

**THE JOBS ACT AT FIVE: EXAMINING  
ITS IMPACT AND ENSURING THE  
COMPETITIVENESS OF THE U.S.  
CAPITAL MARKETS**

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**HEARING**  
BEFORE THE  
SUBCOMMITTEE ON CAPITAL MARKETS,  
SECURITIES, AND INVESTMENT  
OF THE  
COMMITTEE ON FINANCIAL SERVICES  
U.S. HOUSE OF REPRESENTATIVES  
ONE HUNDRED FIFTEENTH CONGRESS  
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## **THE JOBS ACT AT FIVE: EXAMINING ITS IMPACT AND ENSURING THE COMPETITIVENESS OF THE U.S. CAPITAL MARKETS**

**Wednesday, March 22, 2017**

U.S. HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON CAPITAL MARKETS,  
SECURITIES, AND INVESTMENT,  
COMMITTEE ON FINANCIAL SERVICES,  
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 2:05 p.m., in room 2128, Rayburn House Office Building, Hon. Bill Huizenga [chairman of the subcommittee] presiding.

Members present: Representatives Huizenga, Hultgren, Stivers, Wagner, Poliquin, Hill, Emmer, Mooney, MacArthur, Davidson, Budd, Hollingsworth; Maloney, Sherman, Lynch, Scott, Himes, Vargas, Gottheimer, and Gonzalez.

Ex officio present: Representative Hensarling.

Chairman HUIZENGA. The Subcommittee on Capital Markets, Securities, and Investment will come to order. Without objection, the Chair is authorized to declare a recess of the subcommittee at any time. Just for a situational awareness for everybody, we are anticipating votes on the House Floor sometime shortly after 3:00, maybe 3:15 or 3:30.

Today's hearing is entitled, "The JOBS Act at Five: Examining Its Impact and Ensuring the Competitiveness of the U.S. Capital Markets."

I now recognize myself for 3 minutes for an opening statement.

While small companies are at the forefront of technological innovation and job creation, they often face significant obstacles in obtaining funding in the capital markets. These obstacles are often attributable to the one-size-fits-all securities regulations intended for large public companies, which are placed on small companies when they seek to go public.

Signed into law on April 5, 2012, the bipartisan Jumpstart Our Business Startups Act, properly known as the JOBS Act, consists of six bills that originated here in the House Financial Services Committee to help small companies gain access to capital markets by lifting burdensome securities regulation.

By helping small companies obtain funding, the JOBS Act has facilitated economic growth and job creation. Additionally, the JOBS Act has fundamentally changed how the Securities and Exchange Commission approaches securities regulation.

SEC Commissioner Michael Piowar described how the JOBS Act has changed the SEC's mission this way: "The JOBS Act requires the Commission to think of capital formation and investor protection in fundamentally different ways than we have in the past.

"The crowdfunding provision of the JOBS Act forces us to think outside of our historical securities regulation box and to create a different paradigm than the one we have used for the past eight decades."

The bipartisan JOBS Act was an attempt to remedy the SEC's inaction on capital formation, and even President Obama called the law a "game changer" for entrepreneurs and capital formation.

Regrettably, though, the implementation of the JOBS Act by the SEC languished under the chairmanship of both Mary Schapiro and Mary Jo White. By failing to fulfill this important part of its mandated mission, the SEC is hurting small businesses, impeding economic growth, and hindering the creation of new jobs.

It is extremely troubling to me that the SEC seems more intent on pursuing highly politicized regulatory undertakings outside of its core mission. Instead of working to protect investors, maintain fair and orderly and efficient markets, as well as helping to facilitate capital formation, the SEC has been more focused on exerting societal pressure on public companies to change their behavior through disclosure rules such as the conflict minerals and pay ratio rules, et cetera.

It is time to refocus the SEC to advance a broader capital formation agenda. Let's continue to build upon the successes of the bipartisan JOBS Act by further modernizing our Nation's securities regulatory structure to ensure a free flow of capital, job creation, and economic growth.

It is time to get the Federal Government working to support innovation and to reward hardworking Americans. I yield back the balance of my time.

The Chair now recognizes the ranking member of the subcommittee, the gentlelady from New York, Mrs. Maloney, for 3 minutes for an opening statement.

Mrs. MALONEY. Thank you so much, Mr. Chairman, and I look forward to working with you this Congress. And I want to welcome everyone to the very first Capital Markets Subcommittee hearing of the year.

The basic mission of the JOBS Act, and I am proud to have been a sponsor of this bill, was to make it easier for companies to raise capital from investors, whether that capital was being raised in the public markets or the private markets.

Two of the main provisions of the JOBS Act have gone into effect in the past year-and-a-half: Regulation A+ for small offerings; and crowdfunding. Both of these provisions were designed to make it easier and less expensive for small startup companies to raise capital, and both provisions targeted small companies that may not have been able to raise capital using the traditional methods such as an IPO or a private placement to sophisticated investors.

So this is a good time to step back and evaluate the progress of these two provisions by asking some simple questions. Are they working as intended? Are investors using them? Have they caused

any investor protection problems? Are there any changes that need to be made to improve either of these provisions?

The preliminary data suggests that both Regulation A+ and crowdfunding are working broadly as intended, although there is some room for improvement. Both provisions are being used by very small startup companies.

The typical company using both Regulation A+ and crowdfunding only has 3 employees and has less than \$5,000 in cash and no revenues. Crowdfunding is primarily being used by small companies that can't raise money any other way, and only to raise a small amount of capital.

The median amount raised using crowdfunding was only \$171,000. Regulation A-Plus, on the other hand, is being used by a wider range of companies, mostly very small startup companies, but also some larger ones as well.

Most of the companies that use Regulation A+ have also raised money by issuing private securities to sophisticated investors before, which indicates that Regulation A+ is being used as a supplement to other offering methods.

I am concerned, however, about the fact that FINRA has already had to terminate one crowdfunding portal for allowing several companies that appear to be fraudulent from offering securities on its platform. This raises serious investor protection concerns that we have to keep in mind as we review the impact of the JOBS Act.

I look forward to hearing from my colleagues, and from all of the panelists, and I yield back. Thank you.

Chairman HUIZENGA. The Chair now recognizes the vice chairman of the subcommittee, the gentleman from Illinois, Mr. Hultgren, for 2 minutes for an opening statement.

Mr. HULTGREN. Thank you for convening this hearing, Chairman Huizenga. Access to the capital markets and job creation is incredibly important to my district and to all of our districts, and we need to ensure that U.S. capital markets remain a competitive means of financing.

It is very fitting that a review of the JOBS Act is our first subcommittee hearing topic in this subcommittee, in this Congress. Before speaking any further, I would be remiss to not mention how excited I am to be serving as the vice chairman of the Subcommittee on Capital Markets, Securities, and Investment this Congress.

We have our work cut out for us, but I am optimistic that we can advance policy that will allow our economy to recognize its true potential. Competitive capital markets are important to job creators in my State and also to those who work to provide this financing.

There are a number of important financial services entities in the Chicago area that are instrumental to ensuring robust access to financing that make Illinois the home of Midwest finance.

To the point of today's hearing, I know the JOBS Act has made a meaningful impact in Illinois and in my district, and I am eager to hear how Congress can do more. Understanding how difficult it is to operate as a public company really struck me the other day when discussing the reasons Michael Dell took his company private.

This gave Dell, which had long operated as a public company, more flexibility to pursue what it determined to be best for its growth. I am sure this statistic is going to be cited a number of times today, but we should not lose sight of it.

The number of public companies today is about half of what it was 20 years ago. We went from about 8,000 public companies in 1996 to some 4,400 public companies today. We need to learn more about why this is and how we can help change this trajectory.

I believe it is important that job creators have both strong public and private financing options available. I look forward to the testimony today and to discussing some of the specific policy proposals mentioned in the written testimony.

And I yield back.

Chairman HUIZENGA. The gentleman yields back.

The Chair now recognizes the gentleman from Connecticut, Mr. Himes, for 2 minutes for an opening statement.

Mr. HIMES. Thank you, Mr. Chairman, and thank you for holding this hearing. We rise and fall on our ability to innovate. Companies everywhere are creating new products and new services that could change the world, but we might not see the next Pinterest, Blue Apron, Snapchat, or Google if we don't make it easier for them to jump from upstart to established.

Next month marks the 5th anniversary of President Obama signing the JOBS Act into law. The Act is an excellent example, in my opinion, of how the Federal Government can support business and job growth in our Nation by allowing fast growing firms to launch an IPO when they are ready to do so and then scale up to the full regulatory responsibilities and expenses associated with being public.

At the crux of the JOBS Act, of course, is the creation of an IPO on-ramp, which makes it easier for small- to medium-sized companies to undertake an IPO, and creates a new category of emerging growth companies (EGCs) that would enjoy certain regulatory exemptions as a result of that status.

EGCs now apparently dominate the IPO market, accounting for almost 90 percent of IPOs that have gone effective since the JOBS Act was enacted in April of 2012. The online travel site KAYAK, headquartered in my district, was able to go public in 2012, thanks to the JOBS Act, as an EGC.

I am proud of the bipartisan manner in which the JOBS Act came into existence. It really serves as a model for how Republicans and Democrats can work together to help advance one of the primary American competitive advantages, which is good liquid capital markets.

I do have one question which I hope the panel will address. In life, there is rarely such a thing as a free lunch. And obviously, every time we lighten regulations, there is always the possibility, maybe even the probability that you have more scope for abuse, bad behavior, and bad outcomes.

So I hope we hear as much as we celebrate this Act and what it has allowed some companies to do, whether we have seen any downside or bad outcomes associates with this Act.

