and financial portals, and that their financial statements are converted into XBRL to be made available on Yahoo! Finance[5] and to financial database providers. Our OTCQX U.S. Disclosure Guidelines, which we follow when posting our own disclosure, requires an audit by a PCAOB firm and provides comprehensive disclosure for investors in a non-overly complex manner. Our OTC Pink Basic Disclosure Guidelines help small companies meet the minimum standards of Securities Act Rule 144 and Exchange Act Rule 15c2-11, and the cost of our disclosure service and XBRL conversion is significantly lower than charges imposed on SEC reporting companies.

We clearly label each security with its marketplace designation. Investors know that OTCQX-traded companies meet certain qualitative and quantitative standards, including minimum financial requirements and a management review, that they provide ongoing audited disclosure to investors and are sponsored by professional FINRA-member investment bank, depositary bank or securities law firm. Likewise, investors in companies on our OTCQB marketplace know that while these venture stage companies are current in their reporting to the SEC or a bank or insurance regulator, they may also be a shell company, financially distressed or in bankruptcy, and that the SEC does not review or verify the background of their management team. Investors in OTC Pink companies know that these companies provide current, limited or no information to investors, and that they are generally more speculative, smaller and/or less investor-focused. Recently, the SEC publicly recognized the quality of our OTCQX and OTCQB marketplaces by declaring them "established public markets" for purposes of establishing a public market price when registering securities for resale in equity line financings.[6]

In the end, whether a company trades on the NYSE, Nasdaq or the OTCQX, OTCQB or OTC Pink marketplaces, that company can realize all the benefits public trading provides.

[3] See: http://www.otcmarkets.com/learn/otc-company-reporting
[4] Example: http://www.otcmarkets.com/stock/OTCM/filings
[5] Example: http://finance.yahoo.com/q/is?s=OTCM+Income+Statement&annual
[6] See the SEC's Compliance and Disclosure Interpretation:
http://www.sec.gov/divisions/corpfin/guidance/sasinterp.htm at Question 139.13.

I. CREATING BETTER INFORMED PUBLIC MARKETS

Before discussing our specific proposals, I would like to share our insight, as the operator of marketplaces for the trading 10,000 securities, and a publicly traded company ourselves, on the benefits of being a public company and the importance of a vibrant secondary trading market to the small company capital formation process.

The Benefits of Public Trading

We are firm supporters of the value proposition behind companies aspiring to be publicly traded, as it generally creates the most successful and sustainable enterprises over the long term. Being publicly traded provides companies with several important benefits that cannot be found by remaining private:

- **Visibility** – Being publicly traded, having a stock symbol next to your company name and making disclosure publicly available provides a company with a level of visibility that is tougher to achieve if it is private. The media is much more likely to pay attention to a company that is publicly-traded – and public with its information – than one that is private. Public company status also creates a connection with investors, employees, strategic partners and customers that is invaluable to a growing organization.

- **Liquidity** – Public trading allows management to provide their shareholders with maximum liquidity for their shares without having to sell control of the company. Investors in public companies trading on NYSE, Nasdaq, OTCQX, OTCQB and OTC Pink can trade securities through any broker, and property is more valuable if it is transferable. Liquidity gives investors a choice and a realizable value for their shares, and allows shares to be used as collateral.

- **Valuation** – Public trading creates the best valuation for individual shareholders, other than a complete sale of the company. By making shares publicly traded, in a continuous market accessible through any broker, companies create a huge wealth effect as their investors have a readily transferable asset that can be deposited in brokerage accounts. It is much easier to value a company when it is publicly traded, with widely disseminated, easily accessible quote and trade data, and publicly disclosed financial information. A public valuation also gives a company an accurate portrayal of its overall worth, and provides real-time feedback as the market reacts to company news and disclosure.

Public valuation gives investors confidence in the value of the shares they hold, allowing them to accurately assess their personal finances and to trade their shares with confidence.

- **Capital** – Access to capital is perhaps the most obvious reason companies go public. Investors are much more comfortable investing in a publicly-traded company that provides public disclosure than one that is private, because public companies are easier to value and because outside investors know they can sell their shares at any time.

- **Trust** – Finally, publicly-traded companies can more easily convey their reputations and build trust with their various stakeholders. That includes investors, as well as employees, customers, suppliers, strategic partners, the media, regulators and the public. Public disclosure of company financial and other material information breeds trust in potential employees, vendors and customers, and public price discovery does the same for investors. The trust that public companies engender also makes them more sustainable and enduring than private companies, and public companies have built sustainable businesses because they are trusted and transparent, not in spite of it.

We are testifying here because we support changes to regulation that would jumpstart the small-cap initial public offering (IPO) market, however we also know that a traditional IPO, or a reverse takeover (RTO) are not the only ways for a company to enter the public markets and reap the benefits of public trading. We refer to an alternative public offering (APO) that we call the "Slow PO." With a Slow PO, a seasoned company with an established investor base can slowly start to provide liquidity to its shareholders by making previously restricted shares available for trading in compliance with Securities Act Rule 144 or filing a Form 10 with the SEC. Capital raised through private placements to angel investors, private equity firms, and venture capital has created a huge pool of value that can be unlocked and used by companies to build an informed and efficient public market.

In fact, Nasdaq went public via a Slow PO. In 2000, Nasdaq did a private placement offering to NASD members. When the Rule 144 holding period expired, broker-dealers began trading those shares on the public markets. Three years later, Nasdaq did a secondary share offering at $9 a share and up-listed its shares on its own market. OTC Markets Group did our own Slow PO in September 2009, when our previously restricted stock issued in private transactions became available for trading under Rule 144. A few months later, we qualified for the OTCQX marketplace where our shares now trade under the ticker "OTCM."

For a company that is serious about maximizing its visibility, raising capital, recruiting top-quality talent and building trust, being publicly traded can provide significant value to its business and its shareholders, which in turn also benefits our economy. But we must make sure that the costs and burdens we put on public companies do not outweigh those benefits.

Capital Formation Relies on Investor Access to Vibrant Secondary Markets

Public companies require informed secondary markets that allow investors to efficiently trade securities. Our OTCQX, OTCQB and OTC Pink marketplaces, much like NYSE and Nasdaq, facilitate secondary trading in securities by regulated broker-dealers. Before a company can effectively raise capital, potential investors need assurance that the securities they purchase will eventually have a value. The value of a security comes from income, appreciation potential and transferability. Transferability of securities is driven by liquidity, or how efficiently they can be analyzed, valued and traded in a secondary market.

Once an investor buys a share of stock, they have a property right in that share just like an individual owner has in an iPod or a car. And just as an iPod can be sold on eBay and a car can be sold "pre-owned", shareholders have the right to sell their stock. A car, for example, is worth considerably more if it has an easily ascertainable public resale value. Similarly, an active secondary market in stock increases the value of that stock and makes it a more attractive investment.

A quick aside into the history books will bring context to this issue. The model for modern secondary markets dates back to the Dutch East India Company's initial capitalization in the Netherlands in the early 1600s as the first company with perpetual shares. Since investors needed to realize value, a limited secondary market arose to handle buyers and sellers. However, transfer of Dutch shares was restricted by the company and limited to certain investors. When London traders later adopted the Dutch share markets in a more pure and unfettered form, the English allowed regular trading and share transfers among all investors

OTC Markets Group Inc.
304 Hudson Street, 3rd Floor
New York, NY 10013

E info@otcmarkets.com
T +1 212 896 4400
W otcmarkets.com

daily.[7] The resulting value creation resonated with investors and companies alike, and London has been the center of Europe's financial markets ever since.

Trading models that focus on making trading of shares more restricted, keeping company information private and limiting trading to specified dates and a limited group of investors ignore the lessons learned through hundreds of years of secondary trading. Devaluing the property rights of investors and impeding the utility of their investments is not a path to vibrant capital markets, instead it unnecessarily limits the property rights of shareholders and the value of each investment, and makes it harder for companies to raise the capital they need to grow.

Adequate Current Information is a Foundation of Informed Secondary Markets

Of course, as public secondary markets become more inclusive, investors must still be protected. As operator of the primary public marketplaces in the smallest company space, we understand the importance of public disclosure and in ensuring that company insiders and affiliates cannot use their informational advantage to manipulate outside investors.

We have repeatedly advocated for regulation that would increase the transparency of trading by insiders, affiliates and promoters, and restrict the ability of insiders to trade unless adequate current information, as that term is defined in the federal securities laws, is made publicly available. That said, the complex system of SEC reporting is not and should not be the only path to making high quality information publicly available.

Our OTCQX, OTCQB and OTC Pink marketplace designations already incentivize disclosure by making it easy for investors to identify companies that make current disclosure available. Companies may choose how they make information publicly available and securities are clearly labeled by the marketplace they qualified for and the reporting standard they follow. The results are overwhelmingly positive for public disclosure, in that vast majority of trading takes place in companies that make current information publicly available, as noted in the table below.

[7] *The Origins of Value: The Financial Innovations that Created Modern Capital Markets*, Chapter 9, Larry Neal, author, William N. Goetzmann & K. Geert Rouwenhorst, editors, (2005).

OTC Marketplace	# of securities	2012 $ Volume	% of Total $ Volume	Total Market Capitalization (in millions)*	Avg. $ Volume per Security
OTCQX®	400	$22,944,077,655	16.92%	$1,295,150	$57,360,194
OTCQB®	3,401	$31,473,130,100	23.21%	$185,910	9,254,081
OTC Pink® Current Information	2,499	$74,373,618,933	54.84%	$10,160,632	$29,761,352
OTC Pink® Limited Information	609	$3,802,790,602	2.80%	$8,500	$6,244,320
OTC Pink® No Information	3,065	$3,028,536,649	2.23%	$26,496	$988,103
Totals	9,974	$135,622,152,542	100.00%	$11,679,685	$13,597,569

* Selected data as of December 31, 2012

In 2012, the 10,000 securities on our marketplaces traded over $135 billion in dollar volume. Over 95% of dollar volume traded, representing more than $128 billion, took place in securities that made current information publicly available and were therefore identified on our OTCQX and OTCQB marketplaces or on our OTC Pink Current Information tier. Companies making limited information available represented nearly 3% of total dollar volume, leaving just over 2% of dollar volume represented by companies in the OTC Pink No Information category.
This is not to say that the OTC Pink No Info companies should not trade. In fact, some are quite successful operations, but they may have management teams who are not aligned with shareholder interests. The clearly labeled secondary trading marketplaces, where, for example, OTC Pink No Information companies have a stop sign next to their quotes, help warn all investors if the security is a speculation at best and give outside shareholders a choice to sell their shares to someone besides the company.

Capital formation requires investor confidence in the issuers and in the secondary trading market. The investor sentiment is clear – disclosure of adequate current information protects investors, drives confidence, and ultimately leads to more robust capital markets. This must be balanced by protecting the property rights of outside shareholders to be able to transfer their shares in an efficient manner through a regulated broker-dealer.

The JOBS Act

We commend Congress on its bipartisan efforts to pass the JOBS Act. As an operator of Open, Transparent and Connected financial marketplaces, we support this modernization of our securities laws that will add transparency to the capital raising process. Transparency of information makes markets better informed and more efficient.

The JOBS Act rejects the theory that private capital raising should be hidden from the public and adapts U.S. securities law to our interconnected world in which information can easily travel across the Internet and market data networks. The JOBS Act affirms that investors should be protected based on their level of sophistication and wealth at the point of sale, but that all investors benefit from public availability of information about companies and the trading of their securities.

These important changes are going to bring sunlight into the previously dark worlds of private securities offerings under the SEC's Regulation D and Rule 144A, while creating new opportunities for transparent capital raising by U.S. and global companies. Lifting restrictions on the distribution of information regarding 144A securities also means these securities may be transparently traded on our marketplaces by broker-dealers, for their own accounts and on behalf of other Qualified Institutional Buyers (QIBs), leading to improved price formation and greater secondary liquidity. The JOBS Act will allow more companies to make more disclosure publicly available. Where before a company raising capital under Reg. D, would have been restricted from posting their annual report on their website due to general solicitation concerns, the JOBS Act making available general solicitation, Regulation A+ (Reg. A+) and crowdfunding will incentivize companies to make their disclosure publicly available to access capital.

The JOBS Act has already had a significant impact for some companies, such as community and regional banks, and we're hearing from others in our community that are looking to take advantage of future rulemaking when it is complete.

For example, since the passage of the JOBS Act, over 100 community and regional banks have taken advantage of the higher shareholder threshold to deregister with the SEC, resulting in significant cost savings and the elimination of duplicative reporting for many. Paul Garrigues, CFO of Coastal Banking Company , Inc., a $475 million Florida-based bank with 2.6 million shares outstanding and 622 shareholders, estimates that his bank is saving $150,000 to $200,000 a year in attorney's fees and other costs as a result of its deregistration and delisting from Nasdaq in May.[8] The company now trades on our OTCQB marketplace, and has elected to continue publishing its quarterly and annual audited financial statements on our website, www.otcmarkets.com, and for distribution to investors, market data providers and broker-dealers who trade OTCQX, OTCQB and OTC Pink securities. Meanwhile, Coastal Banking's stock price has risen from $4.50 to $7.00 and its average daily trading volume has increased

[8] "Deregistered and Delisted? No Worries," *CFO Magazine*, April 2013, http://www3.cfo.com/article/2013/3/capital-markets_jobs-act-otc-stock-markets-deregister-delisting-sec.

from 400 to 2,000 shares year-over-year. Other banks report similar positive results, and OTC Markets Group is working with them to make sure that when they deregister they continue to make publicly available the quality company information, audited financial statements and transparent trading to which their investors have become accustomed.

That said, we do think it is important for the SEC to hasten its work on writing the remaining rules, particularly relating to Title II, general solicitation and advertising in certain private offerings, Title III, crowdfunding, and Title IV, the offering exemption known as Reg. A+. While we understand the need to balance haste with thoughtful consideration in rulemaking, in this case of Title II, the SEC has received many thoughtful comments and it is time to make decisions and publish final rules. Time is of the essence in this matter as the delay is restricting access to capital. Numerous companies on our marketplaces have said they are urgently awaiting this rulemaking so they can make important financing decisions in their businesses.

Since the changes to capital raising are significant, the final rule will need to allow for adjustments with the benefit of time and experience. These changes will present a risk of abuse, just as with any new rulemaking. That risk can be addressed when it arises, particularly since most potential abuses are already illegal under the numerous other anti-fraud provisions within SEC rules. Meanwhile, it is the SEC's responsibility – and its mandate – to write a rule as soon as possible.

We would like to reiterate recommendations we made in our comment letter to the SEC, dated October 8, 2012[9], relating to the need for publicly available price information on securities for which general solicitation and advertising is permitted. We proposed that the Commission make two additional steps: 1) Require that when conducting capital raising under Rule 506 using general solicitation, the company must directly or indirectly make adequate information publicly available in accordance with the standard under Securities Act Rule 144.
As we stated in our letter:

> *"Rule 144 includes a definition of adequate current public information that would be appropriate for use in conjunction with trading of Rule 144A, Rule 506 and other private securities by affiliates of the issuer. Such a requirement would incentivize disclosure by non-reporting issuers, and would dramatically increase*

[9] http://www.sec.gov/comments/s7-07-`12/s70712-149.pdf.

OTC Markets Group Inc.
304 Hudson Street, 3rd Floor
New York, NY 10013
E info@otcmarkets.com
T +1 212 896 4400
W otcmarkets.com

the amount and quality of disclosure available to investors and regulators. Moreover, the increased disclosure incentivized by these rules may reduce instances of fraud under Exchange Act Rule 1Ob-5, which applies to the purchase and sale of any security.

Under Rule 144, issuers not reporting to the SEC must make publicly available basic financial information. This standard requires disclosure of essential information regarding the issuer and its securities, including the issuer's current financial statements and capital structure. The simplified Rule 144 disclosure provides the basic information and transparency that allows all potential investors to easily analyze a company's general financial condition before engaging in further diligence or a transaction.

When a security trading on the OTC Markets Group platform participates in active promotion without having adequate current information disclosed to the market, we flag it with a skull and crossbones symbol to warn investors of a potential public interest concern. Investors armed with current public information are not only in a better position to analyze, value and trade securities, they are also less susceptible to fraud. With the end of the prohibition on general solicitation, the mandatory public disclosure of the information required under Rule 144 would protect the additional investors that may be presented with the issuer's offering information."

2) Extend the SEC's implicit approval of price dissemination in Rule 144A securities to Rule 506 and to other security types. Again, as we stated in our letter:

"The widespread dissemination of prices for Rule 144A, Rule 506 and other private securities supports capital formation, better informs investors and provides the Commission and other securities regulators with a valuable tool to fight fraud. Widespread transparency of prices and basic current information regarding the issuer empowers investors, analysts, the press and regulators with information on current valuations and trading activity. This openness creates a more efficient and reliable capital formation process. By enacting the JOBS Act, Congress recognized the importance of public availability of information to the capital raising process and the value of increased transparency in the operation of healthy capital markets."

As a final point on the JOBS Act, I want to reinforce the value of Title IV, Reg. A+, to many of the small companies that trade on our marketplaces. The current Regulation A (Reg. A) provides an exemption from SEC reporting requirements for certain public offerings of up to $5 million. With the rising costs of preparing the disclosure required for a Reg. A offering and bringing the offering to investors, the $5 million limit has proven to be a nearly universal deterrent. With Reg. A+ raising the exempted offering limit to $50 million, many more companies will reap a direct capital raising benefit. This will include many of the community banks traded on our marketplaces and smaller companies disclosing audited financial statements. The immediate tradability of the shares issued in a Reg. A+ offering is a big benefit that will increase the valuations at which companies can raise capital and provide a path to public trading.