But nonetheless, this is proof of the progress we can make on behalf of the American people when we work together, and I hope that we won't have to wait another 5 years to see similar successes. With that, I yield back the balance of my time.

Chairman HUIZENGA. The gentleman's time has expired.

Today, we welcome the testimony of Raymond Keating, the chief economist of the Small Business & Entrepreneurship Council; Brian Hahn, the chief financial officer of GlycoMimetics, Incorporated; Andy Green, the managing director of economic policy at the Center for American Progress; Edward Knight, the executive vice president, general counsel, and chief regulatory officer of Nasdaq, Inc., in New York; and Thomas Quaadman, the executive vice president of the Center for Capital Markets Competitiveness at the U.S. Chamber of Commerce. Gentlemen, we welcome you all.

You will each be recognized for 5 minutes to give an oral presentation of your testimony. As we had said, we are going to be a little pressed for time for some votes. So feel free to shorten it up, if you can. We do want to make sure we are able to get to some questions. And without objection, each of your written statements will be made a part of the record.

Mr. Keating, you are now recognized for 5 minutes.

**STATEMENT OF RAYMOND J. KEATING, CHIEF ECONOMIST,  
SMALL BUSINESS & ENTREPRENEURSHIP COUNCIL**

Mr. KEATING. Mr. Chairman, I am from New York, so I will talk fast. Mr. Chairman, Ranking Member Maloney, and members of the subcommittee, thank you for hosting this important hearing today on the JOBS Act and the competitiveness of U.S. capital markets.

I am Raymond Keating, chief economist for the Small Business & Entrepreneurship Council. We are a nonpartisan, nonprofit advocacy, research, and training organization dedicated to protecting small business and promoting entrepreneurship.

Gaining access to financial capital is essential to the creation and growth of businesses. At the same time, access to capital remains a major challenge for entrepreneurs starting up and building enterprises.

In my written testimony, I present data on the recent trends in banks, small business loans, angel investment, and venture capital investment. To sum up, the value and number of traditional small business loans are still down from pre-recession levels.

Angel investment also remains down from its 2008 level, while also experiencing stagnation over the last 2 years. In addition, venture capital has really shown the most life post-recession, but a decline in 2016 is certainly troubling.

So what is going on? First, it is about reduced levels of entrepreneurship. We did a study in August on examining levels of entrepreneurship in the economy. We looked at an assortment of data, which all pointed to declining levels of entrepreneurship.

The mid-range of these data points we estimated about 3.7 million missing U.S. businesses in 2015 compared to where we were at previous times. Reduced levels of entrepreneurial activity naturally mean reduced loan and investment demand.

Number two is these loans and investment trends again speak to the struggles of entrepreneurs to gain access to the financial resources needed to start up and grow. Why does this matter? We all know, I think, the answer to that. Quite simply, entrepreneurship is the engine of innovation, productivity and income growth, and job creation.

And in turn, entrepreneurship depends on the willingness and ability of investors and lenders to supply investment and credit.

During the current recovery expansion period, the U.S. economy has grown at half the rate it should. And that has largely been about poor private investment growth.

So providing small businesses with more options or avenues to expand access to financial capital is a clear positive. Two important parts of the JOBS Act focused on opening up new avenues for individuals to invest in entrepreneurial ventures, such as via crowdfunding.

Title II of the JOBS Act was about accredited investor crowdfunding, and Title III was about crowdfunding for everyone else, if you will. As for the investment under Title II, according to a recent Crowdfunder's report, the number of new offerings actually declined over years 1 to 3, but capital commitments at the same time rose substantially.

Meanwhile, according to Crowdfunder Capital Advisors, since Title III launched in May 2016, capital commitments registered almost \$30 million as of March 10, 2017.

Even given the positive changes, areas in need of improvement always exist, including government placing too many limits on the ability of entrepreneurs to gain access to capital, and/or on investors' abilities to make investments in entrepreneurial ventures.

For example, crowdfunding opportunities should be expanded for businesses of different sizes and stages, and therefore, the limit of raising \$1 million during a 12-month period under Title III, crowdfunding, should be raised, for example, to \$5 million.

Jason Best and Sherwood Neiss of Crowdfunder Capital Advisors have pointed out that 2.2 jobs are created within the first 90 days after a company is successful with a securities crowdfunding campaign. So we very much see job creation happening.

Also, the ability of investors to invest should be expanded. In addition, it should be clarified that funding portals cannot be held liable for material misstatements and omissions by issuers unless portals are guilty of fraud or negligence. This assurance would reduce unnecessary risks for crowdfunding portals.

In conclusion, U.S. capital markets are the envy of much of the world, but we must be vigilant in making sure that while regulatory policy protects against fraud and abuse, it also reflects the reality that free markets provide the foundation upon which entrepreneurship investment, innovation, and business can flourish, thereby providing a breathtaking array of goods and services and jobs that improve all of our lives.

Financial regulation must recognize these realities, recognize the transparency that technology has imposed upon the system, and be built on a respect for free enterprise. Thank you for your time, and I look forward to the discussion and questions.



[The prepared statement of Mr. Keating can be found on page 66 of the appendix.]

Chairman HUIZENGA. Thank you, Mr. Keating.

Mr. Hahn, you are now recognized for 5 minutes.

**STATEMENT OF BRIAN HAHN, CHIEF FINANCIAL OFFICER,  
GLYCOMIMETICS, INC.**

Mr. HAHN. Thank you, Mr. Chairman, and Ranking Member Maloney. As a CFO of a company that benefited from the JOBS Act, I would like to personally thank the subcommittee for its hard work as we celebrate the law's 5-year anniversary.

The JOBS Act was a game changer for biotechs like mine, because it increases the capital formation potential of an IPO and decreases the capital diverted from science to compliance. Two-hundred and twelve biotechs have gone public under the JOBS Act, a fourfold increase from the 5 years before JOBS.

Since our IPO, we have nearly doubled our employee headcount, and we have moved two additional new drug candidates into human clinical trials. These 212 innovators are seeking treatments for a wide range of devastating diseases.

At GlycoMimetics, we are working toward therapies for patients suffering with sickle cell disease, acute myeloid leukemia, and multiple myeloma.

Under the JOBS Act, the industry has seen a surge in IPOs for diseases that were previously difficult to finance, including diabetes and Alzheimer's. We have also seen a dramatic increase in early-stage financing. There were just 3 early-stage IPOs in the 5 years before JOBS, but since JOBS was enacted, there have been 48.

The JOBS Act's testing-the-waters and confidential filing provisions were vital to the success of our IPO, and we continue to benefit from the 5 years of reduced compliance with costly burdens like SOX 404(b). In short, the JOBS Act has changed the game for financing therapeutic innovations.

JOBS Act's biotechs have 696 therapies currently in development, and the FDA has approved 18 new treatments from JOBS Act's companies. I am excited that the subcommittee continues to consider ways to build on the success of the JOBS Act.

Many of the capital formation provisions for the Financial CHOICE Act would further support the growth of small, public biotechs. In particular, I strongly support the Fostering Innovation Act introduced by Representatives Sinema and Hollingsworth.

The JOBS Act's 5-year SOX exemption has saved millions of dollars for growing biotechs, but most will still be pre-revenue when the IPO on-ramp expires.

GlycoMimetics expects annual expense to increase by upwards of \$350,000 starting in year 6 on the market, capital that could treat over a dozen patients in the clinic.

The Fostering Innovation Act would extend the JOBS Act exemption for pre-revenue companies. This bipartisan bill recognizes that a low revenue company that has been on the market beyond the 5-year EGC window is still very much an emerging, growing business.

The continued cost-savings in the bill are vital because every dollar spent on a one-size-fits-all burden is a dollar diverted from the labs.

I also support Congressman Duffy's Corporate Governance Reform and Transparency Act. Proxy advisory firms' outsized influence on emerging companies has proven to be uniquely damaging to growing biotechs, to say nothing of the firms' conflict of interest and opaque standard-setting processes.

Mr. Duffy's bill to regulate proxy firms would be a welcome change from the status quo that forces companies to contort themselves to satisfy proxy advisors rather than making decisions in the best interest of the company and its shareholders.

These important bills and other capital formation provisions in the CHOICE Act, like cost-savings from XBRL and SOX, will build on the JOBS Act by supporting the growth of the 212 newly public biotechs that have enjoyed big success over the last 5 years.

The JOBS Act has shown the strong impact that a policymaking drive toward capital formation and away from one-size-fits-all regulatory burdens can have. I applaud the subcommittee for considering further initiatives to support small business innovators, and I look forward to answering any questions you may have.

[The prepared statement of Mr. Hahn can be found on page 57 of the appendix.]

Chairman HUIZENGA. Thank you very much.

Mr. Green, you are recognized for 5 minutes.

#### **STATEMENT OF ANDY GREEN, MANAGING DIRECTOR OF ECONOMIC POLICY, CENTER FOR AMERICAN PROGRESS**

Mr. GREEN. Thank you, Mr. Chairman, and Ranking Member Maloney for the opportunity to testify on this important topic. I would like to make three points overall. First, the impact of the JOBS Act has been mixed, although many results are not in.

For the public markets, regulation is not the problem, rather a focus on structural issues, which is where competition would be very helpful. And then for the private markets, small business access to capital impacts have also been mixed and investor risks remain. A new focus on the wealth, skills, and network gaps for would-be entrepreneurs is needed.

One of the principal goals of the JOBS Act was to increase IPOs. For better or worse, the IPO market is now dominated by EGCs. But being an EGC has nothing to do with any particular nature of the company itself, whether innovative and exciting or non-innovative and not exciting. It is just a regulatory label.

Unfortunately, data suggests that these EGCs tend to be lower in quality from a listing and investment perspective—46 percent of EGCs that filed a management report on internal controls reported material weaknesses in those controls.

One study found EGC companies had a 21.8 percent lower return on assets, and a 3 percent lower stock performance on average. Capital formation and market liquidity for any stocks also appears negatively affected. And another study found that EGCs experienced 7 percent more underpricing than similarly sized companies prior to the JOBS Act.

Another study was more positive about the JOBS Act effects on IPOs. It found a 25 percent increase in IPO volume compared to the 2001–2011 levels. But this was largely due to the confidentiality and test-the-waters provisions that de-risked the offerings in terms of their outward-facing communications with investors.

The de-burdening provisions such as reduced disclosure and lighter accounting rules were not meaningful. And this is an important conclusion because it shows that most provisions that reduce investor protection were not important in terms of increasing IPO availability. The study also found little evidence of improved analyst coverage despite the reductions in investor protection on conflicts of provisions.

Unfortunately, this good news did not last. In 2015 and 2016, IPO volume fell to the lowest level since the Great Recession. I am not pleased to note this. I would just highlight that other factors, other than compliance requirements, may have a much stronger influence in IPO behavior.

So the question then is whether the lighter compliance requirements of Title I make sense? It appears that the confidentiality and test-the-waters provisions seem like good ideas, seem to be working, and seem to have limited negative consequences, so let's keep them.

It may make sense to revisit some of the de-burdening provisions, at least by giving the SEC more flexibility to restore those that were removed by statute, given the somewhat lower quality results in EGC companies.

If Congress wishes to boost the viability of the public markets overall, it needs to turn its attentions to other factors. One I would particularly like to highlight is competition policy. Mergers and acquisitions are now the biggest reason for the market decline in listed companies. And there is growing evidence of market concentration across the economy.

Stronger approaches to antitrust enforcement are needed. The SEC may have a role to play as well. The Exchange Act, Section 23(a), mandates that the SEC consider competition as part of its rulemakings.

Competition is sprinkled throughout the Federal securities laws as an idea. It is even part of the title of this hearing. And the SEC has a number of tools to boost transparency, better regulate M&A, and help level the playing field back towards the public markets.

I don't have specific recommendations today, but I think it is a topic that I would encourage all of us to think about more as we think about holistically how to boost our public markets.

Let me briefly say a word about the private market provisions of the JOBS Act. First, old Rule 506(b) is still working very well. The market more than doubled from 2000 to 2014 in terms of the amounts raised annually.

The Title II provisions of 506(c) are not widely used. So 506(c) is really the workhorse, and that is still a success. New provisions, such as Title II crowdfunding, appear to be working well.

And we are in the early stages of Title III and State-based crowdfunding, which are not part of the JOBS Act but are part of the spirit of it. And I look forward to seeing the results as companies take advantage of it, and it goes well.

Risks are yet to manifest and we still need to be very careful about those. I remain deeply concerned about the broader reach solicitation. Even though most companies are not taking advantage of it, it is still used.

And when there are problems, investors don't get all their money back, and the SEC does not have enough resources to track down everything after the fact. That is why stricter requirements for filing Form D make a lot of sense.

Lastly, I would like to encourage a focus on the wealth, training, and network gaps that would make a lot of difference in terms of enabling entrepreneurs from minority and women-headed households to have more opportunities to access the capital markets.

There is a lot more I could say, and I look forward to answering any questions you may have. Thank you very much.

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

Chairman HUIZENGA. Thank you.

Mr. Knight, you are recognized for 5 minutes.

**STATEMENT OF EDWARD S. KNIGHT, EXECUTIVE VICE PRESIDENT, GENERAL COUNSEL, AND CHIEF REGULATORY OFFICER, NASDAQ, INC.**

Mr. KNIGHT. Thank you very much for inviting us here today. I want to highlight a few elements of my testimony. I have been general counsel at Nasdaq now for 17 years. I have seen the markets evolve a lot. One of the most consequential acts of Congress in that period has been the JOBS Act.

It has been positive for both the public markets and the private markets. But I want to say up front that Nasdaq believes in regulation. We do a lot of regulation at Nasdaq. It is important to protect investors.

We looked at 46,000 SEC filings last year. We deregistered, delisted 68 companies. We did background checks on 4,100 directors and officers before we allowed them to list.

But there is no doubt that listing on a public market does have a positive impact in terms of, for instance, jobs creation. I think there is just irrefutable evidence that jobs get created once companies go public. Most public companies grow by 100 percent to 150 percent in terms of their employment.

In the last 5 years, Nasdaq has taken 621 companies public. They have a market cap of \$850 billion. They raised about \$100 billion in new capital in doing that. And it has had a huge impact, we think a positive impact, on the economy.

The JOBS Act helped with that. I want to summarize what we see as the effects of it. As others have said, the ability to file confidentially, the ability to test waters, those provisions helped immensely, particularly with companies that were on the edge of going public. It pushed them to do it.

Many in the healthcare area did it. And we have seen, I think, no adverse impact on investors because of these provisions. All we have seen is more entrepreneurship, more job growth, and I think a very positive impact.

But it petered out after a while as the chart will show you, I think the number 2 chart in my prepared testimony. Over the last

few years, the number of companies going public has gone down. There are things that can be done to restore the vibrancy of these markets, to create an ecosystem that will be more conducive to companies going public. And I want to touch upon that.

I do want to note that at the same time, while the U.S. markets have been dropping in terms of IPOs, other markets that we run in Northern Europe, for instance, are having a vibrant IPO market. So these things do react to public policy. This is not necessarily something that has to happen.

I do also want to point out, even when the Government doesn't regulate, these markets regulate themselves in the sense that major market participants, institutions, require of these companies a lot.

It is not for everyone to go public. Not only is there regulation by the Federal and State Governments, but large institutions require a lot of these companies. And it is not for everyone. But what we are hearing over and over again from companies who are thinking about it, is not necessarily going private. It is the process of staying private and what they have to accept in terms of regulation that may not be directly related to running a company. In a highly competitive, global marketplace, distraction from the job of running that company and competing around the world is a cost that these companies pay.

And you have to ask yourself, is this regulation really necessary for the running of this company, building these companies, creating opportunity, creating jobs, and creating innovation?

Another key aspect of a public company that gets lost sometimes in the debate is when these companies go public, they are open to investment by individual investors. You do not have to be an accredited investor as you have to be in the private market.

In my testimony, you will see one of the most dramatic examples: Amazon went from the 1990s with a market cap of \$350 million to a market cap of over \$350 billion, employing hundreds of thousands of people. In the last year alone, they have created 100,000 jobs.

What we think should happen more often is early stage companies having the opportunity to go public, having a market that is more inviting than it is today, so that they will go public and grow in the public markets, not only to create those jobs but also to give the investing public an opportunity to grow with them, which they do not always have today.

So there are a number of things we would focus on. One is the Main Street Growth Act that Congressman Garrett introduced last year that has been part of the CHOICE Act. We think that is positive legislation. The proxy reform legislation and modernizing disclosure in our markets, but we can get more into that. Thank you very much.

[The prepared statement of Mr. Knight can be found on page 77 of the appendix.]

Chairman HUIZENGA. Thank you, Mr. Knight.

And Mr. Quaadman, you are recognized for 5 minutes.

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

Mr. QUAADMAN. Thank you, Chairman Huizenga, Ranking Member Maloney, and members of the subcommittee. The Chamber appreciates the continued work of this subcommittee on capital formation legislation, including recent efforts with the FAST Act, legislation to create the small business advocate in the SEC, as well as the Poliquin legislation, which forces the SEC to either modernize regulations or to explain why not.

Yesterday, the Chamber, in conjunction with RSM, launched our quarterly middle market survey. And next week, in conjunction with the Morning Consult, we are going to release our small business survey.

Both of these surveys find that while economic challenges still exist, there is increased optimism amongst middle-market and small business companies. However, that optimism is coupled with an expectation for Washington to remove barriers to growth.

We need to have a balanced private and public capital market system in order to support our diverse economy. The JOBS Act was a bipartisan and helpful way of trying to address those imbalances, and it provided rules that would allow businesses to grow from small to large, make the IPO process easier, and to help companies to go public and remain public.

There are initial successes with the JOBS Act, but the progress has been halting, and in some ways the situation is worse today than it was in 2012. More must be done and SEC implementation issues have also harmed and blunted the effectiveness of the JOBS Act.

The public company markets are in worse shape today than they were 5 years ago. As Mr. Hultgren mentioned, we have less than half the public companies today than we did in 1996, and that number has gone down in 19 of the last 20 years.

But let's take a look at 1982. Since 1982, the population of the United States has grown by 40 percent. Our real GDP has increased by 160 percent. And we have roughly the same number of public companies today as we did in 1982. To put it in other words, the gains of the Reagan Administration and the Clinton Administration have been wiped out.

There are four main drivers of this problem. One is structural and managerial issues at the SEC. We have issued three separate reports on that with 70 recommendations. I am not going to get into that today. Also, financing issues, regulatory obstacles, and a 1930's style disclosure regime that is increasingly used to embarrass businesses and not provide decision-useful information to investors.

Combined, these issues create a tax on innovation and growth. And we if take a look at those numbers of public companies, as Justice Marshall observed 200 years ago, that power to tax is a power to destroy. We need to restore an ecosystem of growth that provides benefits throughout the economy.

The Kauffman Institute did a study which showed that between 1996 and 2010, IPOs created 2.2 million jobs. Boosting growth from 2 percent to 3 percent takes 12 years off of the length of time need-

ed to double the economy, and reduces the deficit by \$3 trillion over 10 years. A 0.5 percent uptick in growth creates 1.2 million jobs and \$4,200 in additional income for workers.