The implementation of Reg. A+ is about more than just the offering limit, however. "Blue Sky" laws that govern offering restrictions in each U.S. state and jurisdiction are uncoordinated and can present a significant roadblock to capital formation using Reg. A+. Subjecting companies to Blue Sky laws will undermine and negate the benefits of Reg. A+. To ensure that Reg. A+ provides the path to capital that Congress clearly intended in the JOBS Act, it must also provide that Reg. A+ offerings are not subject to state Blue Sky laws. Similarly, the success of Reg. A+ depends on the SEC defining the term "qualified purchasers" to be more inclusive than the current definition of "accredited investors." Qualified purchasers should include financially sophisticated individuals that may not have obtained the wealth to be accredited investors, such as employees of the issuer and those that meet the current requirements applied to broker-dealer customers trading stock options. A Reg. A+ prospectus will require audited financials and be subject to SEC review, which makes it inherently more transparent and more regulated than a private offering and leads to the logical conclusion that a Reg. A+ offering should be available to at least as many, if not more, investors as a Rule 506 private offering.

Reducing Fraud in Small Company Trading

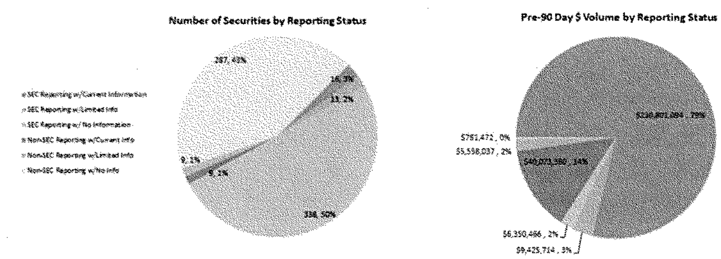
Our position in the market makes us hyper-aware of the risks of fraud, particularly in the microcap space. We applaud the SEC's past and recent efforts to suspend trading in microcap securities that present a heightened risk of fraud. Fraud in the trading of small company securities hurts investor confidence in small companies and ultimately impedes the capital formation process.

Last year, the SEC ordered 10-day suspensions on 672 microcap and shell[10] securities. We analyzed those suspensions focusing on the dollar volume of trading in each of the suspended securities for the 90 days leading up to their suspension. The suspensions included only 16 companies that were current in their reporting to the SEC. Yet, those 16 securities accounted

[10] Recent SEC suspensions of groups of shell companies have included operating companies with high stock prices that have chosen to go dark and disenfranchise outside shareholders. The SEC enforcement staff's lack of analysis and understanding will assist in these companies efforts, as removing the public trading will make shareholders dependent on the company as the only bidder. We would recommend the SEC enforcement staff engage in fundamental research and stock analysis before suspending any companies.

for the vast majority, nearly 80%, totaling $230 million, of the total dollar volume of all suspended securities in the 90 days prior to their suspensions. We urge the SEC staff, in seeking to demonstrate their enforcement oversight, to focus on the quality of enforcement actions and not just the total number of suspensions.

Analysis of SEC Suspensions



Clearly, the majority of the problem in the small/micro-cap fraud arena – in terms of dollar volume and, thus, investor losses – involves companies that are current in their reporting to the SEC. Unfortunately, a company with little revenue and no assets can be an SEC reporting company with minimal cost and effort. The SEC needs to recognize this all too easy path to fraud and take pro-active steps to focus on the companies that are causing the largest investor losses. We should encourage the SEC to focus their limited enforcement efforts on the most highly promoted SEC reporting micro-cap companies that are heavily advertised on the Internet. These companies and their brazen promotional activities make a mockery of the regulation of our securities markets.

In 2007 we instituted a "caveat emptor" policy under which we place a "Skull and Crossbones" icon next to the trading symbol of stocks for which unsolicited SPAM emails are sent or that have engaged in promoting their securities without making adequate current information available to investors. Since instituting the caveat emptor program, we have seen a clear reduction of promotion and spam in OTC Pink No Information companies, and this is one of the main reasons why the majority of promotion takes place in SEC reporting companies.

Focus on the People Behind SEC Reporting Companies

A logical place for the SEC to begin a ramped-up enforcement effort is with increased transparency and scrutiny of the officers, directors, affiliates and major shareholders of SEC reporting companies. This type of review would also allow the SEC to tie a shareholder list back to any future promotional or other potentially fraudulent activity in which those holders may engage. Currently, the SEC does not engage in background checks of company officers and major shareholders as part of the SEC registration process, or when reverse mergers are announced in 8K filings. Nor does the SEC request or review the shareholder lists of SEC reporting companies or the history of share issuances from SEC registered transfer agents, which leaves them limited in their ability to identify companies with questionable officers, directors, affiliates and shareholders for further scrutiny and monitoring.

Better Transparency of Promoters

In conjunction with increased focus on the shareholder lists of SEC registrants, we strongly support increased regulation to provide for better transparency of the people behind stock promotion activity. We submitted a rule proposal to the SEC several years ago that would require increased disclosure associated with any stock promotion material under SEC Rule 17b, with the goal of exposing and preventing unlawful and fraudulent activities by stock promoters and their sponsors.[11]

One example is the current 17b disclosure from one promotional website that advertises via links on major news and financial websites:

> *"TheAmericanSignal.com has been retained by an unrelated third party for promotional and advertising services intended to increase investor awareness of Nano Labs Corp. ("Nano"). The common shares of Nano trade on the OTC Bulletin Board under the ticker symbol "CTLE". As of the date of posting of this disclaimer, TheAmericanSignal.com has received six hundred fifty thousand US dollars from an unrelated third party for performing these services."*

This type of disclosure does not provide valuable information or serve to prevent fraud. This and other promotional web sites that widely advertise their links at the bottom of financial portals

[11] The Petition for Rulemaking, dated April 24, 2006, is available on the SEC's website at http://www.sec.gov/rules/petitions/petn4-519.pdf.
Public comments to our Petition for Rulemaking were overwhelmingly positive, and are also available on the SEC's website at http://www.sec.gov/comments/4-519/4-519.shtml.

OTC Markets Group Inc.
304 Hudson Street, 3rd Floor
New York, NY 10013

E info@otcmarkets.com
T +1 212 896 4400
W otcmarkets.com

and media web sites harm investors with their lack of useful disclosure. Investors should have the information to identify the people behind the promotional web site and those who are paying the website so much for promotion of this SEC reporting company.

I encourage you to ask the SEC why our rule proposal, or similar regulation, has not been enacted. Transparency of promoters will make it easier for investors to avoid questionable characters, broker-dealers to identify customers they should scrutinize and regulatory enforcement to target the bad guys. Lack of transparency and enforcement against highly visible internet-based promotions allows the image of our public markets and the capital raising process for all small companies to be harmed.

Better Regulation of Transfer Agents

Unlawful activity can also be curbed by better regulation of transfer agents and the share issuance process. Transfer agents can play a critical role as the caretakers of a company's shareholders and key gatekeepers against fraudulent issuances of securities. While the vast majority of transfer agents are lawful, there is a small subset that causes significant problems in the system. In the micro-cap market, problems are created when "clean" certificates are issued to insiders or promoters in violation of registration requirements and then the shares are illegally sold in the public market. Unfortunately, the licensing regime for SEC registered transfer agents, who supervise the share register, is nearly nonexistent. The only requirement to become a transfer agent for SEC-reporting companies is to register with the SEC or a bank regulatory agency[12] via a simple online form. The SEC form itself takes an estimated 1.5 hours to complete and asks only for the registrant's name, address, names of the control people and any regulatory actions against them. Once submitted, it is effective automatically after 30 days unless the SEC finds cause for concern. Compare this to the SEC's Form S-1 for registration of a class of securities, which takes an estimated 972.32 hours to complete and possibly months to approve, and you get some indication of the lack of scrutiny paid to the transfer agent role. Increased licensing requirements, background checks and inspections would likely root out those allowing many of the fraudulent stock issuances.

[12] From what we have seen, the problematic transfer agents register with the SEC. We suspect this is because bank regulators are typically more hands-on overseers of bank transfer agents.

The SEC should require transfer agents retain and provide to broker-dealers information on the issuance, ownership and transfer history of shares. Currently, transfer agents issue "clean" certificates that have no restrictive legend when directed by the company. They do not identify if the shares are currently owned, or were ever owned, by an affiliate of the issuer. Subsequently, the broker-dealer who receives those certificates from a customer has no indication if the holder is an affiliate of the issuer and no information regarding the issuance and transfer history of the shares. Placing information sharing requirements on transfer agents in these securities would allow broker-dealers and regulators to more quickly identify promoters and prevent this type of micro-cap fraud before investors are harmed.

The uncertainty created by the lack of regulation of transfer agents and inefficiency in the share issuance process are among the main reasons DTC has made it very hard for small companies to gain eligibility. The lack of available information regarding share history makes DTC uneasy about potential problems when it attempts to allocate shares among participant accounts following a transaction. This lack of clarity along with DTC's apparent disinterest in finding a solution has harmed numerous small companies. Many broker-dealers will not trade securities that are not DTC eligible, as they find it too arduous and cost-prohibitive to facilitate transactions in these shares. Investors in those shares are left without an efficient trading option, which devalues the company's shares in the market. With a devalued share base, companies face an uphill battle when seeking to raise capital from new investors or when borrowing against their market value. Transfer agent regulation and improved communication with DTC would rectify what has become a significant inefficiency in the market.

13(f) Disclosure of Securities Holdings

Another benefit of public secondary markets is the ability for companies and their investors to learn who has taken an interest in them. Section 13(f) of the Exchange Act protects that important benefit. Under Section 13(f), an institutional investment manager is required to disclose its holdings in securities listed on a national securities exchange. Unfortunately, 13(f) does not include a similar requirement relating to non-exchange listed securities. Institutional investment managers disclose these holdings only on a voluntary basis, leading to inconsistent, unreliable information being made available to the market.

In April, we submitted a comment letter to the SEC[13] in which we advocated amending Section 13(f) to require disclosure of holdings in all publicly traded securities. We noted that issuers of securities on our OTCQX, OTCQB and OTC Pink marketplaces are unable to determine which institutions hold their securities. With the JOBS Act increasing the number of shareholders of record a company must have before being subject to mandatory SEC reporting, disclosure of share ownership will become an increasingly important issue. Expanding the scope of Section 13(f) to require institutional investment managers to report holdings of all securities traded on the OTCQX, OTCQB and OTC Pink marketplaces would rectify existing problems and create a valuable pool of data for issuers, investors and regulators.

Disclosure of Insider Transactions

Insiders and affiliates transacting in non-SEC registered securities should be required to make timely public SEC filings of those transactions in a manner similar to the SEC's Forms 3, 4 and 5 when trading through a broker-dealer or engaging in private transactions involving publicly traded securities. Promoters should also be considered affiliates that need to file Forms 3, 4 and 5 when trading the securities of SEC reporting companies. Prior to depositing shares or initiating trades with a broker-dealer, insiders, affiliates and promoters should be required to provide written notification of their affiliation with the issuer or be liable for antifraud and recession of the transactions. This information will be useful for investors to understand when insiders are trading, for regulators to monitor markets and for broker-dealers to know their customers. Broker-dealers cannot fulfill their roles as gatekeepers if they do not have transparency into the identities of the affiliates of publicly traded companies.

II. CREATING MORE EFFICIENT PUBLIC MARKETS

Tick Size & Small Company Liquidity

Many securities regulators have interpreted the language and intent of the laws that created the national market system (NMS) as a mandate to favor agency trading by broker-dealers over principal trading with customers. The NMS laws passed by Congress include discussion of the opportunity for investors' orders to be executed without the participation of a dealer. This has led to regulations that continually undercut the profitability of market making and supplying liquidity as a service. It is no surprise that we now suffer from a lack of displayed liquidity in

[13] The full text of our comment letter is available at http://www.sec.gov/comments/4-659/4659-13.pdf.

many smaller companies and a perception that market makers are being regulated out of existence[14] by securities regulations.

Regulators often seem to forget that the NMS laws also asked the SEC to assure economically efficient execution of securities transactions and fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets. We strongly agree that regulation should not favor any business model. There should be no favoritism of brokers over dealers or exchanges over non-exchange markets. Instead, consumers of liquidity and execution services should make those choices.

The issue of decimalization, or tick size, is the perfect example of an issue that requires a balanced approach. Congress, through the decimalization study and solicitation of industry expertise mandated by the JOBS Act, clearly understands the need to review the effects of decimalization and to incentivize market makers to build liquidity in small and mid-cap company stocks.

We support the need for a pilot program implementing tick size reform, as it could help restore a balance that incentivizes market making to create more liquidity for investors. The pilot program must be structured properly in order to attain the desired results. We support proposals for a long-term pilot to allow for proper data collection and analysis, and the involvement of the SEC and the securities industry in evaluating the impact of such a pilot. Beyond those structural concerns are five main themes to a successful tick size pilot:

1. Any tick increment program should include securities traded on our OTCQX, OTCQB and OTC Pink marketplaces. Our marketplaces have thousands of small companies that can benefit from improvements in displayed market liquidity.

2. Tick increments should not artificially widen spreads. Many smaller, relatively illiquid companies are already subject to bid/ask spreads far above the one penny limit. A company with a natural 10 cent spread should not be forced to operate with a 20 or 25 cent spread just to push the outer boundaries of tick size on broker-dealer behavior. Securities at different price and trading activity levels tend to maintain similar natural tick

[14] The number of market makers has declined by approximately 1/3 since 2005.

sizes, making it possible to determine the appropriate tick size for each price and trade activity "band." Regulations should not create tick sizes that are unnaturally wide, frustrating investors and ultimately removing liquidity from the market. In the past, our OTC Link ATS had quote increments until changes in FINRA rules made them unworkable. What we observed when we had increments was increased display of larger sizes by broker-dealers. When increments are lowered, displayed size reduces as any display of size is easily out bid by a penny for 100 shares.

3. Broker-dealers should display greater proprietary liquidity to enhance the larger tick sizes. The implementation of tick size reform should come hand in hand with larger minimum displayed sizes for broker-dealer proprietary quotes. For example, at price points that currently require display of quotes for 100 shares[15] or more, broker-dealer proprietary quotes should be displayed only when they are for a minimum of 500 shares. Customer agency orders will glean the benefit of tick size reform, but the real impact on liquidity in small and mid-cap companies will come from increased broker-dealer proprietary quotes. FINRA is currently operating a tier size pilot program for securities traded in our marketplaces, which lowered the minimum displayed quote size at many price points in an effort to increase the display of customer limit orders. While FINRA has not yet released its academic study of the pilot program, it is clear from our data that broker-dealers have reduced displayed proprietary quote sizes in line with the new minimum tier sizes, resulting in a loss of liquidity in the affected securities. We have also seen broker-dealers displaying fewer priced quotes when they have no customer orders on their books because of increasing "air gaps" cause by smaller displayed sizes and lack of proprietary quotes. Tick size reform can easily remedy this problem by raising the minimum displayed size for broker-dealer proprietary quotes in securities with mandated larger tick sizes. Tick size reform on its own will be a valuable tool for increasing liquidity. Combining tick size reform with larger minimum displayed sizes for proprietary quotes would lead to a faster, tangible result for the small and mid-size companies that need it most.

4. Tick size reform should apply to quotes and orders, but not trades. Requiring trades to occur only at specific tick sizes could have several negative effects on investors and the

[15] To encourage the widest participation, smaller share sizes should remain for customer orders.

OTC Markets Group Inc.
304 Hudson Street, 3rd Floor
New York, NY 10013

E info@otcmarkets.com
T +1 212 896 4400
W otcmarkets.com

broker-dealers that these rules are intended to incentivize. Investors currently benefit from lower access fees and price improvement when there is choice on where trades are executed. This leads to lower costs for investors with marketable orders, incentivizing them to trade. Requiring trading only at specific price increments would harm investors by eliminating the possibility of price improvement. A rule requiring trading at specified tick sizes or a "trade at" rule that forces trades to go to the venue with displayed prices would limit competition for order flow and provide no corresponding benefit for consumers of liquidity, potentially negating the beneficial effects of a change in tick size policy. The taker of liquidity is the one who sets market prices, and we should not adopt a "trade at" rule that would regulate what bid or offer the taker must interact with.

5. The default market wide quote and order increments should be set by price and trading activity. Publicly traded companies should have a chance to opt out if they do not want tick increments or opt back in by notifying their primary national stock exchange or ATS market operator.

With tick size reform, we expect investors will see more displayed liquidity on the bid and offer. This will lead to a multiplier effect of competing liquidity providers willing to provide larger execution sizes at the bid and offer to attract order flow. Increased liquidity will lead to a higher willingness of many investors to trade and be filled on the bid and offer or better, leading to a higher quality investor experience.

Fragmentation is Good for Transparent and Connected Financial Markets

When the national stock exchanges discuss the increase in trading volume taking place on other venues, they use the term "fragmentation" to paint a picture of a broken marketplace in need of repair. In fact, "fragmentation" is just a spin-doctor's word used by those on the losing side of diverse choice and healthy competition. Trading on multiple broker-dealer internal systems, crossing networks and ATSs provides benefits to investors and actually drives liquidity.

The competition among trading venues in our financial markets mirrors a change taking place in every industry: the shift from a three-tier model of producer, distributor and retailer to a networked model where consumers and producers connect directly through public and private networks. The shift towards networks allows buyers and sellers to meet more easily. For example, investors in Apple, Inc. stock can purchase shares from a broker who places traditional buy orders on an exchange. In addition, that broker may use a network to connect directly to brokers who are selling Apple stock, or it can internalize the order and provide liquidity directly to the investor without another intermediary. The network model creates efficiencies for investors by providing a choice of trading partners and forcing intermediaries to add value in price, speed or execution quality or potentially be left out of the trade. Market "fragmentation" has actually improved the market.