We need to recreate that culture that rewards success, and celebrates when a UPS driver or a Microsoft executive assistant becomes a millionaire when their company goes public. In order to rebalance this system and reverse this trend, we think the SEC and Congress should do the following:

Disclosure effectiveness needs to be a top priority. We shouldn't talk about it any longer. The SEC needs to move forward and bring a disclosure regime into the 21st Century. We need to pass proxy advisory reform legislation that creates transparency, accountability, and oversight over proxy advisory firms.

We need to recognize that capital formation and corporate governance are inextricably linked and have 14a-8 reforms, including resubmission thresholds, overturning the Whole Foods decision so the SEC is a fair umpire in the shareholder process, ownership verifications so that we know that a shareholder proposal proponent actually owns shares in the company that they are making proposals in. And Reg. D clarification to make the JOBS Act effective.

We need to fix financing through the passage of BDC legislation, fixing crowdfunding, the Main Street Growth Act, as well as providing micro-offering safe harbors.

We need to modernize rules including expanding the eligibility for Form S-3. Clarifying the definition of accredited investors exempting emerging growth companies from XBRL, and simplifying small private equity disclosure and registration.

And we should also pass those remaining provisions of Title X of the CHOICE Act. These are, we think, very simple, common-sense reforms. We think that others can be done as well. And I look forward to answering your questions.

[The prepared statement of Mr. Quaadman can be found on page 85 of the appendix.]

Chairman HUIZENGA. Thank you for that. At this time, the Chair will recognize himself for 5 minutes for some questions.

Mr. Quaadman, while we were having this discussion, you noted that, I think, the average initial regulatory cost associated with an IPO is \$2.5 million. And the estimated annual compliance costs for public companies average about \$1.5 million. What are the main drivers of these costs?

Mr. QUAADMAN. A lot of the costs that are associated with that are legal costs. And it is also a matter of being able to go out and talk to investors and the like. The JOBS Act actually did a lot to help facilitate that. However, with every IPO, there is a securities class action waiting to happen.

And so the legal costs are actually high and that company is also going to be expected to be sued. So I would say that the costs are even more than that, but the regulatory costs are in that ballpark.

Chairman HUIZENGA. And the significant portion of these costs, are they relevant to all publicly traded companies regardless of size? Or are some of them hit sort of disproportionately?

Mr. QUAADMAN. What the JOBS Act did that was very beneficial is to allow emerging growth companies to ease into the regulatory

process. As you are a public company for a longer period of time, those costs are going to go up.

And they are going to go up dramatically, because you are going to start to deal with different rules such as conflict minerals or whatever, which impose very expensive reporting regimes on companies.

And that is actually the reason why Michael Dell said he was no longer going to run a public company, because he felt he would rather manage a company than having to deal with those extraneous issues.

Chairman HUIZENGA. Okay. Mr. Knight, you testified that you had a number of discussions with CEOs and that the primary challenge is not about going public, but about being public. And it sounds like that is a consistent thing that you are hearing a lot. Why is that? Can you elaborate on that a little bit?

Mr. KNIGHT. I will give you a statistic. If you asked a Silicon Valley accomplished lawyer who takes companies public a few years ago what the rule of thumb was in terms of revenues for a company before they go public, they would have said \$30 million.

Today, they would say \$100 million. The infrastructure that you need in order to support all the reporting requirements and the regulatory requirements—I am not talking about the financial disclosure. No one is arguing about financial disclosure. That is a key to a well-run market and protecting investors.

It is the other public policy goals that have been put on the public company model that makes the market look uninviting, particularly at a time when—

Chairman HUIZENGA. Put on by whom?

Mr. KNIGHT. By a CEO or a board that is considering options.

Chairman HUIZENGA. Okay.

Mr. KNIGHT. Shall we go public? Shall we be acquired? If we get acquired, maybe some of the R&D we are doing is going to be thrown overboard and the innovation in that company by the acquired company. The opportunity for investors to invest in that company through an IPO will be lost.

The environment does not look very inviting, particularly when you have \$8 trillion in sovereign wealth funds available to invest in these companies as private companies.

Chairman HUIZENGA. But to interrupt here just a moment, on your Chart 1, that did strike me showing that—it is on page 2 for anyone who wants to take a look at it here.

But you talk about the sovereign wealth funds and private equity firms and how they are the ones now capturing all that initial growth, rather than the public, who would be investing on that.

And you kindly included two companies from my district, Macatawa Bank and Herman Miller, that have had that and have had challenges. And stock prices are going up and down. But—

Mr. KNIGHT. And there is—

Chairman HUIZENGA. —elaborate on that a little bit.

Mr. KNIGHT. There is nothing wrong with this. The private market is vibrant. That is great. It gives people funding choices they might not otherwise have. But it won't always be. And the public markets need to be there. And they need to be there in a modern way.



Many of the issues we are talking about on this panel are regulatory issues that haven't been revisited in 20 years. We are not talking about getting rid of them. We are talking about modernizing them.

We are not talking about getting rid of disclosure. We are talking about bringing it into the 21st Century where there is electronic disclosure.

Why do you have to file with the SEC? That is an 18th Century concept. You can put it on a website. You can use other electronic means of communication. And modernizing these markets will make them more competitive with other markets at the same time.

Chairman HUIZENGA. I have run out of time, and that was going to be one of my last questions, is what specifically can Congress do to alleviate some of those crippling burdens, for you and for Mr. Keating and others. But hopefully someone will be able to get to that.

So with that, the Chair recognizes the ranking member of the subcommittee for 5 minutes.

Mrs. MALONEY. Mr. Green, I would like to ask you about crowdfunding. As you know, the crowdfunding rules have been in place since last May. The SEC recently did a study of it and found that it was broadly working as intended, but noted that one funding portal had been terminated by FINRA for failing to supervise several potentially fraudulent companies that were trying to raise money on their platform.

What is your take on how crowdfunding has gone so far? Is it helping small companies get access to capital like we intended? And are you concerned that one of the intermediaries that Congress intended to reduce the risk of fraud has already been shut down? What is your take on all of this?

Mr. GREEN. I thank you for that question. I think it is going well. I think that it has only been a short period of time and the uptick is increasing. And we need to let the market mature. I am actually pleased to hear about this enforcement action because it shows that our regulators are on the beat.

And one of the most important things to make crowdfunding be successful is that investors have confidence that when they go to the market, they are going to have opportunities to pick from reliable companies via reliable intermediaries, funding portals, and other broker-dealers that are running portals.

So actually shutting down a portal that is not doing their job makes me think that things are on the right track.

Mrs. MALONEY. Okay. Great. Does everybody agree? Are there any other takes on it that they would like to add from any panelists on crowdfunding?

Then, I will go to Tom Quaadman. I noted in my opening statement that the new Regulation A+ has been used by a wide range of companies. Some are extremely small, with 2 or 3 employees. Some are much larger.

I found it very interesting that many of the community banks have chosen to raise money through Regulation A+, even though they can raise capital in other ways, such as private placement to sophisticated investors.

Was this the target market? Do you think it is a problem that companies that can already raise money in other ways have been using Regulation A+ to raise capital?

Mr. QUAADMAN. I think what the JOBS Act did is try to create as many different options as possible for businesses to raise capital. So if they could do it through Regulation A+, if they are eligible for it, fine. If there are other ways to do it, that is fine too.

One of the things that Regulation A+ does is it creates a system whereby a smaller company can raise capital from a known investor base, which is why you also don't see the testing of waters as you do in other places.

And it would make sense actually for community banks to use that because as a smaller bank in a smaller community, they are going to know that investor base a lot better. And they are going to be able to use that as a device to try and raise capital from them, as well as the fact that there may be other costs involved with other systems that they may not have with Regulation A+.

Mrs. MALONEY. You mentioned the testing of the waters. The vast majority of companies that have used Regulation A+ so far have not taken advantage—

Mr. QUAADMAN. Correct.

Mrs. MALONEY. —of this testing-the-waters option. So what do you make of this? Is testing the waters with potential investors just not that important for companies? Or is it too difficult and time-consuming to go through the testing-the-waters process? What is your take on all of that?

Mr. QUAADMAN. No. Actually, I think it is a very important device to use, and also, you could look at it in one context in terms of Reg D, general solicitation of Regulation A+. And I think with Regulation A+, again, you are dealing with sometimes companies that already exist that have a known investor based that they can go after.

Obviously, you want to use testing of the waters when you are talking about a newer company that doesn't have that known investor base. So I think actually being able to do it both ways satisfies the needs of companies at different parts of a maturity scale.

Mrs. MALONEY. I would like to go back to Mr. Green. The current SEC rules require issuers using Rule 506 to offer private securities to file a form called Form D with the SEC only 15 days after the first sale. In addition, there is no penalty or disqualification for failure to file Form D.

The SEC proposed to change these rules in 2013 when it implemented Title II of the JOBS Act, to lift the ban on general solicitation. Do you think these safeguards are important for securities offered under the new rule 506(c)?

Mr. GREEN. I do think they are quite important. They are important for a number of reasons. One is baseline data collection. We don't have a great deal of insights across the entire Reg D market. So having a full compliance with the Reg D for the Form D filing would be very helpful.

But the more important aspect really is investor protection. As we move more towards making the private markets quasi-public by having public advertising, which is what general solicitation is, we need to be a lot more concerned about the impacts on ordinary in-

vestors who are liable to make bad decisions and be taken advantage of.

And there is a very interesting study that the AARP put out only a couple of days ago that I would recommend that everyone take a look at. It has some amazing statistics.

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

Chairman HUIZENGA. With that, the Chair recognizes the vice chairman of the subcommittee, Mr. Hultgren, for 5 minutes.

Mr. HULTGREN. Thank you, Mr. Chairman. Again, thank you all for being here. I really appreciate your valuable insight and testimony here today.

Mr. Hahn, I would like to start with you. I was drawn to this line in your testimony. You said, "The JOBS Act has been an unqualified success, enhancing capital formation and allowing companies to focus on science, rather than compliance."

I am also a member of the House Science Committee, and I am keenly aware of the innovative work that bio and its members are doing. I wondered if you could provide some insight into how access to the capital markets is driving changes in medicine?

We are really talking about making lives better, saving lives. I wonder if you could just give a little insight into that?

Mr. HAHN. Thank you. As I had stated in my testimony, the testing-the-waters provision of the JOBS Act was instrumental in our successful IPO.

So at GlycoMimetics, it is a very novel, unique approach that we are taking that takes a very sophisticated approach that—with a single meeting with an investor before the JOBS Act in a 2-week IPO roadshow, investors could not get comfortable with the science and the technology.

And testing the waters allowed enough time leading up in the months before the IPO to actually get their head around the technology and the science, and to ask follow-up questions. And that was instrumental in helping a successful IPO.

Mr. HULTGREN. That is great. Thanks.

Mr. Knight, thanks for being here.

Mr. KNIGHT. Thank you.

Mr. HULTGREN. I wanted to follow up on your testimony. In your testimony you mentioned the idea of permitting companies of all sizes to file for their IPOs with the SEC on a confidential basis, and permit other types of registration statements besides IPOs to be initially submitted on a confidential basis.

Could you explain the benefits of filing under a confidential basis, and what other type of registration statements you believe that this might be able to be extended to?

Mr. KNIGHT. Yes. I think it is important to understand when companies are considering going IPO, they are also looking at other options. And they want to be able to explore the option of going public while looking at these other options.

If you have to file in the public, you are committing yourself in the sense that if you don't do it, the market will exact a price on you for having "failed." So they don't want to fail at that. They want to explore it.

These companies, like all companies, are dealing in a very competitive marketplace, and these filings often have information that

has a proprietary impact. And it is required. The public needs to know what your strategic plans are before they invest. But you are putting them out there for all of your competitors to see.

So to have the option of deciding not to go public, but perfecting your disclosure, is very valuable to companies that are looking at this.

Mr. HULTGREN. Mr. Knight, continuing with you, you mentioned briefly in your testimony about this, but I wanted just to drill a little bit further. As you are aware, the former chairman of this subcommittee, Chairman Garrett, sponsored legislation that would permit exchanges to list venture securities.

Do you believe such an exchange would improve liquidity and price discovery for these securities? And could you explain how intelligent tick sizes would improve liquidity for these securities? Also, do you have any other feedback on the Tick Size Pilot currently under way?

Mr. KNIGHT. The Tick Size Pilot, our current assessment is that it is, frankly, too early. It does look like there is more liquidity that is being generated, but it is too early to make conclusions. People are still adjusting to it.

But Congressman Garrett's bill had a number of what we think are very important features. The market structure that secondary trading occurs in has a cost associated with it. And we have a structure today that is designed to facilitate trading of Google and Amazon, which is great.

But it doesn't work for smaller cap companies. And there needs to be an examination of that to have a small cap company trade across 11 stock exchanges in 40 dark pools, fragments that liquidity. It undermines the price discovery process.

So the Garrett bill would allow the company that lists to decide to aggregate that liquidity on one market. It would allow the exchange to adjust the tick size to encourage liquidity by having wider tick sizes, bringing more market makers into it.

I would like to point out the Saudi Arabian stock exchange that we sell technology to. It has intelligence tick sizes. We don't have it here. We petitioned the SEC to consider it. We have not ever gotten a response. So we think it is an intelligent idea, and we are glad it was in that bill.

Mr. HULTGREN. Thank you all.

I yield back.

Chairman HUIZENGA. The gentleman's time has expired.

With that, the Chair recognizes Mr. Lynch for 5 minutes.

Mr. LYNCH. Thank you, Mr. Chairman. Mr. Chairman, I would ask unanimous consent to enter into the record a statement written by Mike Rothman, who is the president of the North American Securities Administrators Association, Inc. And also, a communication to the committee from the Council of Institutional Investors.

Chairman HUIZENGA. Without objection, it is so ordered.

Mr. LYNCH. I thank the chairman.

I want to thank all of the witnesses here today for your help. It's very important, and Mr. Knight, I want to thank Nasdaq for its help on the tick size experiment, and I am eager to hear what the data might show.

Mr. Green, last Congress, we had the chairman's Financial CHOICE Act, which seeks to expand some of the exemptions that we included in the JOBS Act. It also increases the penalties that the SEC might levy against some bad actors. But in an important way, it imposed significant requirements on the Commission prior to bringing an enforcement action.

For example, the bill would require the Commission to conduct a cost-benefit analysis of whether the penalty would negatively affect shareholders of the company of which we believe their officers and employees may have broken the law.

In addition, the Financial CHOICE Act would permit defendants to choose their own venue, which I have a problem with. It actually creates an ombudsman to separately defend these bad actors before the Commission. And there are several other opportunities in the bill to slow down the enforcement process.

So how would provisions like these, that make it more difficult for the SEC to hold wrongdoers accountable, harm the integrity of our markets and a company's ability to raise capital?

And does this framework that is being suggested here in the Financial CHOICE Act create a moral hazard where it is so hard to hold the bad actors accountable, people say why not?

Mr. GREEN. Congressman, I 100 percent agree that it creates a very serious moral hazard. I think that there is a lot more that needs to be done to improve the SEC's enforcement ability and its scope, but it is not going the direction of tying their hands and making it harder for them to bring cases.

I think there has been 20 to 30 years of accumulated Supreme Court and other precedents that make it hard for them to go after anybody other than the immediate speaker, and a bunch of other cases make it hard for private attorneys general to bring cases.

And all those things that you are talking about, being able to choose your forum, doing cost-benefit analysis, not actually holding the shareholders accountable for the decisions that their board and their executives make with their money, those are all completely the wrong direction.

And I also highlight one more part of the CHOICE Act that gives me great concern is getting rid of the bad actor automatic disqualifications.

Mr. LYNCH. Right.

Mr. GREEN. These are forward-looking prophylactic things that improve investor confidence in our markets. And I think we have to come back to that, that the strength of our markets is investor confidence.

Mr. LYNCH. But you would be hard-pressed to find an example of the SEC actually enforcing the bad-actor provision. In case after case after case after case, they don't enforce that, even when we have a successful enforcement action.

I have this issue with Sheila Bair and other folks there who gave rise to this too-big-to-jail accusation and a lot of criticism at the SEC.

Let me ask you as well, while we are on this, the CHOICE Act would also allow emerging growth companies to be exempt from Section 404(b). I know a lot of people hate this, but it does introduce some accountability where the CFO has to sign off on the in-

ternal controls audit. And I would like to have your thoughts on that.

Mr. GREEN. I think the evidence from the data is that the EGCs that don't have to do this have much weaker internal controls and are lower performing and there is greater investor risk. So I think expanding that is the absolutely wrong way to go.

I think holding people accountable—and that is the point of capitalism. Your money is on the line. You are the board. You are the CEO. You ought to sign on the dotted line and take responsibility.

Mr. Knight, if there were one recommendation that you would like to make this committee aware of in order to increase the number of companies going public and creating the jobs—and I appreciate the work that Nasdaq has done on this—what would that one suggestion be?

Mr. KNIGHT. Part of the difficulty in answering that is the problem is death by a thousand cuts.

Mr. LYNCH. Yes, okay.

Mr. KNIGHT. It is not one issue.

Mr. LYNCH. All right.

Mr. KNIGHT. Two is, I will get back to the 404(b) issues if I could respond to that also?

Mr. LYNCH. Sure.

Mr. KNIGHT. Our experience has been that companies going public are not taking advantage of that. Why? Because there is a private ordering that is going along here. Institutions do not like you not doing 404(b).

Mr. LYNCH. Yes.

Mr. KNIGHT. So even though Congress may not require it, Fidelity may not invest unless you do it.

Mr. LYNCH. Yes. That is a good point.

Mr. KNIGHT. So you have to keep that factor in mind also.

Mr. LYNCH. Yes, so it is positive peer pressure, as opposed to—

Mr. KNIGHT. It is the investing community.

Chairman HUIZENGA. The gentleman's time has expired.

Mr. LYNCH. I'm sorry.

Mr. KNIGHT. It imposes a discipline.

Mr. LYNCH. I thank you for your indulgence, Mr. Chairman. I yield back.

Chairman HUIZENGA. The Chair now recognizes the gentleman from Arkansas, Mr. Hill, for 5 minutes.

Mr. HILL. I thank the chairman. I appreciate you holding this hearing to assess what progress we have made under the JOBS Act, clearly one of the most important and successful fiscal economic policy acts passed during the Obama days.

I would like to start out—we have talked a lot about the costs of being a public company and the challenges of being public because of those costs and the immense size of the market cap one has to have to really kind of justify going public and the frustrations of that.

And some of that is 404-related, for example, in hardcore accounting costs, but I want to talk a minute and get people's views on the proxy process, and sort of the challenges of being a public enterprise, 14a-8 for example, on proxy access.

I will start with you, Mr. Quaadman. You referenced this in your testimony. It was meant to be a way for shareholders and management to communicate. That is why the Commission organized it and to have a two-way dialogue, if you will.

But it has really, in my view as a former business guy, sort of been taken over by various eccentric, occasionally volatile activist-type topics and can be very distracting to corporate management, not just on annual meeting day—

Mr. QUAADMAN. Right.