The trend towards networks has been enabled by the SEC's adoption of Regulation NMS, which allowed investors to shop for the best liquidity supplier and ensured that broker-dealers matched the best publicly displayed price. As a result, the U.S. financial markets support a wide variety of trading models that provide efficient service to institutional and retail investors. Attempts to curb this innovation, such as proposals for a "trade-at" rule, will remove tangible benefits from the market and ultimately harm the capital raising efforts of companies that seek to reach all types of investors.

As supporters of diverse choice and healthy competition for trade executions, we also strongly disagree with some suggestions by stock exchanges that trading in smaller companies should only take place on one exchange. Any attempt to create a monopoly on trading, through congressional mandate, SEC regulation or otherwise, is a restriction on the rights of shareholders to dispose of their property. The idea that we should mandate trading rights to one exchange, ATS or broker-dealer to improve liquidity is ludicrous and goes against all we have learned from history.

When Nasdaq was primarily a market for smaller companies, it was not a centralized stock exchange. In those days, Nasdaq was an automated quotation system and the quotes on it came from hundreds of OTC market makers across the country acting as individual market centers. Investors and broker-dealers benefitted from the fragmented Nasdaq network-based model, and that directly lead to Nasdaq successfully fostering small company trading.

We are strong believers in the network model for small company trading, and our OTC Link ATS has over 130 broker-dealers that act as market centers, providing diverse choice for buyers and sellers. As Nasdaq proved many years ago, the OTC network model promoting competition and efficiency is what drives a successful small company marketplace, and it would be a step in the wrong direction to centralize all small company trading on one monopoly exchange.

Margin Eligibility

Any discussion of the value of efficient secondary markets requires an exploration of the different ways in which that value is created. One of those ways is margin eligibility, or the ability for securities to be used as collateral in a margin account. Margin eligibility creates a wealth effect for security holders. Holders of marginable securities can access the value of their holdings by borrowing against them, which increases the utility of owning those securities and ultimately encourages investors to purchase them. This creates a credit multiplier effect as more shares can be used to access credit, and shareholders are able to access capital without having to sell their shares. The effect of margin eligibility on an investor's willingness to purchase a security, particularly the smaller companies that trade on our marketplaces such as the 600 community banks, should not be understated. Employed properly, margin eligibility can have a direct impact on small company capital formation.

Again, a quick history of the issue will inform the discussion. Traditionally, the Board of Governors of the Federal Reserve System would publish a quarterly list of stocks trading on the OTC market that were deemed "marginable" based on certain standards. That practice ceased in 1999 when the Board determined that all stocks on the NASDAQ Stock Market were marginable. Since that time, the responsibility for determining margin eligibility of non-exchange listed shares has been abdicated by the Federal Reserve, and small companies have suffered from their securities not being an asset that brokers can lend against collateral. More recently, the SEC's Division of Trading and Markets has filled the void and provided guidance on the margin eligibility of certain foreign securities. The SEC, as the primary regulator of the securities markets, should in our view have authority over margin eligibility of equity and other classes of securities.

We propose that the SEC make marginable any equity security that is not a "Penny Stock" as that term is defined in Rule 3a51-1 under the Securities Exchange Act of 1934 (the "Exchange Act") for which the issuer makes adequate current information publicly available under Rule 144 and is actively traded on an established public market[16]. Adequate current information and active trading on an established public market will ensure that margin eligible securities are easily valued and traded. The Penny Stock standards include thresholds relating to stock price, net tangible assets and revenue. Instituting these standards would ensure that securities subject to the SEC's Penny Stock Rules do not inadvertently gain marginable status, while giving investors in qualified small companies access to the added value, and investment incentive, that margin eligibility provides.

It should be noted here that the definition of Penny Stock could also use some updating. A company may be exempt from classification as a Penny Stock if it meets certain net tangible asset (NTA) thresholds, but only based on its most recently audited financial statements. Since most companies are audited only annually, the Penny Stock rules fail to take into account a company that does not meet the NTA threshold as of its audited year-end, but shortly thereafter completes a capital raise and increases its NTA significantly. Under the current rules, that company could remain classified as a Penny Stock until its next annual audit. Alternatively, if the Penny Stock rule allowed exemptions for NTA based on quarterly financial statements, a company that completes a capital raise and meets all of the required financial standards for exemption would not be forced to needlessly accept a misleading Penny Stock designation while it waits for the calendar to turn.

Thoughtful expansion of margin will increase the availability of credit for investors in small companies and the pool of capital for small companies. The 600 community banks on our marketplaces are a great example of companies that will benefit from margin eligibility.

State Blue Sky Secondary Trading Restrictions

Non-penny stocks that are actively traded on "established public markets" should be made exempt from state Blue Sky secondary trading restrictions. There is an antiquated patchwork of state restrictions for secondary trading that is a compliance nightmare for broker-dealers and smaller companies. While companies listed on exchanges are exempt from Blue Sky laws for both primary offerings and secondary trading, securities on our marketplaces are not. Many states have implemented the Uniform Securities Act of 2002[17] or its predecessor to a varying

[16] As noted above, our OTCQX and OTCQB marketplaces have been deemed established public markets by the SEC.

[17] See: http://uniformlaws.org/Act.aspx?title=Securities%20Act

extent, other states have developed their own set of requirements, and there are some states such as Alabama that have no process for an non-exchange traded issuer comply with Blue Sky laws for secondary trading without engaging in a primary offering. State Blue Sky restrictions create a complex web of compliance costs that add little to oversight of secondary trading and apply needless restrictions on investors who are trading through full service brokers and investment advisors.

Issuer Payments for Market Makers

The SEC is starting to approve exchange programs allowing payments by ETF issuers to market makers. This reverses a longstanding ban on these types of payments. However, the small companies that need it the most are still banned from contracting with market makers to provide more displayed liquidity and continuous bids and offers at an appropriate spread. These activities should be allowed as long as there is public disclosure and appropriate regulatory oversight.

The outright ban on payments to broker-dealers limits small company access to the public markets. SEC Rule 15c2-11 and FINRA Rule 6432 require that broker-dealers review and supply to FINRA certain information before initiating quotations in a new equity security. Broker-dealers have an economic incentive to initiate these filings if they have investor interest in trading the security, or a significant investment banking or advisory business with the issuer or major shareholders. However, since broker-dealers cannot be paid to perform due diligence and make these fillings with FINRA, smaller companies without these pre-existing relationships are often unable to find a broker-dealer willing to sponsor them. The outright ban on a service for which there is clearly a demand and need for has led to many small companies not being able to legally purchase these services, and a black market of secret payments to those that skirt the rule.

Restricting smaller companies access to public markets, harming the quality of their markets and incentivizing illegal activity should not be the goal of our securities laws. By allowing companies to pay for market making services, the quality of markets and the quality of review before initiating quotations can be improved. FINRA Rule 5250 Payments to Market Makers should be changed to remove the ban on payments and require they be publicly disclosed by the issuer and the company as well as reported to FINRA.

Delay XBRL Filing for Smaller Companies

We see vendors charging small companies $35,000 per year and up for XBRL conversion at SEC reporting companies. For smaller companies that amount of outside costs, plus the internal resources required to make accurate XBRL fillings is not worth the current benefit they receive, as their financial information is already in the vast majority of financial databases and portals. Until the cost and complexity is reduced, we propose that XBRL fillings not be required of SEC reporting companies traded on our marketplaces.

Remove Section 17B of the Exchange Act (or Modernize it to Include ATSs)

The venues available for the quoting and trading of penny stocks have drastically advanced in the nearly quarter-century since Congress enacted Section 17B of the Exchange Act in 1990 to create price transparency in penny stock trading. With the development and success of OTC Link ATS and the OTCQB and OTC Pink marketplaces, it no longer makes sense to require a regulator like FINRA or a national securities exchange to operate a penny stock marketplace.

When Section 17B was enacted, the market for penny stocks was disjointed at best, and commercial enterprises were not providing an electronic facility for publishing or disseminating quotes in those stocks. Congress correctly determined that the market for penny stocks suffered from a lack of reliable and accurate quotation and last sale information available to investors and regulators. Given the state of the penny stock market in 1990, Congress reasonably concluded that it was in the public interest to require the creation and operation of an "automated quotation system" for penny stocks, and that the system should be operated by a registered securities association or a national securities exchange. It should be noted that in 1990 the regulatory category of ATS did not exists and FINRA's predecessor, the NASD, as still operating NASDAQ.

Fast forward to 2013. Over 99% of priced quotes, including nearly all priced quotes in penny stocks, take place on the OTC Link ATS trading system. The system created in response to Section 17B's mandate, FINRA's OTC Bulletin Board, is left with less than 1% of priced quotes. The information that Congress rightly sought access to in 1990 is now provided seamlessly and electronically to any investor or regulator with internet access. Market data from broker-dealer activity on OTC Link ATS is widely disseminated through a multitude of market data distributors, financial portals and the internet.

Moreover, OTC Link ATS is a highly regulated trading system. It is operated by OTC Link LLC, a FINRA member broker-dealer and SEC registered Alternative Trading System. NYSE's ArcaEdge ECN is also registered as and ATS, and many other ATSs are being created to trade private securities. Commercial enterprises have stepped in to provide this service and there is no need to

The private sector has stepped in and negated the need for Section 17B. Congress has an opportunity to remove this antiquated section of the Exchange Act or at least modernize it to be more inclusive of the systems that have and will provide innovation in the future. If FINRA wants to continue to operate the OTC Bulletin Board to provide an alternative choice to its member firms like they do with their Alternative Display Facility (ADF) that should be an option, but the time has passed and there is no longer a need for the Congressional mandate or the extra complexity that arises from Section 17B.

A Note on Taxes

While it is not this Committee's focus, I would like to share with you some data regarding the inherent expense and unfairness of the tax system for smaller U.S. based companies. According to the NY Times, the average S&P 500 Company pays a combined federal and state tax burden of 29.1%[18] (the average IT company pays 21%). OTC Markets Group paid a tax rate 39% last year. We also have costs of tax compliance; we pay more to our tax accountants at Grant Thornton LLP than we do in audit fees to our independent auditor Deloitte & Touche LLP. It is time we simplified the tax code and made the U.S. tax rate and complexity competitive with global tax rates. It is unfair that larger companies pay significantly lower tax rates than small companies and it is unsafe for our economy that we incentivize debt over equity with lower effective tax rates. We could easily incentivize smaller companies to go public in the U.S. if we allowed smaller publicly traded companies with over 100 shareholders to have a 25% tax rate and deduct dividends[19]. Tax efficiency has created an incentive for REITs to be public and we can do the same thing for America's smaller companies.

[18] http://www.nytimes.com/interactive/2013/05/25/sunday-review/corporate-taxes.html?_r=0

[19] Dividends should be deductible like interest payments and the receiver should be taxed at the same rate as interest payments. For more information about the debt bias see my Op Ed at Forbes.com: http://www.forbes.com/sites/greatspeculations/2012/12/07/tax-code-rewards-debt-penalizes-dividends/

Conclusion

The Dutch invented the modern corporation with perpetual capital and tradable shares, but it was the English who introduced fewer restrictions on transferability and took the lead in Europe and the world. There are vigorous and growing markets for small company shares in Canada, the United Kingdom and Australia. It has been reported that the China Securities Regulatory Commission (CSRC) has identified expanding the New Third Board, a nationwide OTC market, as its primary task this year.[20] While I cannot tell if the reports are true, I can confirm that I was invited to speak at a CSRC conference focused on creating a Chinese OTC market five years ago. There over 80 regulators peppered me with questions about how our marketplaces had developed. Today, American markets are the world leaders, but we cannot rest on our laurels. The competition for ideas, people, companies and capital is global.

Our public markets must be as open, transparent and connected as possible to deliver the value of being a public company to the largest number of companies and their investors.

Thank you again for inviting me to testify. While the issues I discussed may seem diverse, each is a vital component to reducing barriers to capital formation by creating better informed, more efficient marketplaces. I look forward to responding to your questions.

[20] http://www.marketwatch.com/story/excitement-over-new-china-stock-market-board-2013-05-20.

PROSPECT

Testimony of Joseph Ferraro,
General Counsel, Prospect Capital Corporation
before
The House Subcommittee on Capital Markets
and Government Sponsored Enterprises
on
"Reducing Barriers to Capital Formation"

June 12, 2013

Mr. Chairman and Members of the Committee, thank you for the opportunity to testify today. My name is Joseph Ferraro and I am General Counsel to Prospect Capital Corporation, a leading provider of capital to job-creating small- and medium-sized companies in the United States.

I. Prospect Capital Corporation

Prospect is a publicly-traded business development company. A business development company is a closed-end investment company that focuses on investing in small- and medium-sized private companies rather than large public companies. Our company completed its initial public offering in July 2004, and since then we have invested more than $5.5 billion in over 175 small- and medium-sized companies. Prospect is a growing company whose operations utilize over 75 employees in 5 locations – New York, Chicago, Houston, San Francisco and Westport, Connecticut.

Prospect invests primarily in first-lien and second-lien senior loans and mezzanine debt, which in some cases include an equity component. Our flexible mandate allows Prospect to provide capital to small- and medium-sized companies for re-financings, leveraged buyouts, acquisitions, recapitalizations, later-stage growth investments, and capital expenditures.

Small- and medium-sized companies use capital from Prospect to expand their businesses, hire workers, construct factories, and achieve other important objectives. Prospect's portfolio is diversified across a wide variety of industries – about 50 in total – including manufacturing, industrials, energy, business services, financial services, food, healthcare, and media. The small- and medium-sized companies we finance employ more than 100,000 American workers in nearly every state in the nation.

From the perspective of our shareholders, our investment objective is to generate both current income and long-term capital appreciation through debt and equity investments.

Prospect seeks to maximize returns and minimize risk for our investors by applying rigorous credit analysis to make and monitor our investments small- and medium-sized companies.

We are proud of our track record supporting scores of small- and medium-sized companies that we have helped grow over time. In the current calendar year we have already closed more than $1.1 billion of investments, and we have closed about $3 billion of originations in the past twelve months. Our capital has helped create thousands of American jobs over the years, and our capital is much needed in this critical period of high unemployment and economic uncertainty.

II. Business Development Companies

In 1980, Congress enacted amendments to the Investment Company Act of 1940 authorizing business development companies (BDCs). Congress wanted to facilitate private finance investment at a time when, much like today, bank balance sheets were reeling from a period of economic largesse in the 1970s, and small- and medium-sized American businesses faced limited credit options. In response, Congress authorized a publicly traded, closed-end fund structure, the sole intent of which was to facilitate private finance investment to small- and medium-sized American businesses while offering such homegrown businesses significant guidance and counseling concerning management, operations, business objectives, and policies. Put simply, a BDC is a lender to and investor in small- and medium-sized businesses and has stepped into a role commercial banks have largely abandoned – lending to small- and medium-sized American businesses that might not otherwise obtain financing to grow.

BDCs must invest at least 70% of their assets in so-called "eligible assets." The most common type of "eligible assets" are private and "micro-cap" public American companies. These investments must be privately negotiated and the BDC is required to offer managerial assistance to these companies in which the BDC invests to meet specific business challenges.

Small- and medium-sized American companies generally face difficulty in meeting their capital needs.

And why is that?

On the one hand, generally such companies are too small to afford the expense of directly accessing the public debt and equity markets. On the other hand, their capital needs are frequently too large to be well served by SBA programs or small community banks. These small- and medium-sized companies generally require $10 million or more in incremental financing.

Financing these companies requires significant time and energy by the lender or capital provider, including due diligence activities and rigorous credit analysis that have become uneconomical for traditional banks, with transaction sizes that are too small for many other capital providers.

Thus, for small- and medium-sized companies BDCs represent a very important source of capital. Our industry today is composed of about 40 publicly traded BDCs collectively managing $39.1 billion in assets with an aggregate market capitalization of $26.4 billion. BDCs have become an integral part of the credit markets. Over the nine-year period from 2004 to 2012, BDCs' total loan balances grew from $2.4 billion to $21.8 billion. As a percentage of the leveraged loan market, BDCs today represent about 4.1%, up from 2.2% in 2004. And the companies for which our industry has provided capital employ millions of American workers.

BDCs are heavily regulated. They are public companies that are subject to the Securities Act of 1933 and file an election with the SEC to also become subject to the Investment Company Act of 1940. Thus, BDCs are transparent vehicles both for investors and for small- and medium-sized American companies seeking capital. For example, BDCs file the same periodic reports with the SEC as any other public company, while also being subject to the additional regulatory constraints of the Investment Company Act of 1940.

The shareholders of BDCs, many of them retirees on a fixed income, receive the investor protections of our securities laws while having an opportunity to participate in the types of investments that otherwise are only available to deep-pocket investors through private partnerships. BDCs also offer advantages to the companies that are in need of investment capital to grow. For many of the companies in which a BDC invests, traditional sources of financing like bank lending or public offerings are unavailable. For these companies, BDCs offer an alternative source of capital that is subject to public disclosure and transparency.

In summary, BDCs provide substantial benefits to the American economy, including the opportunity for the investing public to invest in smaller growing businesses and the opportunity for such small- and medium-sized companies to obtain much-needed financing.

III. Common Sense Modernization

Mr. Chairman and Members of the Committee, we believe that modest changes to our securities laws can greatly enhance the benefits offered by BDCs to the American economy and allow BDCs to better serve the capital needs of small- and medium-sized companies. These changes have been recommended by legislation introduced by Representatives Mulvaney (H.R. 1973), Velazquez (H.R. 31) and Grimm (H.R. 1800). Our industry already helps to create many American jobs, and if Congress modernizes some of the rules under which we operate I believe that we will be able to create many, many more.