Mr. HILL. —but as a general matter. Maybe driving up the cost involved in being public, but maybe driving down the desire to be public because it just is a distraction from the core business.

You talked a little bit about a policy that the incoming Commission might consider withdrawing: Staff Legal Bulletin 14H CF. Would you comment a little bit more on that topic?

Mr. QUAADMAN. Sure, and I will actually give you, I guess, both sides of the coin there. One is 92 percent of CEOs in the IPO Task Force said that the reporting regime is very burdensome, and it doesn't allow for them to provide information in a constructive way to investors.

Stanford University did a study 2 years ago where they surveyed institutional investors with \$17 trillion in assets. What those institutional investors came back with and said is: "The proxy is too long; it doesn't provide information; and only a third of the information is relevant."

Furthermore, when we were putting together a disclosure effectiveness report a couple of years ago—and this is anecdotal—we came up with everybody sort of thought that about half of the proxy was repetitive for legal reasons, for liability reasons.

And somebody actually went back and ran some numbers through EDGAR and it came out to be about a third. So all that sort of encapsulates that that information, or those information delivery devices, are not providing decision-useful information to investors, and unfortunately, the SEC as well.

And this is why, also with what you had raised there, the SEC has not been acting as the arbiter that they should be, where they are being the umpire here.

So as an example, with the Whole Foods decision, Mary Jo White issued it on a Friday night and effectively abdicated the SEC's role to be able to act as the arbiter for what proposals should be going forward and not either. So the system is broken and neither side sees it working.

Mr. HILL. Thanks, Mr. Quaadman. I want to switch gears just with the time remaining, and one of the issues I have been most interested in is, can we make progress on crowdfunding?

I introduced a bill that exempts crowdfunding from the burdens of Subchapter S filing for the IRS code as a way to encourage people to use the Subchapter S technique.

I'll start with you, Mr. Knight. What problems have you identified with the SEC's final crowdfunding rule? And then we probably have time for one other person. If you would respond to that? What can we do to make it better?

Mr. KNIGHT. Obviously, because there has not been the public response that people expected, it needs to be revisited. And I just

think from the outset, the SEC's view of it was that they were not for this. And they made it, shall I say, needlessly complicated and did not approach it except as this was something where the public is going to get harmed, and we need to narrow it as much as possible.

Mr. HILL. Thanks for that.

In my time remaining, Mr. Chairman, I just would say to Mr. Hahn, I think you referenced IPRs under the patent law in your short-selling testimony.

I think, potentially, there is abusive use of IPRs. And I hope that Mr. Clayton, once he gets his team in place at the SEC, will look at this. I have heard about specific concerns in the district about that issue. So I appreciate you raising that.

And with that, I will yield back, Mr. Chairman.

Chairman HUIZENGA. The gentleman's time has expired.

And just for information, votes have just have been called.

So what I would like to do is go to Mr. Scott for his 5 minutes, and then we will need to break. And hopefully, everybody can stick around, if that is all right?

We anticipate walking off the Floor at about 3:50. And so I would ask everybody to get back here as soon as they possibly can, as a courtesy to our guests, our witnesses.

So with that, I recognize Mr. Scott for 5 minutes.

Mr. SCOTT. Thank you, Mr. Chairman, for squeezing me in before the bell. I appreciate that.

Let me ask each of you, if you could change one thing about the JOBS Act, what would it be? And as you are pondering that, do you think the JOBS Act went too far in loosening security regulations? And if so, why?

I understand that some of you certainly want to make it easier for businesses to raise capital or for entrepreneurs to start that new company, and so do I. But this is just me speculating, that is why I want to find out. Do you think we went too far with these regulations? What do we need to do with that?

Mr. Green, maybe you can start?

Mr. GREEN. If I could squeeze two in, it would be Title II, general solicitation with the exception of the crowdfunding aspects of it, and also Title V, if I remember correctly, the one that took it from 500 to 200 shareholders, because I actually think that works against our desire to have a more robust public market by making it much easier for companies to stay big and private for much longer.

Mr. SCOTT. Okay.

Mr. Hahn? What would you change?

Mr. HAHN. I think targeted bipartisan acts like the Fostering Innovation Act, is a one-size-fits-all regulation that—I appreciate some of these large companies, but I am a very small biotech. So a lot of the regulations that large companies have to adhere to, I don't think that same one-size-fits-all is appropriate for a company of my size.

Mr. SCOTT. All right.

Mr. Knight, what about you?



Mr. KNIGHT. I think extending the confidential filing and testing-the-waters provisions to all companies would be a positive development. And I don't think the JOBS Act went too far.

Mr. SCOTT. Good. That is what I wanted to hear.

Mr. Quaadman?

Mr. QUAADMAN. Mr. Scott, I agree with Mr. Knight that the JOBS Act could have removed more obstacles, but I think, more importantly, Title I was self-effectuating. The other titles in the JOBS Act were not, and that allowed a hostile SEC to either draw out the implementation of the JOBS Act, or in fact, blunt its effectiveness.

Mr. SCOTT. Mr. Keating?

Mr. KEATING. I certainly don't think that it went too far. I think I mentioned raising the amount that a company can seek in a 12-month period would be a good thing.

And one quick comment. I am on board with all of the comments that we have talked about in terms of the problems of going public versus staying private.

But when you look at Title III in particular, and what we are talking about with crowdfunding, we are talking about the decision really of, should I partake in entrepreneurship? Should I start up and build a business or not? That is a very fundamental question, and I appreciate that it was addressed in the JOBS Act.

Mr. SCOTT. Good.

Mr. Green, quickly? I have another point.

Mr. GREEN. I will just supplement by saying that one of the things that the JOBS Act doesn't do, is it doesn't do things other than deregulation. I think that deregulation has very limited, and frankly, a lot of negative implications, a very limited impacts on increasing access to capital.

We did a report of cap that looked at minority- and women-owned businesses and the challenges for them in terms of access to capital. And it is really the wealth gap. The average middle-class family saw their wealth decline by 49 percent between 2001 and 2010. And it has only recovered a little bit. We need to do other programs to boost that.

Mr. SCOTT. Right. Let me ask you this, because if you follow this committee, you know that I have been very concerned about jobs, unemployment, all of that. And while I have this brain trust before me, how do we put more emphasis on this other feature of our economy that is moving so fast, that has an impact on the joblessness rate?

What I am talking about is this rapid expansion of technology. Technology is being driven so fast that it is eliminating jobs. And I don't think we are all grabbing this as quickly as we could.

There are jobs now that we once had, we no longer have because of automation. I always use the example out there, the elevator guy or other examples. What do you think of it? Are we doing enough to call attention to that?

Mr. GREEN. One of the things that we noted was that there is a misalignment between the interests of the corporations and the public interest. And we just took the issue of workforce training, which is so essential to grappling with that.

And we found that if we increased the disclosure of workforce training and made it more like R&D, you would actually incentivize companies to invest in their workforce to be able to respond to these new, emerging technologies and changes.

And it is those types of expanded disclosures that are so important to making the economy work for everyone long-term.

Mr. SCOTT. It is so true in manufacturing now. We have the robots doing jobs that we used to do. It is thousands and thousands. Thank you, Mr. Chairman.

Mr. GREEN. Yes.

Chairman HUIZENGA. The gentleman's time has expired.

All right, with that, we will just remind everybody, we are going to go and vote and then get back here as soon as we possibly can after votes. And with that, the subcommittee is in recess.

[recess]

Chairman HUIZENGA. The subcommittee will reconvene, and I appreciate the patience of our witnesses. Thank you very much for that.

And with that, the Chair will recognize Mr. Emmer for 5 minutes.

Mr. EMMER. Thank you. Thanks to the chairman and the ranking member for having this hearing and examining the JOBS Act and how successful it has been, and things that still need to happen. I want to thank the panel for being here. And, like the chairman, thanks for your patience.

This place just never stops moving. Thank you for waiting. Very quickly, I come from the great State of Minnesota, where we still are home to 17 Fortune 500 companies, and agriculture and manufacturing drive our State's private economy.

But in Minnesota, like in other States in the union, I suspect, it is imperative that we are constantly starting new businesses, because today's big business was yesterday's startup. The Kauffman Index is a publication that comes out and ranks States based on new startups.

In 2014, in Minnesota again, a State with some very serious economic activity, we ranked number 44 on the Kauffman Index in terms of new business startups in this country. In 2015, we dropped to number 47.

In the most recent rating, we really haven't moved much. We are still in that mid to low 40s range for new business startups. And this is a State that is full of innovators and a highly educated workforce. We have many things going for us.

So what is the problem? We look around and we see that it is access to capital. It is access to capital that is so necessary to start up these new businesses.

That is why in the short time that I have, I have a couple of questions related to accessing capital and what maybe we could do to hopefully enhance what the JOBS Act started.

Mr. Quaadman, in your testimony today, you talk about the need to fix the current rules regarding crowdfunding. And to make them "workable for businesses and their investors." You, I believe mention, at least in your written testimony, Representative McHenry's legislation, as well as a bill that I offered in the last Congress,

called the Micro Offering Safe Harbor Act. It is two steps that would be in the right direction.

Can you please explain in more detail on the record today how these bills would help to provide early stage companies access to the capital they so dearly need?

Mr. QUAADMAN. Yes. Thank you, Congressman, for that question. In fact, the head of the Minnesota State Chamber is a former colleague of mine at the Chamber. He and I have spoken, so I understand the issues there.

One of the things that we have found consistently, and we have gone around the country doing different events with State and local chambers, is that there has been a disconnect between Main Street businesses and their traditional forms of financing. So they have been cut off from community banks for a variety of different reasons and other forms of financing.

And this is a point I was making with my answer to Ranking Member Maloney before is, what the JOBS Act does and I think what you are trying to do with your bill, and I think what Mr. McHenry is trying to do to make crowdfunding more efficient, is let's create different options that allow those Main Street businesses to access different alternative means of funding. And let's create some new ones, and let's see what works and what doesn't.

I think also to Mr. Himes' point, we have also asked the SEC as they are putting rules together in each of these, that they do a post-implementation study, both to check on how investor protection is working and also how the economics is working.

So I think your bill is very important. I think we need to restore that access to funding to actually get the entrepreneurial machine going again.

Mr. EMMER. And thank you for adding that on the SEC, because that was going to be one of my questions. What can the SEC do better? Why don't I move on with the short time I have left?

Mr. Keating, in your written testimony, you indicate that despite significant and positive changes created by the JOBS Act, there is still need for improvement.

And again, back to this crowdfunding, could you please describe some specific changes that you would suggest in the crowdfunding regulations? What should be implemented to maximize the ability of companies to raise capital through that process?

Mr. KEATING. Sure, and quickly, as a background to that, first off, on our Small Business Policy Index, Minnesota ranks very poorly. So there are a whole host of issues, I think, in the State in terms of taxes and regulations that need to be dealt with.

But when you look at the financing issue, community banking, earlier somebody mentioned that community banks were using the JOBS Act. That is encouraging because community banks, small banks, suffered the greatest declines since 2007.

So the large banks essentially remain steady, the number of them. The small banks is where we sort of collapse. A Federal Reserve report said that also there was an unprecedented decline in new bank entries. So we don't have that replacement going on, new banks coming into the marketplace.

Mr. EMMER. Right.

Mr. KEATING. So these are all critical issues that actually have to be dealt with on that side, but then in terms of the JOBS Act, as I said, raising the level that companies can go out and raise in Title III funding, for example, would be good.

Raising the limits that investors can put into these companies would be positive. And then, in written testimony, we listed a whole host of areas where just those costs, the tremendous—the costs are still significant to go through this process.

I think it was David Burton at the Heritage Foundation who did a study not too long ago talking about, when you look at the total cost of crowdfunding, it is a significant percentage of what you raise. And obviously the smaller you are, the greater those costs are.

So anything in terms of lightening those requirements, those regulatory burdens would go a long way to help.

Mr. EMMER. Thank you very much.

I see my time has expired, Mr. Chairman.

Chairman HUIZENGA. With that, the Chair will recognize Mr. Hollingsworth for 5 minutes.

Mr. HOLLINGSWORTH. Hi, good afternoon. Thanks so much for being here. I really appreciate all the testimony this afternoon and bearing the indulgence of a brief recess as well.

My question is for Mr. Hahn. Tell me a little bit about some of the cures you are working? What are some of the ailments you are working on to cure in business?

Mr. HAHN. I'm sorry, some of the—

Mr. HOLLINGSWORTH. Ailments, some of the illnesses, some of the challenges that you are working on cures for?

Mr. HAHN. Our lead asset is in a Phase III right now for vaso-occlusive crisis for sickle cell disease.

Mr. HOLLINGSWORTH. All right.

Mr. HAHN. Our next compound that we have brought in the clinic is for acute myeloid leukemia. We also have a trial in multiple myeloma.

Mr. HOLLINGSWORTH. Most of those are certainly words that I probably couldn't even spell, frankly. So I am glad that you are working on them and not me.

One of the big questions I continue to ask myself is, how do we get capital in the hands of people who know how to innovate and develop new products far beyond my meager comprehension?

And I think one of the things that I introduced, along with Representative Sinema across the aisle, is the Fostering Innovation Act that you had mentioned earlier today and how we enable and empower you to be able to devote more of your resources to science, as you say, and not compliance.

And so I continue to be a big champion for that innovation. Tell me a little bit about what the costs of complying with a 404(b) audit might be, both internally and as well as the check you might have to write to an accounting firm to verify that?

Mr. HAHN. First, thank you for sponsoring that Fostering Innovation Act. To comply with 404(b), we are looking at upwards of \$350,000. So our external auditors have given me a number of \$150,000 to \$200,000.

Right now, we do have an outside firm that is auditing our internal controls. Those costs would increase up to \$100,000 and up to about \$100,000 in internal costs, whether it is personnel or other internal-related costs.

When you first think about a \$350,000 to \$400,000 number, it is hard to believe at first. But if you take a step back and look, the last year our external audit fees, the last year we were private, we paid just under \$50,000. In 2016, we paid \$567,000 alone just to our external auditors.

And that goes back to an earlier comment about the cost of just being public for us is about \$1.8 million to \$2 million between the lawyers, insurance, auditors, and reporting requirements.

Mr. HOLLINGSWORTH. Right. And to the best of your understanding with regard to the Fostering Innovation Act, there is nothing in here that says, you absolutely cannot engage in a 404(b) if you, as a company, deem that it was necessary to do so.

That you wanted to lower your cost of raising equity and follow ons, et cetera, or investors pressured you to do so. You can still go through a 404(b), but it would be a business decision, not a regulator decision. Right?

Mr. HAHN. Correct. It is optional, and as with growing companies, it is what makes sense.

Mr. HOLLINGSWORTH. Right.

Mr. HAHN. Our 1231 financial statements, 95 percent of the assets on our balance sheet were cash.

Mr. HOLLINGSWORTH. Right.

Mr. HAHN. So it doesn't make sense to me to talk to investors. They want all of the money they invest to go towards the science, toward the clinical trials to get these therapies to market.

And to sit there and tell them, \$350,000 just to make sure our bank reconciliations and the cash confirmations, just to go an extra layer there, the cost-benefit ratio just doesn't make sense. Same thing, we do 125 checks a month, and the CEO and I are still the only check signers in the company.

Mr. HOLLINGSWORTH. Right.

Mr. HAHN. So we still have good controls around the cash disbursements.

Mr. HOLLINGSWORTH. Right. And certainly, biotech is a risky space. It is challenging to develop these new drugs, these new medical devices, et cetera, and so it is certainly risky and some of those companies do fail. Either the products didn't work or they were unable to get the products that they thought they would when they first raised capital.

But that doesn't mean that we shouldn't lower the regulatory burden for the many companies that are trying to succeed and bring drugs to the market. And so I certainly appreciate you being here, and I appreciate your testimony on behalf of the Fostering Innovation Act.

And with that, I yield back.

Chairman HUIZENGA. Okay. The gentleman yields back.

The Chair now recognizes the gentleman from New Jersey, Mr. MacArthur, for 5 minutes.

Mr. MACARTHUR. Thank you, Mr. Chairman. This is kind of like coming back from a rain delay in a ballgame. You have to get back

into the swing of it. I am reminding myself of a few things that we were talking about before the recess. And I just want to explore them.

Mr. Quaadman, you represent a host of different kinds of companies, different sizes, very different capital structures. And just briefly, because I only have a few moments, would you just remind us what are the reasons for and the benefits of companies using a public market capital structure?

Mr. QUAADMAN. Yes. The traditional form of businesses was to go public. That was always the goal. And the reason for that is that you can acquire or traditionally you could have acquired an amount of capital that you normally could not have. So if you are a rapidly expanding business, that allowed you to access those capital markets.

What has shifted in the last 20 years—I think there are two shifts—one is there is more of a desire to remain private, partially because of some of the rules that the SEC imposes on you. And a fear, particularly amongst founders, of losing control.

The second is that there has been a fundamental shift in mindset as well. I spoke before, a few years ago, to the top 100 entrepreneurs under 30, and I asked them the question, “Do you want to go public, remain private or be acquired?” And it broke out, a third, a third, and a third.

If I had asked that question about 10, 15 years ago, it would have been 95 wanted to go public.

Mr. MACARTHUR. Yes. And I think that has been my experience, too. I was a lifelong businessman. And as I was thinking about your four reasons why you think companies aren’t going public, they were sort of environmentally structural issues. The way the markets work, and I jotted them down.

You mentioned structural and managerial issues at the SEC, financial hurdles, the regulatory environment, the disclosure regime. It got me thinking about, I hit a tipping point in my business right around that number you mentioned, \$100 million in revenue, and I was growing rapidly, needed to grow more rapidly, needed capital. And I had to assess how to get it.

Mr. QUAADMAN. Yes.

Mr. MACARTHUR. And I wanted to go public. Actually, I was one of those 15 years ago, 90 percenters who thought that would be an interesting way to evolve the company.

I chose to go in a different direction, private equity. I know why I did. I will keep that to myself for a moment. But I am curious why you think—and Mr. Knight feel free to weigh in, too—why do you think companies are choosing, beyond the things you have already mentioned, to avoid the public markets?

Mr. QUAADMAN. Let me give you one very small example, but then you start to multiply this out, as I think one of the issues I was talking about internally, the disclosure regime, pay ratio. Right?

So Congress decides companies now have to publish a pay ratio between what the median average worker’s compensation is worldwide versus the CEO. So some people look at that, well, that is sort of an innocuous thing or whatever.

Courts have recently started holding though, that disclosures like that are really intended to embarrass companies, and they violate the First Amendment.

But now look at what is also happening. You now have jurisdictions that are passing a pay ratio tax, in Portland, Oregon. You have others that are looking at it. And you sort of look at the progression of the Soda Tax. This is where it is going.

So when you start to multiply that out by hundreds, people look at that those burdens are no longer necessary. You don't want to go through those in order to have to be public, and that is why Michael Dell decided to go private.