We appreciate not only the efforts of these Members and those of you who are co-sponsoring their bills, but also this Committee's actions in prior years to modernize the rules under which BDCs must operate. Your bipartisan efforts have made BDCs more efficient and the regulations that we operate under more responsive to the needs of both our investors and the small- and medium-sized companies that we serve. This was true in the "National Securities Markets Improvement Act of 1996" when Congress modified the definition of eligible portfolio company and made other adjustments to the original 1980 law. And it was true in 2004 and 2005 when this Committee moved legislation to further improve the definition of eligible portfolio companies.

Today, I would like to urge the Committee to consider some additional steps that can be taken to help make BDCs even more robust capital providers to small- and medium-sized companies, thereby helping with American job creation in this period of high unemployment. As suggested by the bills I have referenced above, a few modest reforms to our securities laws can help every BDC more effectively achieve their purpose without undermining investor protections.

(1) Further Update the Definition of Eligible Portfolio Company

Registered investment companies are allowed to invest in financial services companies, including community banks, leasing companies, factoring firms, and automobile financing companies. However, as described above, BDCs must invest at least 70% of their assets in "eligible portfolio companies." When Congress created BDCs, it focused on industry and services, but excluded financial services companies from qualifying as "eligible portfolio companies." Thus, no more than 30% of a BDC's assets can be invested in financial companies. This limitation makes no sense decades later given the substantial growth of financial services as a leading job provider in the American economy since 1980. Financial services companies employ millions of American workers and have a capital magnifying effect that results in more capital flowing into small- and medium-sized American businesses.

A policy that limits BDC investments in small- and medium-sized financial services companies runs counter to the objective of helping attract capital for the benefit of small- and medium-sized American companies. In fact, frequently such companies in turn serve the financial services needs of other, smaller companies. For example, we have one company in our portfolio called Nationwide Acceptance. Based in Chicago, Nationwide provides capital to Americans with modest means in order for such individuals to purchase automobiles that those individuals need to get to and from work, drive their children to after-school activities, and pursue their individual transportation freedoms. BDCs should not have limits on providing capital to such important companies. Financial service companies serve a vital role in our economy and should be encouraged, not stifled.

Financial businesses that are subject to the current law limitation are comprised of a wide array of companies: community banks, insurance and reinsurance businesses, asset and investment advisors, real estate businesses, industrial loan companies, consumer financing businesses, credit card receivables companies, business inventory and receivables financing companies, automobile financing businesses, equipment financing businesses, companies making loans to purchase livestock feed and farm products, companies owning or holding oil, gas or mineral leases or royalty interests, and many more. Again, these types of companies amplify the amount of capital made available to small- and medium-sized American businesses and American consumers, thereby helping with economic stimulation and job creation at no cost to the federal government.

The original justification for Congress back in 1980 limiting a BDC's level of investment in financial companies is not clear. I believe that this old part of the law is painfully antiquated and arbitrary. BDC investments in small- to medium-sized American financial services businesses are consistent with the principal purpose for which Congress created BDCs – to provide capital and assistance to small, developing businesses that are seeking to expand and create American jobs.

H.R. 1973, the "Business Development Company Modernization Act", would eliminate this outdated limitation, bring small- to medium-sized American financial services businesses into the family of "eligible assets," and by doing so remove an artificial and unnecessary obstacle to their growth and increase the flow of BDC dollars into such new and expanding American businesses.

(2) Update 1940 Act's limitations on owning investment advisors

The Investment Company Act of 1940 prohibits a BDC from acquiring more than 5% of any class of equity securities or more than 10% of the total debt securities of (or invest more than 5% of its assets in) any company that directly or indirectly derives more than 15% of its consolidated gross revenues from securities-related activities including acting as a registered investment advisor. Thus the 1940 Act limits the ability of a BDC to invest in investment advisers.

Prior to the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, an investment adviser having fewer than 15 clients could generally avoid registration under the Investment Advisers Act of 1940, and BDCs could and did invest in unregistered investment advisers. BDCs typically used this flexibility to form and manage captive investment advisers that would manage investments on behalf of third party investors or the BDC itself, permitting stockholders in the BDC to benefit from the stream of advisory fees generated by such investment advisers. Following implementation of the Dodd-Frank Act, which repealed this registration exemption for "private advisers," BDCs owning (or wishing to acquire) a registered investment adviser must apply to the SEC for exemptive relief. Although the SEC has provided administrative relief from this prohibition through several exemptive relief orders, the process is very time consuming and expensive.

The three pending BDC bills would modernize the statute by repealing this prohibition and end the needless spending of shareholder resources to seek administrative relief. In essence, it simply codifies existing practice, removes unnecessary costs and levels the playing field between those BDCs that have been granted exemptive relief and those that have not. Changing the law here also reflects that asset management companies are no riskier, and arguably less risky, than many other parts of the economy. Such companies also employ plenty of American workers, and their growth should be encouraged rather than discouraged.

(3) Modernize and Re-examine the Restrictions on How BDCs Raise Capital

Both H.R. 1800 and H.R. 31 offer some common sense reforms on how BDCs raise capital in the market. Reducing the cost of raising capital benefits both BDC shareholders and the small- and medium-sized American companies in which they invest.

(A) Shelf Registration Forms

BDCs, like other companies that regularly raise capital through securities issuances, rely on pre-filed "shelf registration" – a securities filing that allows a company to be prepositioned to issue additional securities. Because shelf registrations contain financial information that becomes outdated as companies publicly report their most recent financial information, companies are allowed to incorporate by reference in their shelf registrations subsequent financial reports. However, BDCs are not allowed to take advantage of this common sense approach, and instead we must manually update our shelf registration statements *each time* we report new quarterly information. This slows down the timetable for a BDC to access the capital markets and adds the unnecessary expense of lawyers, accountants and printers to the securities offering process.

Why must BDCs replicate the information in duplicative public filings at needless cost and with no known investor benefit?

Why must we file the electronic equivalent of reams of duplicative paper?

Dr. Seuss' Lorax famously asked: "who speaks for the trees?" The pending legislative initiatives properly ask: "who speaks for common sense?"

These measures require the SEC to reform the forms and instructions for shelf registrations to treat BDCs like other companies eligible to use shelf registration statements. BDCs currently must copy and paste entire documents over and over again into filings, thereby requiring armies of lawyers, accountants, and printers. Every other type of public company in America has more streamlined rules reflecting the electronic age. BDCs should have access to the same streamlined filing benefits.

(B) Offering Reform

BDCs can only offer additional capital to small- and medium-sized American companies when we can increase our own capital. Our industry is traditionally a frequent issuer of new securities offerings to raise such funds. For example, Prospect has raised some $2.5 billion since our IPO in 2004 through more than 26 public offerings.

In 2005 the SEC modernized the issuance process for frequent issuers, reducing costs and making the process more efficient. However, BDCs were excluded from these common sense reforms, with a promise that the issue would be revisited. Some eight years later nothing has happened. This situation has not benefited the capital needs of small- and medium-sized companies, nor has it provided any beneficial investor protections. It is time that our business development companies have the same access to the capital markets as enjoyed by other publicly traded companies.

For example, the offering reforms recognize companies that are "Well-Known Seasoned Issuers" or "WKSIs." These are companies that generally are frequent issuers in the public markets and have significant market capital size. Generally, WKSIs can take advantage of new, liberalized rules relating to communications with investors and the registration process. Unfortunately BDCs were explicitly excluded from the definition of WKSI without any explanation or rationale.

In fact, BDCs are the only industry disadvantaged by offering reform.

How?

Offering reform allows issuers greater freedom to communicate with prospective purchasers. One such method that is allowed is a recorded electronic road show that is played on a delayed basis. Before offering reform, BDCs and other issuers relied on a series of no-action letters issued by the SEC to use electronic road shows. As part of the reform, the SEC withdrew the electronic road show no-action letters. As a result, BDCs are no longer permitted to use or disseminate recorded copies of electronic road shows and were not made eligible for the new modernized communication rules.

There is no public policy justification for BDCs being left behind when the SEC modernized the rules that govern how companies can raise capital in the public markets, nor to have an otherwise constructive modernization effort inadvertently turn the clock back on our industry.

(C) Other Reforms

H.R. 31 and H.R. 1800 also offer other reforms that can assist BDCs in raising and deploying capital to small- and medium-sized American companies. For example, these bills provide some easing of the leverage limits imposed by the Investment Company Act of 1940 on BDCs. The leverage limitations suggested by these bills remain very conservative but provide more leeway for BDCs to have a greater ratio of debt to asset valuation on their balance sheets. These changes underscore the importance of ensuring that BDCs have adequate access to capital themselves, so they can redeploy funds to support the small- and medium-sized companies that they serve. The proposed leverage limitations are still far more restrictive than what banks and insurance companies are allowed to enjoy.

IV. Conclusion

In conclusion, business development companies are an important source of capital for small- and medium-sized businesses. With some common sense reforms it is possible to increase the capacity of BDCs to offer capital to job-creating American businesses without in any way undermining the strong investor protections afforded by the Investment Company Act of 1940.

We applaud the efforts by Representatives Mulvaney, Grimm, and Velazquez and urge the Committee to act favorably on BDC reform legislation to expand capital access and remove inefficiencies in the current regulatory rules. Our industry and our economy, with its still unacceptably high unemployment rate, require action by the Committee in a manner that I have presented to you today without costing the government and taxpayers a single penny.

Again, I greatly appreciate the opportunity to testify today and would be pleased to answer any questions that you may have.

ALLIANCE OF MERGER AND ACQUISITION ADVISORS

United State House of Representatives
Committee on Financial Services
Subcommittee on Capital Markets and Government Sponsored Enterprises

Hearing Entitled "Reducing Barriers to Capital Formation"
Room 2128 Rayburn House Office Building

June 12, 2013

Written Statement by
Shane B. Hansen, Partner
Warner Norcross & Judd LLP

Submitted as counsel for and on behalf of the

Alliance of Merger & Acquisition Advisors
200 East Randolph Street, 24th Floor
Chicago, Illinois 60601

With respect to H.R. 2274
The Small Business Mergers, Acquisitions,
Sales, and Brokerage Simplification Act of 2013

WARNER NORCROSS & JUDD LLP
ATTORNEYS AT LAW
900 FIFTH THIRD CENTER • 111 LYON STREET, N.W.
GRAND RAPIDS, MICHIGAN 49503-2487 • WWW.WNJ.COM

Written Statement by
Shane B. Hansen, Partner
Warner Norcross & Judd LLP

With respect to H.R. 2274
The Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2013

June 12, 2013

Introduction

Chairman Garrett, Ranking Member Maloney, members of the Capital Markets Subcommittee, thank you for this opportunity to explain how and why today's "one size fits all" system of regulating securities broker-dealers adversely impacts and unnecessarily increases the costs that business owners incur to sell, buy, or grow their small and mid-sized businesses through privately negotiated mergers, acquisitions, business combinations, and sale transactions.[1] This legislation represents the culmination of more than six years' effort to work cooperatively with the staff of the Securities and Exchange Commission ("*SEC*" or "*Commission*"), through its Division of Trading and Markets, and with state securities regulators through the North American Securities Administrators Association ("*NASAA*"), to craft a regulatory solution. As quoted below, even the SEC recognizes the need to address this small business issue, but it has been unable to make this a rulemaking priority and, in the absence of a Congressional mandate, is unlikely to do so any time soon.

The purpose of the Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2013, H.R. 2274 (the "*Small Business Brokerage Act*"), is to appropriately scale federal regulation of securities broker-dealers with respect to privately negotiated business sales, mergers, and acquisitions ("*M&A*"). It would enhance public protections for business sellers and buyers by clarifying and creating relevant regulatory requirements while addressing these critically important small business considerations:

- An estimated $10 trillion of privately owned businesses will be sold or closed as baby boomers retire.

- Jobs are preserved and created when new entrepreneurs and other companies acquire and grow existing businesses.

- Business brokers play a critical role in facilitating private business mergers, acquisitions, and sales.

---

[1] This written statement is submitted by Shane B. Hansen as legal counsel for the Alliance of Merger & Acquisition Advisors ("*AM&AA*"), a national professional association of more than 900 M&A brokers and associated members headquartered in Chicago, Illinois. More information about the AM&AA is available on its website at http://www.amaaonline.com/. This effort is supported by the International Association of Business Brokers ("*IBBA*"), including the M&A Source, a national professional association of business brokers headquartered at 3525 Piedmont Road, Building Five, Suite 300, Atlanta, Georgia, 30305. More information about the IBBA and the M&A Source is available on their websites at: http://www.ibba.org/ and http://www.masource.org/. Fourteen regional professional associations of M&A and business brokers also support this effort.

❖ Simplified and appropriately scaled regulation of business brokerage services will reduce costs and better protect business owners.

Public Policy

The public policy considerations supporting this legislation began in 2005 with the American Bar Association, Business Law Section, *Report and Recommendations of the Private Placement Broker-Dealer Task Force,* available on the SEC website at www.sec.gov/info/smallbus/2009gbforum/abareport062005.pdf. A similar recommendation was made the next year in *The Final Report of the Advisory Committee [to the SEC] on Smaller Public Companies*, also available on the SEC's website at www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf. Following the issuance of these independent and unbiased reports, working drafts of proposed rules to accomplish these recommendations were developed by the Alliance of Merger & Acquisition Advisors ("*AM&AA*"), with the support of the International Association of Business Brokers ("*IBBA*"), and submitted to the SEC and NASAA in 2007 and 2008. A proposal to appropriately scale federal regulation of M&A intermediaries and business brokers ("*M&A brokers*") has been among the top recommendations in the 2006, 2007, 2008, 2009, 2010, and 2011 Government-Industry Forum on Small Business Capital Formation hosted by the SEC (http://sec.gov/info/smallbus/sbforum.shtml). This topic was not on the 2012 agenda, which is set by the SEC. The SEC has been studying these issues, as acknowledged by former SEC Chairman Schapiro, but has not engaged in rulemaking.

In December 2011, a bipartisan group of eight Congressmen wrote to then SEC Chairman Schapiro asking about the status of the recommendations from past SEC-Government Small Business Capital Formation Forums. Chairman Schapiro's response to the Congressmen, attached to this statement, was encouraging. She gave the following response to a similar "question for the record" following her December 2011 Senate testimony:

> The staff of the Division of Trading and Markets, which is primarily responsible for administering the regulation of brokers and dealers, is analyzing the SEC's rules and regulations that apply to business brokers. The Division staff is developing options that it could recommend that the Commission consider to revise those regulations in light of the role that business brokers play in the purchase, sale, exchange or transfer of the ownership of privately owned businesses. The Division staff is also revisiting existing guidance about whether certain business brokers must be registered with the SEC as brokers in order to determine whether the Commission or the staff should provide further guidance in this area. We are mindful of the importance of considering both the burdens on small businesses' capital formation arising from our regulatory requirements and the benefits of those requirements to investors and other market participants.

Despite this encouragement, in more than six years the SEC has been unable to make this small business issue a rulemaking priority and will be unlikely to do so without a Congressional directive. A solution is urgently needed as more baby boomers retire, many of whom must choose between finding a buyer or closing their businesses. More jobs would be preserved and created by facilitating business mergers, acquisitions, and business combinations of small and mid-sized companies at a lower cost for professional services. Let me emphasize, these *are* *not* publicly traded companies, but these *are* the companies largely responsible for innovation and fueling economic growth in the U.S.

Business Context

Each of you has in your district hundreds, and more likely several thousands, of business owners who, sooner or later, want to sell their small and mid-sized businesses. They will want and need professional assistance preparing their business for the sale, valuing their business, talking about potential human resource issues when ownership and control of their business is changing, marketing the business, finding and screening potential buyers, talking about possible sale transaction structures, preparing for prospective buyers' due diligence, assessing buyers' competing offers, and consulting on a wide range commonly recurring business transition issues. The sellers will also be advised by their lawyers and accountants performing their customary legal, tax, and account services, but whose training, experience, and skills typically do not include the consulting services previously mentioned.

Similarly, back in your districts, there are hundreds, and more likely several thousands, of entrepreneurs committed to owning their own business, as well as larger companies wanting to grow by adding product lines, production capacity, intellectual property, or expanding geographically. These potential buyers want and need professional assistance finding and screening potential sellers; assisting with and assessing their due diligence investigation into each potential seller's business; advising about possible purchase terms and conditions; anticipating issues with staffing, intellectual property, and other commonly recurring business transition issues; financial modeling and advising about possible financing alternatives and their impact on profitability; and working with the lawyers and accountants employed by the buyers for their customary legal, tax, and accounting services. Sometimes these buyers are sophisticated and well-funded venture capital or private equity groups "in the business" of buying start-up and smaller companies.

These are the kinds professional services provided to small and mid-sized business sellers and buyers by M&A brokers. M&A brokers and their firms are themselves small businesses, ranging in size from solo practioners to perhaps a dozen or more professionals and support staff. M&A brokers come from diverse business and financial backgrounds, such as commercial real estate, accounting, law, finance, and business management, and many have extensive study, training, experience, and professional education in a broad range of business management consulting, human resources, financial, accounting, and tax matters. You likely have hundreds of M&A brokers in your districts as they can be found in both small towns and urban centers. Typically, lawyers and accountants do not provide the kinds of business marketing and consulting services just described.

Typically, small and mid-sized businesses organically build wealth through many years of hard work, innovation, and jobs creation. Very small businesses have an "owner life cycle" that is affected by the owners' death, sickness, burnout, or other economic opportunities (e.g., a sale). At this conclusion of the business ownership lifecycle, the business either continues under new owners or it closes, ending its economic contribution, and the employment and associated commerce it has created for the communities where it has operated. Mid-sized companies are similarly, though typically not as immediately, impacted by the owners' or managements' changing personal circumstances. M&A brokers are the bridge that enables many small and mid-sized businesses to continue with fresh energy and momentum. M&A brokers help protect the wealth accumulated by the exiting owner through a well-advised sale, while enabling new owners to maintain the economic viability, jobs and commerce that the exiting owner had created, most often bringing fresh ideas, new energy, and commitments to grow and improve.

Capital formation, businesses grown and saved, and jobs created and saved by small and mid-sized businesses are all facilitated when sellers and buyers can obtain cost-effective professional advice and assistance with the transfer of ownership through stock sales, mergers, and other business combinations. For example, the acquisition of one business by another enables the combined business to expand and accumulate investors' capital in a more diversified, often financially stronger, business enterprise. Even when a business seller receives the buyer's cash, instead of the buyer's stock, that cash is often reinvested in another business enterprise.

Today, federal securities laws and rules regulate "Main Street" M&A brokers handling privately negotiated "sale of business" transactions the same way as "Wall Street" investment bankers handling transactions involving publicly traded companies. Most of those compliance costs must be passed on to the business buyers and sellers in order for the M&A brokers to stay in business, thus unnecessarily making their professional services unaffordable. These compliance-driven costs are unduly high in light of the inherent safeguards protecting the buyers and sellers in these privately negotiated transactions.

These types of M&A transactions are negotiated between sellers and buyers by their lawyers and M&A brokers. The parties negotiate and the lawyers document their representations, warranties, covenants, rights, and remedies. Buyers conduct extensive due diligence on the sellers' businesses. Buyers will actively own, operate, and directly manage their business entities following the closing; they are not unsophisticated passive investors. These are vastly different circumstances than investment bankers handling M&A transactions involving public companies, or passive investors relying upon information provided through SEC filings. These sellers and buyers do not rely upon federal or state securities laws for their protection; rather, they rely upon the fully negotiated transaction-related agreements created by their lawyers.

Legal Background

Very small business sale transactions are commonly accomplished through the sale of the business's assets in exchange for cash, which is generally not subject to securities regulation. However, even the sale of business assets can become a securities transaction under some circumstances if it involves an "earn-out" or the buyer's giving its promissory note to the seller, each of which may be regarded as "securities" under federal and state securities laws. Moreover, when for a variety of reasons the ownership of a privately held business is transferred by means of the purchase, sale, exchange, recapitalization, repurchase, issuance, merger, consolidation, or other business combinations involving stock or other securities, then federal and one or more state securities laws apply[2] to the parties, the transaction, and regulate the transaction-related activities of the M&A broker.

---

[2] *See, e.g.*, SEC Rule 145, *Reclassification of Securities, Mergers, Consolidations and Acquisitions of Assets*.

Since the U.S. Supreme Court's opinion in *Landreth Timber Co. v. Landreth*,[3] the federal securities laws have been applied to the offer and sale of a business regardless of whether the transaction involves the sale of one or all of the outstanding shares of a company's securities. When an intermediary is brokering the sale of businesses involving securities, the intermediary often comes within the broad definition of a "broker" under the Securities Exchange Act of 1934, as amended ("*Exchange Act*"). The Exchange Act generally requires the intermediary to be registered and regulated as a "broker-dealer" by the SEC and to be a member of, and regulated by, the Financial Industry Regulatory Authority ("*FINRA*"). Offering-related registration exemptions (*e.g.*, SEC Regulation D) do not exempt broker registration requirements. State securities laws impose registration and regulatory requirements on brokers, dealers, or broker-dealers as those terms are similarly defined. State real estate and business brokerage licensing laws also apply to these activities, creating multiple layers of initial and on-going regulatory requirements, professional qualifications, and compliance-related costs for M&A brokers.

"Broker" Status

Section 3(a)(4)(A) of the Exchange Act defines a "broker" broadly as "any person engaged in the business of effecting transactions in securities for the account of others". Section 15(a)(1) of the Exchange Act provides, in pertinent part, that:

> It shall be unlawful for any broker or dealer . . . to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security . . . unless such broker or dealer is registered in accordance with subsection (b) of this section.

15 U.S.C. § 78o. This proscriptive language applies not only to either purchases or sales, but also to solicitations intended to result in purchases or sales whether or not a transaction ultimately occurs.

The SEC's *Guide to Broker-Dealer Registration*[4] provides guidance about and various examples of "broker" status. According to the *Guide*, each of the following individuals and businesses may need to register as a broker, depending on a number of factors:

- "finders," "business brokers," and other individuals or entities that engage in the following activities:
  - Finding investors or customers for, making referrals to, or splitting commissions with registered broker-dealers, investment companies (or mutual funds, including hedge funds) or other securities intermediaries;
  - Finding investment banking clients for registered broker-dealers;
  - Finding investors for "issuers" (entities issuing securities), even in a "consultant" capacity;
  - Engaging in, or finding investors for, venture capital or "angel" financings, including private placements;

[3] *Landreth Timber Co. v. Landreth*, 471 U.S. 681; 105 S. Ct. 2297 (May 28, 1985).

[4] Available on the SEC's website at http://www.sec.gov/divisions/marketreg/bdguide.htm#II.

- Finding buyers and sellers of businesses (*i.e.*, activities relating to mergers and acquisitions where securities are involved);

* * *

The SEC looks at the activities that the intermediary actually performs and the *Guide* lists some of the questions that, in the staff's view, bear upon whether an intermediary is acting as a broker:

- Do you participate in important parts of a securities transaction, including solicitation, negotiation, or execution of the transaction?

- Does your compensation for participation in the transaction depend upon, or is it related to, the outcome or size of the transaction or deal? Do you receive trailing commissions, such as 12b-1 fees? Do you receive any other transaction-related compensation?

- Are you otherwise engaged in the business of effecting or facilitating securities transactions?

- Do you handle the securities or funds of others in connection with securities transactions?

In the staff's view, a "yes" answer to *any* of these questions indicates the intermediary may need to register as a broker (which encompasses registration as a dealer and hence is commonly referred to as a "broker-dealer").[5] SEC registration as a broker also requires membership in FINRA. A similar analysis is applied under state securities laws, which all define "broker" in essentially the same terms.

In recent years, the SEC's application of these criteria through various enforcement cases and no-action letters has focused upon the presence of transaction-based compensation—a "hallmark of broker-dealer activity"[6]. Transaction-based compensation, including success fees and commissions, is generally contingent on the outcome and is often measured by the consideration exchanged in the transaction. This type of incentive compensation creates inherent conflicts of interest that the SEC considers to be a paramount concern in protecting investors. Other forms of compensation may satisfy the "engaged in the business" element in the "broker" definition, but typically carry somewhat less weight when there is no incentive or "salesman's stake" tied to the transaction's outcome (thus helping lawyers and accountants to distinguish their role and fees in an M&A transaction). While old SEC no-action letters implied that a mere

---

[5] For additional factors relevant to private equity funds, venture capital funds, business development companies, and similar issuers *see*, Speech, *A Few Observations in the Private Fund Space*, , David W. Blass, Chief Counsel, SEC Division of Trading and Markets (April 5, 2013), available at: http://www.sec.gov/news/speech/2013/spch040513dwg.htm (the "Blass Speech").

[6] *See Order Exempting the Federal Reserve Bank of New York, Maiden Lane LLC and the Maiden Lane Commercial Mortgage Backed Securities Trust 2008-1 from Broker-Dealer Registration*, SEC Release No. 34-61884 (April 9, 2010). *See also, 1st Global, Inc.*, 2001 SEC No-Act. LEXIS 557 (May 7, 2001) (reiterating the staff's position that "the receipt of securities commissions or other transaction related [sic] compensation is a key factor in determining whether a person or an entity is acting as a broker-dealer. Absent an exemption, an entity that receives commissions or other transaction-related compensation in connection with securities-based activities that fall within the definition of 'broker' or 'dealer'... generally is required to register as a broker-dealer." (internal citations omitted)).

introduction of the parties might be permissible[7], more recent no-action letters express the SEC staff's skepticism about a broader scope of involvement or the regularity of participation in capital-raising activities being present in the fact patterns presented (*e.g.*, actively soliciting prospective investors, transmitting offering documents, or recommending an offering).[8] For example, seeking and introducing prospective investors to different issuers in exchange for a finder's fee may be deemed to be engaging in the business of a broker.[9] The SEC staff has publicly stated that the oft-cited *Paul Anka* no-action letter[10] is to be limited to its facts[11]—an issuer's use of a singer's rolodex without any contact between the Canadian singer and potential investors.

While the SEC places considerable weight on the presence of transaction-based compensation, a number of federal district court decisions have articulated other factors to be considered in analyzing key aspects of the definition of "broker". In *SEC v. Kenneth Kramer*[12] the court criticized the SEC for failing to provide sufficient proofs with respect to factors beyond transaction-based compensation. The *Kramer* opinion summarized various factors identified in prior court decisions:

> Because the Exchange Act defines neither "effecting transactions" nor "engag[ing] in the business," an array of factors determines whether a person qualifies as a broker under Section 15(a). The most frequently cited factors, identified in *S.E.C. v. Hansen,* consist of whether a person (1) works as an employee of the issuer, (2) receives a commission rather than a salary, (3) sells or earlier sold the securities of another issuer, (4) participates in negotiations between the issuer and an investor, (5) provides either advice or a valuation as to the merit of an investment, and (6) actively (rather than passively) finds investors. See also *Cornhusker Energy Lexington, LLC v. Prospect St. Ventures* (Bataillon, J.) (identifying as evidence of broker activity a person's "analyzing the financial needs of an issuer," "recommending or designing financing methods," discussing "details of securities transactions," and recommending an investment); *S.E.C. v. Margolin* (Leisure, J.) (finding evidence of "brokerage activity" in the defendant's "receiving transaction-based compensation, advertising for clients, and possessing client funds and securities.").
>
> However, "[t]he factors articulated in Hansen . . . [a]re not designed to be exclusive," and some factors (i.e., those factors typically associated with broker activity) appear more indicative of broker conduct than others. For example, *S.E.C. v. Bravata* (Lawson, J.), describes "[t]he most important factor in determining whether an individual or entity is a broker" as the "regularity of participa-

[7] *See, e.g., Mike Bantuveris*, 1975 SEC No-Act. LEXIS 2158 (1975).

[8] *See, e.g., Brumberg, Mackey & Wall*, 2010 SEC No-Act. LEXIS 406 (2010) a law firm could not introduce its issuer clients to potential investor clients in exchange for a finder's fee.

[9] For a summary of SEC no-action letters, *see the Report and Recommendations of the Private Placement Broker-Dealer Task Force*, Business Law Section, American Bar Association, 60 *Business Lawyer* 959-1028 (2005), and available at http://sec.gov/info/smallbus/2009gbforum/abareport062005.pdf (the "ABA PPB Task Force Report").

[10] *Paul Anka*, 1991 SEC No-Act LEXIS 925 (1991).

[11] SEC 2008 Small Business Capital Formation Forum Transcript, Private Placement and M&A Brokers Panel (Nov. 20, 2008).

[12] *SEC v. Kenneth Kramer*, 778 F. Supp. 2d 1320, 2011 U.S. Dist. LEXIS 38968 (M.D.Fla. 2011). The SEC's initial appeal of the decision was dismissed by the court because final judgments had not yet been entered as to all parties. Final judgments were entered on February 22, 2013.

> tion in securities transactions at key points in the chain of distribution." [S]ee also *S.E.C. v. Kenton Capital, Ltd.* (Kollar-Kotelly, J.) (describing "regularity of participation" as one of the primary indicia of "engag[ing] in the business"). ** Cornhusker describes "transaction-based compensation" as "one of the hallmarks of being a broker-dealer." (stating that "[t]he underlying concern has been that transaction-based compensation represents a potential incentive for abusive sales practices that registration is intended to regulate and prevent."). In other words, transaction-based compensation is the hallmark of a salesman. By contrast, a person's recommending a particular investment or participating in a negotiation typically occurs in an array of different commercial activities and professional pursuits, including brokering.

Kramer, p. 1334-1335(internal citations omitted). The court's contrasting statement above fails to note that giving investment advice for compensation usually requires registration and regulation as an "investment adviser" under federal and state securities laws.

Importantly, the SEC has granted limited relief to M&A intermediaries and business brokers who may meet the "broker" definition through a small number of no-action letters, notably including *Country Business, Inc.*, *Victoria Bancroft*, and *International Business Exchange Corp.*[13] These no-action letters include a number of significant factual limitations but they are commonly relied upon by business brokers to conduct their activities without federal broker registration (states may or may not follow the SEC staff's guidance). For example, among the nine enumerated factual predicates in the *Country Business, Inc.* letter, the entire business must be sold, that business must meet the "small business" definition under the Small Business Administration's standards[14], and the intermediary may not talk about securities-related transaction structures (e.g., a purchase of stock versus a sale of assets). The SEC has also denied no-action relief in similar M&A contexts but without providing meaningful explanations,[15] perhaps reflecting the lack of factual detail in the requestors' letters.

If asked, many states may follow the SEC's no-action letter guidance, even though it is not binding on them; some states may impose their own conditions, while others may not grant any relief. State regulators are often unfamiliar with how the activities of an M&A broker differ from those of investment banking or retail broker-dealers. Some states impose specific registration and related requirements on all types of finders.[16] Some states have broker-dealer registration exemptions when the owner/investor qualifies as an "institutional investor" as the term is defined in their blue sky law or rules.[17] California exempts by rule "any person who effects transactions in securities in this state only in connection with mergers, consolidations or purchases of corporate assets, and who does not receive, transmit, or hold for customers any

[13] *Country Business, Inc.*, 2006 SEC No-Act. LEXIS 669 (2006); *Victoria Bancroft*, 1987 SEC No-Act. LEXIS 2517 (1987); and *International Business Exchange Corp.* 1986 SEC No-Act. LEXIS 3065 (1986).

[14] Available on the Small Business Administration's website at: http://www.sba.gov/content/table-small-business-size-standards.

[15] *Hallmark Capital Corporation*, 2007 SEC No-Act. LEXIS 509 (2007); and *Mike Bantuveris*, 1975 SEC No-Act LEXIS 2158 (1975).

[16] *See, e.g.*, Texas Administrative Code, Title 7, Chapter 115, Section 115.11, *Finder registration and activities*; and Administrative Rules of South Dakota, Article 20:08, Section 20:08:03:17, *Finders*.

[17] *See, e.g.*, Section 401(b)(1)(C) of the Uniform Securities Act of 2002.

funds or securities in connection with such transactions", generally referred to as a "merger and acquisition specialist".[18]

Today's "One-sized" Regulatory System

The burdens and costs of initial broker-dealer registration and on-going compliance with current SEC and FINRA requirements are substantial. Initial set-up and compliance-related costs often exceed $150,000. On-going compliance costs often exceed $75,000 per year. Applying for and obtaining FINRA membership typically takes six to nine months, and frequently longer. There are competency exams that test on substantive material totally irrelevant to the professional knowledge base required to advise about M&A transactions[19]. Accrual-based GAAP accounting is required and minimum net capital must be maintained at all times regardless of the ebbs and flows of transaction-related income and expenses. Monthly or quarterly financial reporting is required prepared by specially qualified financial and operations principals. Annually audited balance sheets and related schedules and attestations must be filed with the SEC and FINRA. Anti-money laundering programs, procedures, and independent third-party AML testing are required, even though M&A brokers rarely, if ever, handle the parties' funds or securities. Membership in the Securities Investors Protection Corporation is required and membership fees are assessed, even though M&A brokers do not handle securities. The SEC, FINRA, and the states charge the firm annual registration fees and membership assessments based on the firm's gross revenues, as well as annual registration fees for each registered representative.

The body of existing SEC and FINRA rules impose significant requirements affecting every aspect of a broker-dealer's business ownership, staffing, marketing, operations, and recordkeeping. These rules have become highly complex over the years in response to, among other things, evolving financial markets, major securities frauds, national financial crises, and perceived regulatory gaps. This "one size fits all" body of regulation has been written largely to address investor protection in the context of retail brokerage services and investment banking services for publicly traded companies. Most of the SEC's and FINRA's rules and related guidance require "translation" when applied in the M&A and business brokerage context. For example, FINRA's "know your customer" and "suitability" rules must be applied to "customers" in the context of transactions between business buyers and sellers. Even the basic registration application, Form BD, does not explicitly identify either M&A or investment banking activities as a category of regulated activities—in Item 12 of the form the registrant must mark "Private placements of securities", "Other", and explain its activities in a supporting schedule. Newly released regulatory guidance comes from FINRA weekly and must be monitored for changes pertinent to the narrowly focused activities of M&A brokers.

All of this complexity and cost disproportionately impacts small and mid-sized businesses and the professional intermediaries who serve them because they typically handle smaller transactions that generate smaller success fees, so they are less able to spread these fixed costs over multiple transactions. The commitment of management and staff time, as well as largely fixed compliance-related costs, are annually required to maintain registered status regard-

[18] *See* 10 CCR Section 260.204.5, 10 CA ADC Section 260.204.5, *Merger and Acquisition Specialists*, adopted in 1974.

[19] Content outlines for FINRA's examinations are available on its website at http://www.finra.org/Industry/Compliance/Registration/QualificationsExams/Qualifications/p011051.

less of the number of securities-regulated business sale transactions closed by the M&A broker in any given year, which for smaller firms may be one or perhaps two per year since smaller M&A transactions are often cash-for-assets sales not regulated under securities laws. Substantially all of these costs are necessarily passed on to the business sellers and buyers who use the registered broker-dealer's services.

These high costs drive some business sellers and buyers to engage unregistered M&A brokers if they want professional assistance with their transactions. Accordingly, a very high percentage of M&A brokers are not registered with the SEC and so, technically, are violating the registration requirements in federal securities laws today. Their registration violations may put their clients' transactions at risk of being rescinded if the post-closing business does not run as hoped or is run into the ground by the buyer. Registration violations put the M&A brokers at risk for regulatory enforcement and sanctions, as well as their livelihood, even though today's registration and body of regulation is largely irrelevant to their services and does little to protect business sellers and buyers, who protect themselves through their negotiated rights and remedies in M&A and stock purchase agreements.

Regulatory Reform

"Right-sizing" federal regulation of M&A brokers and finders has been among the top recommendations in the 2006, 2007, 2008, 2009, 2010, and 2011 Government-Business Forum on Small Business Capital Formation hosted by the SEC[20] at the direction of Congress (the topic of M&A brokers and finders was not on the SEC's agenda for the 2012 forum). The *Final Report of the Advisory Committee on Smaller Public Companies* (2006), reached the same conclusion in Recommendation IV.P.6, page 81[21], as did the *Report and Recommendations of the Private Placement Broker-Dealer Task Force* of the Business Law Section of the American Bar Association.[22]

In light of this well-articulated need, in 2006 the AM&AA, with the support of the IBBA and its M&A Source, and 14 regional professional associations of M&A brokers, began developing and actively seeking a simplified system of "broker" registration and regulation under the Exchange Act for M&A brokers advising buyers or sellers in purchases, sales, mergers, and acquisitions of privately-owned companies. The AM&AA developed and presented proposed rules to the SEC staff in March 2007. The rulemaking proposal was expanded in March 2008 to add a proposed codification of the *Country Business, Inc.* no-action letter into an SEC rule defining circumstances when no type of broker registration would be required. On a parallel track, the AM&AA also developed and presented proposed model state rules to NASAA to develop a coordinated and complementary system of simplified state registration and regulation in March 2007. The model rule proposal was expanded in March 2008 to create a model state-level codification of the *Country Business, Inc.* no-action letter.

Neither the SEC nor NASAA have taken any action to address these small business issues, though significant time and attention has been paid by each of them in their consid-

---

[20] Available on the SEC's website at http://sec.gov/info/smallbus/sbforum.shtml.

[21] Available on the SEC's website at http://sec.gov/info/smallbus/acspc/acspc-finalreport.pdf.

[22] The ABA PPB Task Force Report is available on the SEC's website at http://sec.gov/info/smallbus/2009gbforum/-abareport062005.pdf.

eration and there have been discussions between them at their annual "Section 19d" meetings. With more than six years passing without rulemaking, and the prospect for rulemaking any time soon unlikely, the AM&AA and IBBA have turned to Congress to address and mandate the SEC's consideration these small business issues.

The Small Business Brokerage Act (H.R. 2274)

The Small Business Brokerage Act (H.R. 2274) would amend the Exchange Act by adding a new subsection to Section 15, which governs broker-dealer registration. The amendment would reduce the regulatory costs incurred by sellers and buyers of small and mid-sized privately held companies for professional business brokerage services, while enhancing their protection through well defined, appropriately scaled, and cost effective federal securities regulation. It would direct the SEC to create a simplified system of registration through a public notice filing, publicly available on the SEC's website, and would require appropriate client disclosures, pertaining to M&A brokers and their associates. The bill would also direct the SEC to tailor its rules governing M&A brokers in light of the limited scope of their activities, the nature of privately negotiated M&A transactions, and the active involvement of buyers and sellers in those transactions.

Important investor protections would be preserved. Federal law would continue to control the capital, custody, margin, financial responsibility, recordkeeping, bonding, and financial or operational reporting requirements applicable to M&A brokers, tailored by the SEC to their circumstances. Statutory disqualifications would continue to apply. The SEC, in coordination with state securities regulators, would establish the content of the notice registration and disclosures, and could establish uniform and consistent standards of training, experience, competence, and qualifications for the associates of M&A brokers, presently prescribed by FINRA. M&A brokers would be exempt from membership in and regulation by FINRA. Existing state securities laws would continue to apply.

Being SEC-registered, an M&A broker could exchange client referrals with fully-registered broker-dealers, thus better assuring that small business clients could be cost-effectively served by appropriately regulated brokers. M&A brokers could not have custody of the funds or securities exchanged by the parties. An M&A broker could not be involved in capital-raising beyond the context of M&A transactions and could not be engaged by an issuer in a public offering of its securities.

Conclusion

Regulatory reengineering is urgently needed to lower regulatory costs incurred by small and mid-sized privately held businesses and the M&A professionals who serve them. Reengineering is needed to make federal securities relevant and effective in this business context. In this context the perception of public perception under the current "one-size fits all" system of broker-dealer regulation is illusory, as there are thousands of small firms engaged in M&A brokerage activities who are not registered because the current body of regulation simply does not address the professional services they provide to small and mid-sized businesses.

The Small Business Brokerage Act would provide a simple, but practical and workable, regulatory architecture for "multitudes" of M&A brokers and small business owners who, today, regularly conduct critical commercial transactions that are extremely valuable to our economy, jobs and commerce. The simplified public notice-filing system would better assure that information about M&A brokers is readily publicly available. The Act adds public protections that do not exist today. Mandated disclosures, including conflicts of interest, would better inform sellers and buyers before they engage the services of an M&A broker. The Act and relevant SEC rules will clarify the application of federal securities law in this context, and so can reasonably be expected to improve compliance. The Act would achieve these objectives with comparatively minimal set up and administrative costs. This will ultimately free-up SEC and FINRA resources to more effectively accomplish their statutory mandate of protecting our public markets and passive investors.

A high Congressional priority has been the critical need to preserve and create jobs to fuel our nation's economic recovery. Today, jobs preservation and growth would be significantly boosted by assuring that retiring baby boomers, aspiring entrepreneurs, and growing companies can be professionally and cost-effectively advised by appropriately regulated M&A brokers. An estimated $10 trillion of wealth is passing between generations. Reducing the cost of professional business brokerage services to privately-owned companies would facilitate an efficient, free-flow of capital between small and mid-sized business sellers and buyers. Thank you for your consideration and I urge you to support H.R. 2274 in order to address this critically important small business issue.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

THE CHAIRMAN

January 11, 2012

The Honorable Bill Posey
U.S. House of Representatives
120 Cannon House Office Building
Washington, DC 20515

Dear Representative Posey:

Thank you for your December 19, 2011 letter in which you request information about the status of a recommendation by the SEC's Government-Business Forum on Small Business Capital Formation ("the Forum") regarding merger and acquisition intermediaries, also known as business brokers. As you know, the Forum provides an annual gathering that focuses on the capital formation concerns of small business. The Forum provides a crucial platform for small businesses to highlight impediments to the capital raising process that may be unnecessary and develop recommendations for governmental action. As you mention in your letter, the Forum has recommended that the SEC adopt a rule providing "an exemption from federal broker-dealer registration and FINRA membership for merger and acquisition (M&A) intermediaries and business brokers involved in the purchase, sale, exchange or transfer of the ownership of privately-owned businesses, subject to the states exercising primary regulatory supervision over these activities under state securities laws."

I have directed the staff of the Division of Trading and Markets, the Division primarily responsible for administering the regulation of brokers and dealers, to analyze carefully the Forum's recommendation and to develop options the Commission may consider in revisiting the regulations that apply to M&A intermediaries who serve small businesses. I also have directed the Division's staff to revisit existing guidance about whether there is any need for certain M&A intermediaries to be registered with the SEC as brokers and to determine whether we should provide further clarity in this area. The Commission staff and I are mindful of the importance of weighing the burdens on small businesses' capital formation arising from our regulatory requirements against the benefits of those regulations.

Thank you again for your letter. Please call me at (202) 551-2100, or have your staff call Eric Spitler, Director of the Office of Legislative and Intergovernmental Affairs, at (202) 551-2010 if you have any questions or comments.

Sincerely,

Mary L. Schapiro

Mary L. Schapiro
Chairman

Congress of the United States
Washington, DC 20515

December 19, 2011

The Honorable Mary Schapiro
Chairman
Securities and Exchange Commission
Washington, D.C. 20549

Dear Chairman Schapiro,

As Congress continues to work to see that our economy recovers, we continue to be vigilant to ensuring that regulations affecting small businesses are smart and proper. It is essential that regulation works to stimulate economic growth. It is our understanding that for five years in a row, the SEC's Government-Industry Forum on Small Business Capital Formation has highlighted the merger and acquisition broker (MAB) proposal as one of its top recommendations to help small businesses – we urge you to consider this proposal.

As you know, the MAB proposal would address securities regulation of business brokers and merger and acquisition advisors who are in the business of facilitating the purchase and sale of privately held companies. This proposal would significantly reduce their federal regulation compliance costs, which I am informed can initially exceed $150,000 and cost $75,000 per year after that.

According to the final report from the 2010 forum, the MAB proposal would eliminate unnecessary regulation as these private sales are already regulated by state laws. Specifically, the MAB proposal states:

> "The Commission should, by rule, adopt an exemption from federal broker-dealer registration and FINRA membership for merger and acquisition (M&A) intermediaries and business brokers involved in the purchase, sale, exchange or transfer of the ownership of privately-owned businesses, subject to the states exercising primary regulatory supervision over these activities
> under state securities laws."

We are aware that the SEC hosted its 2011 Government-Industry Forum on Small Business Capital Formation on November 17, 2011, and the MAB proposal was once again on the agenda. We write to inquire about the status of this proposal at your agency. What action to date has the SEC taken to implement these recommended changes? If the SEC has not acted on this yet, please tell us the timeframe the SEC is operating under to implement these regulations. If impediments exist that preclude your agency from publishing such a rule, please advise us as to the barriers precluding the regulation from advancing.

Sincerely,

Bill Posey (FL-15)
Member of Congress

Brian Higgins (NY-27)
Member of Congress

Allen B. West (FL-22)
Member of Congress

Doug Lamborn (CO-05)
Member of Congress

Joe Walsh (IL-08)
Member of Congress

Joseph J. Heck (NV-03)
Member of Congress

Bill Huizenga (MI-02)
Member of Congress

Randy Hultgren (IL-14)
Member of Congress

Hansen, Shane

Subject: FW: Shapiro Question for Record Response

From: Behnam, Rostin (Agriculture) [mailto:Rostin_Behnam@ag.senate.gov]
Sent: Thursday, August 16, 2012 11:23 AM
To: Hansen, Shane
Subject: Shapiro Question for Record Response

Shane—

As promised, Chairwoman Shapiro's response to the question for the record from the December, 2011 hearing.

2) Prior to the financial crisis, the Securities and Exchange Commission made significant progress in adopting a rule that would have created a limited federal exemption for business brokers who act in limited roles as both intermediaries and advisors during the purchase and sale of existing small businesses. In 2006, the Commission issued a no-action letter granting enforcement relief to a small business broker who acted in a limited role during a business sale. Small business development, which includes the purchase and sale of existing businesses, is paramount to developing a strong economic base. Has the SEC considered taking additional steps to codify this limited small business broker exemption?

RESPONSE: The staff of the Division of Trading and Markets, which is primarily responsible for administering the regulation of brokers and dealers, is analyzing the SEC's rules and regulations that apply to business brokers. The Division staff is developing options that it could recommend that the Commission consider to revise those regulations in light of the role that business brokers play in the purchase, sale, exchange or transfer of the ownership of privately owned businesses. The Division staff is also revisiting existing guidance about whether certain business brokers must be registered with the SEC as brokers in order to determine whether the Commission or the staff should provide further guidance in this area. We are mindful of the importance of considering both the burdens on small businesses' capital formation arising from our regulatory requirements and the benefits of those requirements to investors and other market participants.

Take care and keep in touch,

Russ

Counsel | U.S. Senate Committee on Agriculture, Nutrition, and Forestry
Office of U.S. Senator Debbie Stabenow, D-MI
328-A Russell Senate Office Building, Washington DC 20510
rostin_behnam@ag.senate.gov | P - 202-224-2035 | F - 202-228-2125

Warner Norcross & Judd LLP
ATTORNEYS AT LAW

SHANE B. HANSEN
BIOGRAPHICAL SUMMARY

SHANE B. HANSEN is a partner and co-chairs the Broker-Dealer and Investment Adviser Practice Group in the law firm of Warner Norcross & Judd LLP. His law practice spans more than 30 years and concentrates in the area of financial services regulation, primarily including federal and state securities and banking laws and related rules. He advises broker-dealers, M&A and business brokers, investment advisers, banks, and private fund advisers about a wide range of business, corporate, contract, compliance, and regulatory topics. He has substantial experience involving formations, mergers, acquisitions, and sales of financial services firms. He was recognized in *The Best Lawyers in America®*, *Corporate Law and Securities Regulation, 2007 through 2012 editions* and named a "super lawyer" in the 2006, 2007, and 2009 through 2012 editions of *Michigan Super Lawyers®*.

Mr. Hansen chairs the Committee on State Regulation of Securities in the Business Law Section of the American Bar Association (2011-present). The committee is comprised of more than 600 lawyers, paralegals, state regulators, and law professors from around the country. He also co-chairs its Subcommittee of Liaisons to Securities Administrators in the U.S. and Canada (2007-present), producing an annual report on state securities law developments. He is an active member of the ABA's Committee on Federal Securities Regulation and the State Bar of Michigan's Securities and Financial Institutions Committees. Other professional and associate memberships include the Compliance and Legal Society of the Securities Industry and Financial Markets Association (SIFMA), the Financial Services Institute (FSI), the Investment Adviser Association (IAA), the Financial Planning Association (FPA), and the National Society of Compliance Professionals (NSCP). Mr. Hansen graduated with honors from the University of Michigan Law School in 1982. He graduated with high honors from Albion College in 1979.

Warner Norcross & Judd LLP is a full service law firm with over 220 attorneys practicing from offices in Grand Rapids, Southfield, Holland, Midland, Muskegon, Lansing, and Sterling Heights, Michigan. The firm's Broker-Dealer and Investment Adviser Practice Group is an interdisciplinary group of attorneys with experience dealing in the full range of matters and issues that are important to broker-dealers, investment advisers, financial planners, merger and acquisition intermediaries, finders, and others who may be subject to federal and state securities laws, rules and regulations, as well as FINRA rules, regulation, and enforcement. Client matters include corporate, contracts, formation and registration, compliance, mergers and acquisitions, as well as responding to examination deficiencies, enforcement, customer arbitration, and litigation. Other client matters include human resources, labor, and benefits, trusts and estates, and tax. The firm represents a wide range of clients from large to small, with various business models, and located in various parts of the country.

More information about Shane and the law firm can be found on the Internet at: www.wnj.com. He can be reached at 616-752-2145 or shansen@wnj.com.

118342.118342 9203887-1

Statement of Donald C. Langevoort, Thomas Aquinas Reynolds Professor of Law, Georgetown University Law Center, before the Subcommittee on Capital Markets and Government-Sponsored Enterprises, Committee on Financial Services, United States House of Representatives

June 12, 2013

I am pleased that you have invited me to testify today on the vitally important topic of capital formation and investor protection. With the JOBS Act more than a year old, we still await rule-making by the SEC on many of its key provisions. While this wait is frustrating to all who wish to these reforms take effect, the careful analysis of costs and benefits and consideration of alternatives that should inform all good policy-making takes time, and cannot be rushed if it is to be done well.

However, the JOBS Act hardly exhausts the possibilities for innovations in capital-raising and secondary trading that can make our financial markets more robust and opportunities for honest entrepreneurship more compelling. The SEC's Advisory Committee on Small and Emerging Companies has made a number of recommendations for additional changes that, if appropriately crafted, would be positive steps forward. The regulatory demands of publicness on issuers are heavy, but often warranted for those companies with big enough footprints in our markets, our economy, and our society. Companies with smaller footprints require less precisely because the "externalities" they generate are so much smaller.[1]

---

[1] Along with Professor Robert Thompson of Georgetown, I have written about this possibility in "Publicness in Contemporary Securities Regulation after the JOBS Act," Georgetown Law Journal, vol. 101, p. 337 (2013). We have a follow-up article in progress entitled "Redrawing the Public-Private Boundaries in Entrepreneurial Capital Raising," available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2132813.

We can limit the obligations for smaller companies to that which is truly value-relevant to reasonable investors.

As the Advisory Committee also recommends, we can also do more to facilitate the development of fair and efficient secondary trading markets for both non-public companies and smaller public companies. The main issues have to do what level of ongoing disclosure and governance obligations (via listing standards) to place on the issuers whose shares are traded in such settings, which is not an easy task but could certainly be defined more coherently than the standards that apply today. You should be aware of some crucial policy choices here, however. If, as suggested as a possibility, this new market space is meant for "accredited investors" only, it will most likely have the effect of dampening interest in making an IPO precisely because it will be easier to offer shareholders enhanced liquidity while staying short of the new Section 12(g) trigger for regulation as a public company.[2] Marketplace developments that facilitate capital raising and secondary trading by private companies will have profound consequences for our public markets.

Regulatory reform efforts should continue. But it is essential that this be done with due regard for investor protection, and I would commend to you the SEC's Investor Advisory Committee as another bipartisan voice worth listening to when its members reach consensus. While inefficient regulation raises the cost of capital, *good regulation lowers it.* Research in financial economics shows that investor trust is closely tied to capital formation and economic growth.[3] Although that trust has proven resilient over time, it is not something that can be taken for granted. If it hits some

---

[2] The JOBS Act allows non-exchange traded companies to avoid registration under the Securities Exchange Act of 1934 so long as they have fewer than 2000 shareholders of record, not more than 500 of which are non-accredited investors.

[3] Luigi Guiso et al., "Trusting the Stock Market," Journal of Finance, vol. 63, p. 2557 (2008). In March 2013, according to the "Financial Trust Index" at Northwestern University and the University of Chicago, the trust level in the stock market was at 19%. See http://financialtrustindex.org/resultswave18.htm.

horrible tipping point and recedes because there is too much perceived risk of opportunism and abuse, capital formation will be damaged by poorly-crafted innovations, not enhanced. For all the honest entrepreneurs who deserve a better shot at low-cost funding, there are opportunists as well who not only threaten the financial well-being of targeted—sometimes vulnerable—investors but take funds away from legitimate enterprise, pollute the reputation of our markets generally, and create no jobs. No innovations in capital-raising will work unless they help investors tell the difference between good promoters and bad promoters, as well as between good business plans and dubious business plans. Credible information is necessary to enable investors to price the risk for all issuers. Otherwise this is just gambling, from which smart investors know enough to stay away. Special markets for small and emerging companies that pay insufficient attention to informational needs and investor protection do not do particularly well for investors in the long run.[4]

Although there are many imperatives in crafting the rules to promote entrepreneurship and capital formation, two are paramount. One is that we recognize the role of retirement savings as an at-risk target, a threat to which neither aging Americans nor our economy generally can afford. Wealth tests (for example, $1 million for accredited investor status, or $100,000 for enhanced participation in crowd-funding) may seem large at first glance, but not so much if that is all that there is for a lengthy retirement except for Medicare and Social Security. The other is the need for greater transparency in so-called private markets, so that there are can be

[4] Recent research from the University of Chicago suggests that the London AIM market, for example, significantly underperforms firms on regulated exchanges in terms of post-listing returns and failure rates, especially where retail investor make up the majority of the investor base. See Joseph Gerakos et al., "Post-Listing Performance and Private Sector Regulation: The Experience of the AIM," Feb. 2013, available at www.ssrn.com/abstract=1740809. Similarly, see Jay Ritter et al., "Europe's Second Markets for Small Companies," European Financial Management, vol. 18, p. 32 (2012).

better oversight and surveillance in the otherwise dark spaces where investments are promoted and sold with little or no regulation.[5]

Let me stress an uncomfortable truth: the main impediments to small business capital-raising are economic, not regulatory. Small businesses are very, very risky.[6] Entrepreneurs rarely find the cost of equity or debt that rationally prices this risk to be particularly attractive. But we should beware of reforms driven by the desire to attract capital from less sophisticated investors simply because there are so many of them and they might be more excitable and less demanding. That story will not end well.

Balancing capital formation and investor protection is not easy. I commend members of the Subcommittee for their continuing attention to both of these goals.

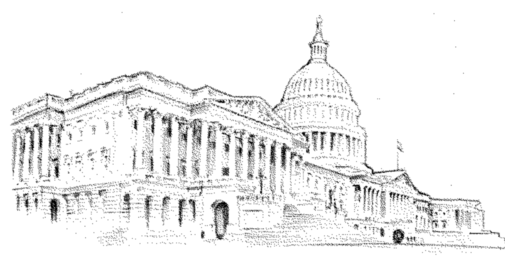
[5] See Jennifer Johnson, "Fleecing Grandma: A Regulatory Ponzi Scheme," Lewis & Clark Law Review, vol. 16, p. 993 (2012). Professor Johnson tells of brokers who qualify retirees for accredited investor status by estimating the future stream of social security payments over their expected lifetime and discounting to present value in search of the requisite $1 million.

[6] In negotiated deals, sophisticated investors demand some combination of credible disclosure to assess the venture, which is expensive; control rights to reduce post-investment risk; and pricing to reflect the considerable risks that remain.

Grant Thornton
An instinct for growth™

Hearing on reducing barriers to capital formation

Statement of David Weild, Senior Advisor — Grant Thornton LLP
before the U.S. House of Representatives Financial Services Committee
Capital Markets and Government Sponsored Enterprises Subcommittee
June 12, 2013



Contents

	Page
Introduction	2
Summary	3
Capital markets landscape	5
Ways we can promote capital formation	11
Conclusion: IPOs lead to job growth	14
Additional materials	16
About David Weild	17
About Grant Thornton LLP	19

Introduction

Chairman Garrett, Ranking Member Maloney and members of the Subcommittee, thank you for inviting me to speak today about an issue of great importance to many Americans: how to reduce barriers to capital formation, particularly for small companies — the growth engine of the U.S. economy.

My name is David Weild. I oversee Capital Markets at Grant Thornton LLP, one of the six global audit, tax and advisory organizations. 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 a major investment bank for many years.

Grant Thornton's Capital Markets Group provides support to companies accessing today's global capital markets. These companies run the gamut from private companies and entrepreneurs to venture capital and private equity-backed companies — both small and large.

I recently authored a study with Edward Kim and Lisa Newport for the Organisation for Economic Co-operation and Development (OECD)[1] — a study that analyzes the world's 26 largest IPO markets. It demonstrates that higher tick sizes (minimum price increments) are essential to bring back U.S. IPO markets and the associated higher rates of innovation, economic growth and job creation that are driven by more productive public markets.

[1] Organisation for Economic Co-operation and Development. See www.OECD.org

Summary

U.S. capital markets have undergone a profound transformation in less than a generation, leaving both investors and the U.S. economy worse off. U.S. public markets have lost nearly half of all listed companies since their peak in 1997. While there were 8,823 exchange-listed companies in 1997, at the end of 2012 only 4,916 remained. Moreover, U.S. stock markets are now — on a gross domestic product (GDP) weighted basis — some of the worst in the world, particularly for small companies. Despite having the world's largest GDP, the U.S. small IPO market has fallen from 1st to 12th place among the top 26 IPO markets.

The U.S. IPO market should be producing five to 10 times the number of IPOs it has produced over the last 13 years, but we won't see a resurgence until we address its biggest obstacle: the lack of aftermarket support. Regulatory and structural changes that have occurred since 1997 led to a collapse in tick sizes from 25 cents to 1 cent — tick sizes that used to pay for the infrastructure small companies need to go and stay public. The collapse in tick sizes has left small companies without aftermarket support, specifically the support of small broker dealers, research analysts and capital.

The U.S. stock markets are now essentially governed by a one-size-fits-all framework, with 1-cent tick sizes for every stock regardless of share price, market capitalization or liquidity. In today's market, small companies can't survive — only big brands and large companies can sustain adequate visibility with investors. Small cap stocks require broker-dealers to support liquidity, sales and equity research, and those don't exist in a 1-cent-tick-size world.

Given the current structural deficiencies in the U.S. stock market, a merger or acquisition is now the exit strategy of choice for many small companies that previously would have chosen to go public. When these companies sell their businesses because they can't raise capital effectively through the IPO market, jobs are generally lost, not gained.

I present today three ways that we can promote capital formation for small companies.

1 Encourage the SEC's full and timely implementation of the Regulation A+ provisions of the JOBS Act, and Senate adoption of H.R. 701 that provides a due date for implementation of Regulation A+. While we wait for the JOBS Act provisions to be enacted, entrepreneurs' access to capital is limited, and job creation and economic recovery have been put on hold. Grant Thornton has been particularly supportive of Title IV — commonly referred to as Regulation A+ — which increases from $5 million to $50 million the cap on public issues of stock utilizing the SEC's Regulation A

exemption. Regulation A+ will allow small companies to issue securities through a registration and disclosure process that is less complex, time-consuming and expensive. As the U.S. continues its struggle to emerge from the Great Recession, the higher offering limit and increased investor protections make Regulation A+ an important catalyst by which small companies can go public, grow and contribute to job creation. For these reasons we support passage of H.R. 701, a bill that would require the SEC to finalize rulemaking for Regulation A+ by October 31, 2013. We are encouraged that the House of Representatives has already passed this bill by an overwhelming vote of 416-6 and hope the Senate follows suit.

2 We support an SEC pilot program of at least five years in length to let Emerging Growth Companies (EGCs) (sub-$1 billion in revenues) and small cap companies (sub-$2 billion in equity market value) expand their tick sizes and regenerate the infrastructure to support small cap stocks. Grant Thornton believes higher tick size increments will increase liquidity and capital formation for small companies by increasing the aftermarket incentives required to fuel investments in equity distribution, sales and aftermarket support. As markets realign economic incentives and refocus distribution on long-term investors — not on short-term traders — share performance and returns on investment will improve — all while laying a foundation for increased IPOs, economic growth and job creation.

3 We also support the creation of a new, parallel stock market for public companies under $2 billion in market value. Adequate aftermarket support is a continuing challenge for small companies, and this new market could allow higher commissions to provide incentives for small investment firms to return to the business of underwriting and supporting small-cap companies. While established markets would continue to operate as they do today, this solution would give issuers a choice in markets.

Capital markets landscape

U.S. capital markets have lost their way. They've undergone a profound transformation in less than a generation — from the heights where they were the envy of the other world markets to the current depths where they're effectively closed to more than 80% of the companies that need them: small entrepreneurial companies.

Our small company market failure is now reverberating across our economy.

IPOs have decreased since the mid-1990s

In the early 1990s, we witnessed over 520 IPOs per year in the U.S., 80% of which were small deals raising less than $50 million. Just 20 years later, that average has dwindled to fewer than 130 transactions annually, with just 113 in 2012. Of that 113, only 14 were small deals.[2]

Public company listings peaked in the U.S. in 1997, with 8,823 exchange-listed companies. At the end of 2012, there were only 4,916 — a massive decline of 44.3%.[3] In fact, since the peak, the U.S. has suffered ***15 consecutive years of lost listings***. As the world's largest economy, the U.S. should be producing five to 10 times the number of IPOs it has produced over the past 13 years.

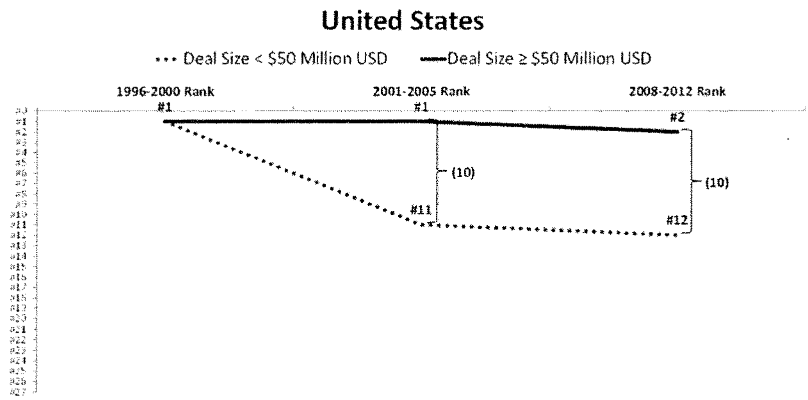
According to our OECD study, U.S. stock markets are now — on a GDP-weighted basis — some of the worst in the world, particularly for small company IPOs. In the 1990s, the U.S. was the top-ranked IPO market for both small and large IPOs.[4] Today, despite having the world's largest GDP, the U.S. ranking for small IPOs has fallen to a dismal 12th place — ***worse than many much smaller economies*** that offer more appropriate (higher) aftermarket incentives.

---

[2] Source: Weild & Co., Grant Thornton LLP and Dealogic. Excludes closed-end funds, REITs, LPs, SPACs and other non-operating company financial vehicles.

[3] Ibid.

[4] To determine which IPO-producing nations have been gaining or losing ground, in terms of the number of small and large domestic IPOs they have produced, we examined the relative rankings of 26 jurisdictions (Australia, Brazil, Canada, Chile, China, France, Germany, Hong Kong, India, Indonesia, Israel, Italy, Japan, Malaysia, Mexico, Norway, Poland, Saudi Arabia, Singapore, South Korea, Spain, Taiwan, Thailand, Turkey, the United Kingdom and the United States) for three different time periods (1996 to 2000, 2001 to 2005, and 2008 to 2012). We found that countries with higher than average tick sizes as a percentage of share price in smaller stocks, such as Australia and Canada, have significantly increased their relative ranking in the number of small IPOs. The U.S., which was once in first place for the number of deals under $50 million USD from 1996 to 2000, and now has low tick sizes as a percentage of share price, has fallen to 12th place for small IPOs — a decline of 11 positions that is among the largest moves, up or down, for the 26 jurisdictions we studied.



Includes domestic corporate IPOs as of Dec 31, 2012, excluding funds, LPs, SPACs, REITs and other trusts

Sources: Weild & Co., Grant Thornton LLP and Dealogic

While the IPO decline is most extreme in the U.S., the world supply of IPOs has also suffered a material decline with the proliferation of electronic markets. Work by the OECD shows that the global number of IPOs has declined from over 2,000 per year in the early 1990s to less than 750 IPOs in 2012. Two-thirds of this decline comes from outside of the U.S.

The IPO market is not in recovery

While the JOBS Act has made it easier for small companies to go public, the IPO market has not recovered, as some news reports would have us believe. The media has focused on a handful of high profile, large transactions, but the actual pace of IPO activity is not much better this year than last.

There were 113 corporate[5] IPOs in 2012.[6] There have been 66 corporate IPOs through May 2013, matching last year's pace of 63 as of May 2012. During May 2013 Dealogic tracked 28 total IPOs, which the media touted as a sign of a healthy IPO market. Seven of them, however, were closed-end funds, REITs and SPACs, leaving just 21 corporate IPOs.

And small company IPOs remain an endangered species. *Only six* of the 66 deals in 2013 raised less than $50 million — not unlike year-to-date May 2012 when *only seven* of 63 deals were under $50 million. Moreover, as of year-to-date May 2013, deal size averaged $272 million, compared to $164 million at this same time in 2012 (excluding the $16 billion Facebook IPO).

Factor in that we are enjoying a Bull Market in equities, buoyed by the Federal Reserve's stimulative monetary policy, and the number of IPOs to date can only be seen as disappointing. We aren't surprised, because the underlying infrastructure remains damaged, as evidenced by the lack of small issuers tapping the market. Despite the good intentions of the JOBS Act in creating "on-ramps," U.S.

[5] "Corporate" IPOs are IPOs of operating companies. We exclude IPOs that are strictly financial vehicles, including closed-end funds, REITs, SPACs and LPs.
[6] Source: Dealogic.

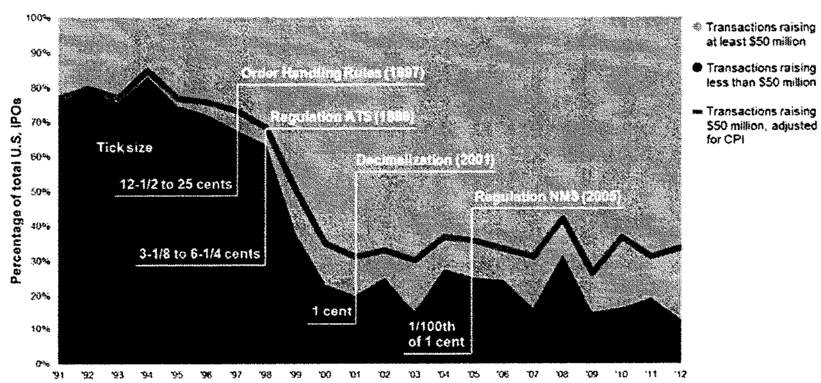
capital markets still need the "highways" — the economic infrastructure that can support small companies in the aftermarket. That aftermarket support can be brought back through higher tick sizes.

Structural and regulatory changes to U.S. capital markets have impacted IPOs

As we have mentioned in previous testimony to this Committee, structural and regulatory changes to U.S. stock markets have been exceptionally harmful to capital formation. The U.S. was once the greatest capital formation engine in the world, but it has been reduced to a shadow of its former productivity because of the elimination of nearly all of the economics that once fueled the growth of the ecosystem.

Since 1997, the U.S. stock market has suffered a devastating decline in the numbers of small IPOs — a result of SEC-implemented regulations that put in motion a decade-long erosion of the U.S. capital formation and support infrastructure on which small companies relied. The structural and regulatory changes that began with new Order Handling Rules in 1997, continued with Regulation Alternative Trading System (ATS) in 1998 and Decimalization in 2001, and culminated with Regulation National Market System (NMS) in 2005 set in motion a dramatic shrinkage in trading spreads and tick sizes in all stocks.

Smaller tick sizes undermined U.S. small-company IPOs



Sources: Grant Thornton LLP, Weild & Co. and Dealogic
Data include corporate IPOs as of December 31, 2012, excluding funds, REITs, SPACs and LPs.

The collapse in tick sizes from 25 cents to 1 cent significantly changed the stock market structure that paid for the infrastructure of small broker dealers, research analysts and capital support required to take small companies public and to support them in the aftermarket (once they are public). This infrastructure is analogous to the system of highways — with roads, on-ramps, bridges, tunnels and tolls — required to support commerce.

Economic infrastructure supporting U.S. capital markets	
Stakeholders: • **Roads** — Trade execution venues (e.g., NYSE) • **On-ramps** — Investment banks • **Bridges** — Market-makers committing capital • **Tunnels** — Analyst and broker support to investors	**Economic incentives:** • **Tolls** — Tick sizes and commissions that support the market's operations and upkeep

In the same way that a city's infrastructure cannot be maintained without adequate capital to support it, an equity market must also be supported with adequate economic incentives in order to maintain vibrancy. Investment banks acting as primary underwriters (or bookrunners) today lose money supporting small company IPOs after they go public. Many investment banks have gotten out of the book-run IPO business, and weak capital commitment from investment banks remains a serious impediment to small businesses accessing U.S. capital markets. Small companies need salesmen, traders and analysts to create liquidity for their securities, but today, computers have taken the place of these people, thereby decreasing the visibility of small cap stocks.

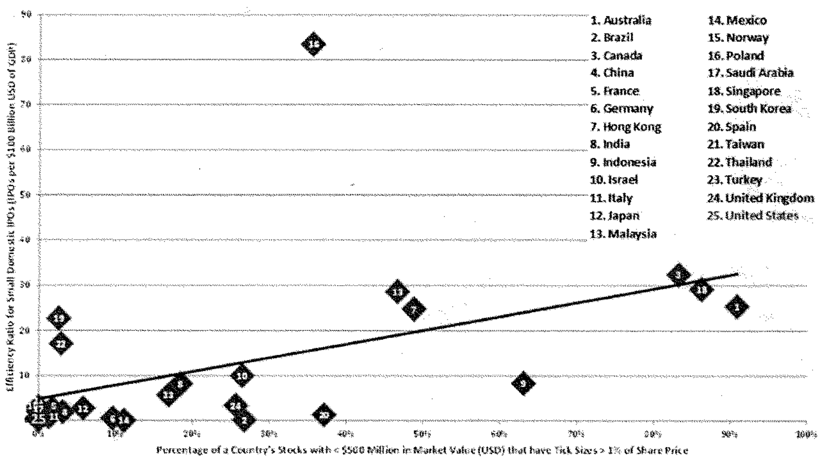
The U.S. stock markets are now essentially governed by a one-size-fits-all framework, with 1-cent tick sizes for every stock regardless of share price, market capitalization or liquidity. One-size-fits-all is a poor basis for regulation. One-size-fits-all stock market structures will underperform markets that are optimized separately to the needs of large cap and small cap stocks and their respective constituencies. Large cap stocks are inherently liquid and benefit from the interest of many investors looking to buy and sell the stocks at the same time. By contrast, small cap stocks typically are less liquid, with asymmetrical — or one-sided — order-book markets. Only big brands and large companies can sustain adequate visibility with investors in today's market. Small cap stocks require broker-dealers to support liquidity, sales and equity research in order to sustain active markets.

The market changes also favored short-term rapid trading over long-term fundamental investing. Hedge funds and other hyper-trading institutions have become the dominant force in the 1-cent tick size market — at the expense of long-term fundamental investors and liquidity providers (intermediaries). When trading interests overwhelm fundamental investor interests, price distortions occur, the marketing of individual stocks is displaced by derivatives (including exchange-traded funds), and capital formation and allocation become less effective. In turn, economic cycles are made more extreme, and long-term economic growth may be stunted.

Ultimately, while lower tick sizes have benefitted short-term, high-turnover traders through lower transaction costs, long-term, fundamental investors are worse off today. The paradox is that smaller spreads and tick sizes have undermined the very infrastructure and services required to take new small companies public and sustain those stocks in the aftermarket.

The U.S. economy is also worse off as a result of the regulatory and market structure changes affecting the U.S. capital markets. We offer compelling evidence in our OECD paper that the primary determinant of long-term sustainability of IPO markets and, as a consequence, an important driver of economic growth is the relative size of aftermarket incentives. Specifically, low aftermarket incentives (defined as tick sizes that are less than 1% of share price for sub-$500 million market value stocks) and low numbers of small public companies lead to low levels of IPO activity. Broker-dealers — who are the facilitators of capital formation — must have adequate incentives in order to support small company IPO activity. Higher tick sizes and larger numbers of small public companies combine to sustain the critical mass infrastructure and services required to support a vibrant domestic IPO market. That vibrant market will, in turn, generate jobs, economic growth and tax receipts.

The U.S. is among the least productive IPO markets globally due to poor aftermarket incentives (tick sizes)



Small companies today face unsuitable options

Given the current structural deficiencies in the U.S. stock market, a merger or acquisition is now the exit strategy of choice for many small companies that previously would have chosen to go public. When these companies can't raise capital effectively through the IPO market and must look to a sale of their business, generally job loss is the result.

It's not uncommon to hear suggestions that the decrease in numbers of IPOs is a misplaced concern, because alternative sources of capital can take the place of the IPO market. In fact, these challenges offer no compelling data to back up their claims. The two most prominent theories maintain that the private equity market or the equity private placement markets have displaced the IPO market in fund raising.

These arguments, however, don't hold up considering that 1) the private equity industry is largely confined to positive cash flowing companies (not venture capital companies), and 2) venture-capital backed IPO exits are depressed despite unprecedented amounts of venture capital invested, while the "gestation period" time-to-IPO for venture-backed companies more than doubled from 4.5 years in

1998 to 9.6 years in 2008.[7] Finally, the IPO Crisis Task Force was led by Kate Mitchell, a former National Venture Capital Association (NVCA) chairman. Clearly, if the venture capital industry in the United States had been enjoying "alternatives," it would not be spending its time trying to fix the IPO market.

[7] NVCA 4-Pillar Plan to Restore Liquidity in the U.S. Venture Capital Industry, April 29/30, 2009, see slide 7 at http://www.slideshare.net/NVCA/nvca-4pillar-plan-to-restore-liquidity-in-the-us-venture-capital-industry-1360905.

Ways we can promote capital formation

Fully implement the Regulation A+ provisions of the JOBS Act

We commend Congress for its bipartisanship in passing the JOBS Act and paving the way for improved capital formation. The JOBS Act was an important first step to encourage small businesses to access U.S. capital markets, spur innovation, generate new jobs and revitalize the U.S. economy. However, many of the regulations required to implement the job-creating provisions of the JOBS Act have not yet been enacted. As a result, entrepreneurs' access to capital is limited, and job creation and economic recovery have been put on hold.

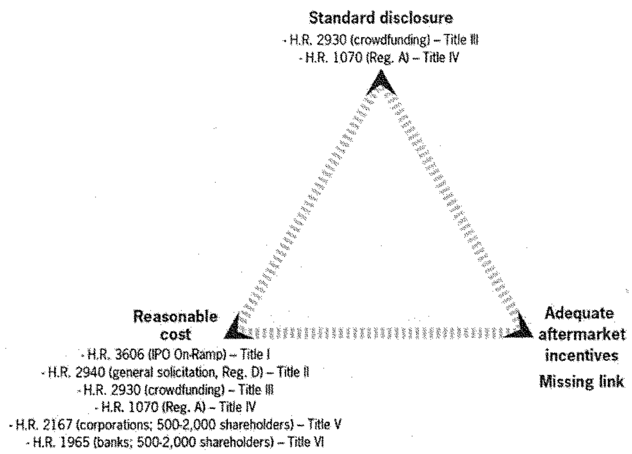
Grant Thornton has been particularly supportive of Title IV — commonly referred to as Regulation A+. It increases from $5 million to $50 million the cap on public issues of stock utilizing the SEC's Regulation A exemption, which allows a small company to issue securities through a registration and disclosure process that is less complex, time-consuming and expensive. Title IV also includes additional investor protections, including that issuers file audited financial statements annually with the SEC and comply with any other terms or conditions established by the SEC — which may include requirements that the issuer file with the SEC and distribute or make available to investors an offering statement and post-offering periodic disclosures regarding its business operations, financial condition, corporate governance principles and other matters.

Regulation A was conceived during the Great Depression and enacted as part of the Securities Act of 1933. The current limit of $5 million — raised from $100,000 in 1992 — is of no use to small companies confronted with the needs of today's economy. As the U.S. continues to struggle to emerge from the Great Recession, the higher offering limit and increased investor protections make Regulation A+ an important catalyst by which small companies can go public, grow and contribute to job creation.

Unfortunately, Regulation A+ is awaiting proposed rules and is lacking an implementation deadline. We fear that without an imposed deadline, rulemaking for Title IV will remain on hold indefinitely. Without implementation of Regulation A+, the original intent of Congress to accelerate job growth — particularly by improving small business access to capital — will not be realized. For these reasons we support passage of H.R. 701, a bill that would require the SEC to finalize rulemaking for Regulation A+ by October 31, 2013. We are encouraged that the House of Representatives passed this bill by an overwhelming vote of 416-6 and hope the Senate follows suit.

Tick size pilot program

The JOBS Act also delivers provisions to help small companies mitigate the costs of going public and better communicate with and disclose information to investors. But a third provision is needed: smaller companies must also be able to attract significantly better aftermarket support. **All three** conditions are required for a vibrant IPO market.



Aftermarket support is the biggest obstacle to resurgence in the U.S. IPO market. Today's public markets are overly complex and don't behave in a manner that the average retail investor understands. Without adequate economic incentives, investment banks can't afford to compensate the salesmen, traders and research analysts who can provide greater transparency to investors regarding small company stocks. Instead of supporting all company sizes, U.S. market structure is optimized for trading (not investing) primarily in large cap stocks.

Grant Thornton believes higher tick size increments will increase liquidity and capital formation for small companies by increasing the aftermarket incentives required to fuel investments in equity distribution, sales and aftermarket support. As markets realign economic incentives and refocus distribution on investors — not on traders — share performance and returns on investment will improve — all while laying a foundation for increased IPOs, economic growth and job creation.

Grant Thornton specifically supports an SEC pilot program of at least five years in length to let Emerging Growth Companies (sub-$1 billion in revenues) and small cap companies (sub-$2 billion in equity market value) expand tick size and regenerate the infrastructure to support small cap stocks. We believe a pilot program should include the following parameters to ensure the integrity of the pilot and data.

- Include companies that are EGCs and already public.

- A "trade at" rule that eliminates trading rebates within the spread and requires trading at the tick increments. Such a rule is the surest way to ensure that the economic incentives we try to create through higher tick sizes are not undermined in dark pools and through sharing arrangements.
- An annual right to elect the tick size increment, understanding that companies require some leverage to grow and make acquisitions or to shrink (if they sell off divisions).
- A set of finite tick size options, such as 5 cents, 10 cents and 25 cents.

A pilot program would enable the SEC to gather valuable research and data to inform the debate on how best to structure the U.S. capital markets to support capital formation and job growth for companies of all sizes. We believe the SEC should file regular reports to Congress on liquidity, trading and analyst coverage. In order to provide the most complete story, we also recommend requiring the SEC to solicit and report on feedback from a broad range of securities firms that specialize in the markets for EGCs to ask why they have or have not committed capital, research or brokerage resources in the wake of the tick size changes, and what changes, if any, would impact these resource allocation decisions.

While the SEC can and should move forward with a pilot program without Congressional action, we are mindful of the SEC's burden in implementing the Dodd-Frank and JOBS Acts. Should the SEC fail to act on its own, Grant Thornton would support a Congressional legislative response.

Alternative exchange concept

In order to reignite the job-creation engine that once made U.S. stock markets the envy of the world, we also recommend the creation of a new, parallel stock market for public companies under $2 billion in value. The structure of this new market should be 1) exempt from Regulation NMS, 2) quote-based, and 3) provide for a governance structure with equal representation by market intermediaries, institutional investors and issuers. Most importantly, trading rules in a new market should allow higher commissions to provide adequate incentives for small investment firms to return to the business of underwriting and supporting small cap companies. This solution would allow issuers to choose the market option that makes the most sense to them, while established markets would continue to operate as they do today.

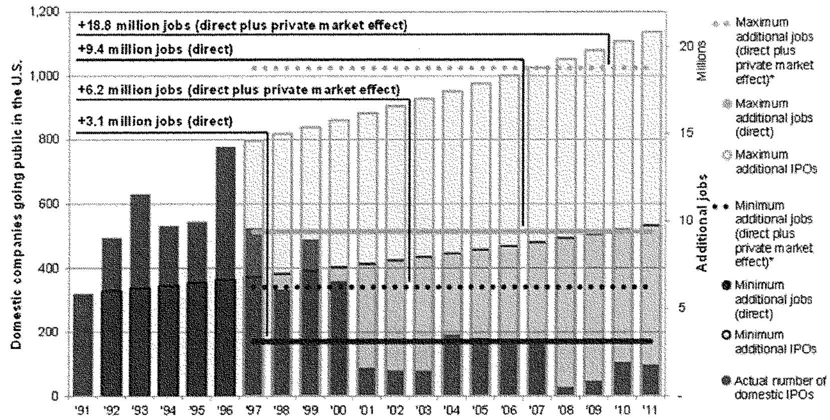
Conclusion: IPOs lead to job growth

A capital market is a multi-layered, complex ecosystem of competing and related interests. Each of the numerous constituents must be governed by rules and encouraged by incentives. The markets that succeed in balancing these many interests are the markets that will go the farthest in facilitating capital formation. Efficient markets need to do more than create rock-bottom trading costs for market speculators — they also need to improve the allocation of capital and enhance long-term economic growth.

If the rules become too burdensome or if the incentives become diminished for any party, the ecosystem will operate far below its potential efficiency. Companies will have difficulty reaching new investors, innovation and job creation will slow or stop altogether, and the macroeconomy will suffer. 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



*Best estimate of the multiplier effect in the private market of more companies going public

Sources: Grant Thornton LLP, Dealogic and the U.S. Department of Commerce Bureau of Economic Analysis
Domestic corporate companies going public in the U.S. as of Dec. 31, 2011, excluding funds, REITs and other trusts, SPACs and LPs.
Assumes an annual growth rate of 2.57% (U.S. real GDP growth, 1991-2011) and 822 jobs created on average post-IPO (see "Post-IPO Employment and Revenue Growth for U.S. IPOs," *Kauffman Foundation*).

In fact, the so-called multiplier effect may be much larger than we estimate above. Enrico Moretti, Professor of Economics at the University of California, 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.[8] 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.

Congressional support is needed

Congress has the power to help reverse our current situation and bring back the stock market that was once the envy of economies throughout the world for its ability to foster U.S. economic leadership. To reduce barriers to capital formation, we recommend that Congress support the measures we outlined:

- Encourage the SEC's full and timely implementation of the Regulation A+ provisions of the JOBS Act, and Senate adoption of H.R. 701 that provides a due date for implementation of Regulation A+.
- Support an SEC pilot program that allows Emerging Growth Companies and other already-public, small-capitalization companies to opt for higher tick sizes on their stocks.
- Support the creation of a new, parallel stock market for public companies under $2 billion in value.

[8] See Enrico Moretti, *"The New Geography of Jobs"* (2013).

Additional materials

Making Stock Markets Work to Support Economic Growth (OECD Corporate Governance Working Papers)

The trouble with small tick sizes: Larger tick sizes will bring back capital formation, jobs and investor confidence

June 20, 2012, testimony to the U.S. House of Representatives Financial Services Committee Capital Markets and Government Sponsored Entities Subcommittee

June 8, 2012, presentation to SEC's Advisory Committee on Small and Emerging Companies

Why are IPOs in the ICU?

Market structure is causing the IPO crisis — and more

A wake-up call for America

Wall Street Journal OpEd entitled, **"How to revive small-cap IPOs,"** October 27, 2011

About David Weild

David oversees Capital Markets at Grant Thornton LLP and is the Chairman and CEO of Weild & Co. (formerly Capital Markets Advisory Partners), an investment bank.

Experience

David is recognized as an 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 OECD (Organisation for Economic Co-operation and Development) with the 35 member nations in attendance, plus the European Commission and IOSCO. 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 nonprofit 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 Grant Thornton studies, including *The trouble with small tick sizes: Larger tick sizes will bring back capital formation, jobs and investor confidence* (with Lisa Newport) in 2012 and *Why are IPOs in the ICU?* in 2008. Released in the fall of 2009, *Market structure is causing the IPO crisis* (updated by *Market structure is causing the IPO crisis — and more* in 2010) and *A wake-up call for America* have been entered into the Congressional Record and the Federal Register. They also authored *Making Stock Markets Work to Support Economic Growth (OECD Corporate Governance Working Papers)* (with Lisa Newport) and the chapter, *Killing the Stock Market That Laid the Golden Eggs* in the recent book on high frequency and predatory practices entitled, *Broken Markets,* by Sal Arnuk & Joseph Saluzzi, published in May 2012 by FT Press (Financial Times).

About Grant Thornton LLP

Grant Thornton has an instinct for growth, and every day we help dynamic organizations unlock their potential for growth. Our clients are the entrepreneurial private businesses and public companies that will generate new jobs. And serving them includes bringing our best thinking to Congress — because we believe members should know all the options in order to make informed policy decisions that foster economic growth.

The people in the independent firms of Grant Thornton International Ltd provide personalized attention and the highest quality service to public and private clients in more than 100 countries. Grant Thornton LLP is the U.S. member firm of Grant Thornton International Ltd, one of the six global audit, tax and advisory organizations. Grant Thornton International Ltd and its member firms are not a worldwide partnership, as each member firm is a separate and distinct legal entity.

Grant Thornton LLP offices

Alaska
Anchorage

Arizona
Phoenix

California
Irvine
Los Angeles
Sacramento
San Diego
San Francisco
San Jose

Colorado
Denver

Connecticut
Glastonbury

Florida
Fort Lauderdale
Miami
Orlando
Tampa

Georgia
Atlanta

Illinois
Chicago
Oakbrook Terrace
Schaumburg

Kansas
Wichita

Maryland
Baltimore

Massachusetts
Boston
Westborough

Michigan
Detroit

Minnesota
Minneapolis

Missouri
Kansas City
St. Louis

Nevada
Reno

New Jersey
Edison

New York
Albany
Downtown
Midtown
Long Island

North Carolina
Charlotte
Raleigh

Ohio
Cincinnati
Cleveland

Oklahoma
Oklahoma City
Tulsa

Oregon
Portland

Pennsylvania
Philadelphia

Rhode Island
Providence

South Carolina
Columbia

Texas
Austin
Dallas
Houston
San Antonio

Utah
Salt Lake City

Virginia
Alexandria
McLean

Washington
Seattle

Washington, D.C.
Washington, D.C.

Wisconsin
Appleton
Madison
Milwaukee