Mr. MACARTHUR. So it sounds like you are really saying that becoming public seems to create an opportunity for the same size company it was before, same quality, same business, serving the same customers with the same employees, being public now means it is an opportunity to have other people exercising a good deal of control and influence and—

Mr. QUADMAN. Control and influence and an injection of political agendas which have nothing to do with running the business.

Mr. MACARTHUR. Mr. Knight, just briefly, do you think we have evolved into a place where failure and bad management seems to have been criminalized?

Mr. KNIGHT. I don't think I would say criminalized. But I think the markets don't seem welcoming to entrepreneurs, the public markets. And they have alternatives in the private markets.

But look at a company like Tesla, Elon Musk. He is investing for the long term. He wants to take us to Mars. You cannot do that—

Mr. MACARTHUR. In a quarter.

Mr. KNIGHT. —in a few months or in a quarter. So the markets aren't designed today to accommodate that kind of vision. The private markets do have funding available, but the public markets won't always have it, and they are not for everyone. The private markets aren't suited, for instance, to many things in the healthcare area.

Mr. MACARTHUR. My time has expired, but that, by the way, is probably the leading reason for me. I didn't want to live under a quarterly microscope. I had plans that were going to take some years to evolve, and they did evolve.

But I thank you all for your testimony today.

Chairman HUIZENGA. The gentleman's time has expired. With the permission of our witnesses here, we are going to do a quick second round.

And I recognize Ranking Member Maloney for 5 minutes.

Mrs. MALONEY. Thank you.

First of all, I would like to thank you, Mr. Quadman, for the Chamber supporting my legislation on just disclosing the number of women who are on boards. Recently, a statue appeared in the middle of the night, in the middle of Wall Street, with a little girl demanding the same thing. And it just took off on social media with great thunder.

I would like to ask you and Mr. Knight and Mr. Green, and anyone who would like to comment, first of all, do you think the definition of accredited investor needs to be revisited?

In 1982, an accredited investor was required to have \$1 million in assets or \$200,000 in annual income. Now it is over 30 years later and it is still the same definition. Should we update that and change that?

And secondly, a common theme that we have seen in this committee's capital markets bills is promoting capital formation by eliminating or weakening investor protections. But it is important to remember that investors are the ones who contribute, and if they don't think it is fair they are not going to invest or they are going to require a higher return.

The Council of Institutional Investors is very strongly in support of the principle of one share, one vote, for public companies. They see this as particularly important. Yet as we saw earlier this month, Snap Inc., went public with shares with zero voting rights.

And could you discuss the problems with permitting lower standards for investors among public companies, particularly from a U.S. competitiveness perspective? And if anybody would like to comment on Basel III and whether you think that is fair to American companies and American banks?

Anyway, just a few ideas if you have any comments on them, I would like to hear them from anybody on the panel.

But I would start with the Chamber, Mr. Quaadman, in the district I represent.

Mr. QUAADMAN. Thank you, Ranking Member Maloney, and I also enjoyed working with you in a previous life on the 9/11 Health bill, as well.

Mrs. MALONEY. Thank you.

Mr. QUAADMAN. Let me take those three things, as well. So one is with the accredited investors, I think we need to look at the definition of accredited investors and who can be an accredited investor.

And I think Mr. Schweikert, during his time here, did a lot of thinking on that, and I think looking at the expertise of an individual is necessary to do that.

And if we take a look at where the courts have held what the investment decision-making process is, both in the TSE case, and basic in their progeny, I think that is something for us to look at.

With Basel III, Basel III creates different restrictions on our banks in that banks are no longer acting like banks. So as an example, under Basel III rules it is a disincentive for a bank to take business deposits.

That is exactly why banking in the Western world started since the Renaissance. What was the second question?

Mrs. MALONEY. The whole thing about Snap, Inc.—

Mr. QUAADMAN. Yes, what—

Mrs. MALONEY. —that it went public with zero—

Mr. QUAADMAN. —but what I would say there is we have to remember that corporate governance ultimately is an outgrowth of State corporate law. And that has allowed for a diversity of different structures and different businesses and the like.

And investors can pick and choose exactly where they want to invest. So if they don't like that class share or whatever that Snap has, they don't have to invest in that company. So I think we are



trying to drive towards a one-size-fits-all system, and that is exactly where I think the public company model is breaking down.

And if we allow for a diverse system that allows for investors to make choices, let them make those choices, and we will also have market-based solutions.

Mrs. MALONEY. Okay. Would anyone else like to comment on any of those things?

Mr. KNIGHT. I would agree with Tom, but highlight also that the flexibility in the capital structure that we allow in the United States, I think is perfectly suited for our culture and society and laws and one of our strengths, which is the ability to attract entrepreneurs to our shores, to grow entrepreneurs in the United States.

People, again like Elon Musk or Steve Jobs, and people want to invest in these entrepreneurs. So creating a capital structure where you have the choice to invest in those entrepreneurs, I think is uniquely American and something we ought to preserve. We are not forcing anyone to invest in these companies.

Mr. GREEN. If I could add a few thoughts? I am very concerned about the trend away from one share, one vote. I think there is a growing problem in this country of concentration of economic power.

We see it in insufficient antitrust enforcement. We see it in more concentration. It is the number one reason we are losing public companies is we don't have sufficient competition.

And I actually see this problem of corporate governance in terms of moving away from basic shareholder accountability. That is capitalism as being a major risk to the vibrancy of our capital markets and fundamentally to the way our capitalist system works, which is empowering shareholders and investors to make good decisions about where to allocate capital over the long run.

If I could just very briefly add two more thoughts? I would like to commend the SEC for very recently putting out proposed new Guide 3, disclosure guidance for bank holding companies. This is a very important update and Acting Chair Piwowar and Commissioner Stein have made good progress on that.

And so that is somewhat responsive to the question about Basel III. I think we need to complement our capital rules with much greater disclosure so that investors have an understanding of what our big banks are doing.

Are they investing in the real economy, in the businesses that need it? Or are they engaged in trading and other activities that, although somewhat important, are not their core function?

Mrs. MALONEY. Okay. Thank you.

Chairman HUIZENGA. The gentlelady's time has expired.

I will take my 5 minutes, and I am actually curious, Mr. Knight, if you could comment on what Mr. Green just talked about. I too am concerned about a concentration of wealth in vis-a-vis that people are not having the opportunity to catch the upside of growth.

And I think that was what your Chart 1 was exactly trying to address. It would seem to me, though, that continuing to add more additional regulation, chasing people away from an IPO is actually maybe compounding what Mr. Green was just talking about? But I will have you comment, too.

Mr. KNIGHT. Early stage, high-growth companies, ideally retail investors, can participate in the growth phase of those companies. My mother paid for my law school education by investing in a local company. That type of story doesn't happen very often today.

If you put your savings in a savings account, you will get 1 percent or 2 percent. That could be—

Chairman HUIZENGA. I would like to know where you are going to get 1 percent or 2 percent?

Mr. KNIGHT. Yes, if you are lucky.

Chairman HUIZENGA. Quantitative easing has taken care of that.

Mr. KNIGHT. But funding education today, how are people going to do it? One way to do it, of course, is by investing in early stage companies. These companies, the rules, the market structure are not attractive for them, and they have other choices. Without sacrificing investor protection, I think you can make these markets more attractive.

Chairman HUIZENGA. Yes, Mr. Green, briefly?

Mr. GREEN. If I could suggest just though that some of the innovations in the JOBS Act, like Title III crowdfunding, like Title II crowdfunding, if there are ways to make it at the very small levels available, those are exciting things that we should see if they are working out and provide greater opportunities.

But I think we also have to be very much aware that a lot of small companies fail. And given the collapse in wealth in the middle-class in this country, we just need to be very aware of that.

Chairman HUIZENGA. Sure, but that is the risk and reward of a free market.

Mr. Keating?

Mr. KEATING. Yes. I am not worried about wealth concentration. I am worried about wealth creation. And I want to see widespread wealth creation, and that is why I was so excited when the JOBS Act passed because that is another avenue for entrepreneurship to flourish.

When entrepreneurship flourishes, entrepreneurs create wealth. They create jobs. They invest in technologies. We heard about technology earlier today. Technology improves productivity. Higher productivity means higher incomes. That is the wonders of the free market.

And if we get our regulatory structure right and our tax structure right, we can unleash some great things in this country, I think, once again.

Chairman HUIZENGA. Right.

Mr. Hahn, I have a quick question for you. To the extent that XBRL tagging may be of some use to small companies, do the benefits for companies outweigh the cost at this point, and particularly for smaller public companies with fewer resources?

Mr. HAHN. We support the Small Company Disclosure Simplification Act targeting the XBRL. We spend upwards of \$75,000 a year for the XBRL that, again, the cost-benefit ratio right now for our size company, it is just not a benefit for us.

Chairman HUIZENGA. Okay. And I believe that is, was Mr. Hurt's bill from last Congress and is part of the CHOICE Act at as we are looking at it. And then I guess I will close with this in my remaining—

Mrs. MALONEY. Then may I make a last question on XBRL?

Chairman HUIZENGA. I will yield to the gentlelady.

Mrs. MALONEY. Okay.

I just want to share, the former Secretary of the Treasury, Jack Lew—the financial crisis started in America, yet we rebounded faster than the rest of the world.

And the reason he gave—I would probably give the usual, that our private sector is so innovative—was the amount of new things that not only the private sector did but government did.

We just kept trying one thing after another. And if it worked, we kept it. If it didn't, we dropped it. And he attributed that to why we came back so fast. But on XBRL, it became a debate amongst some of us on this committee that it may not be as beneficial to small companies as to large companies.

But I personally think it is extremely beneficial to small companies. And my question is, does this make sense? Investors to have to do the research to figure out where to invest, they will go to the big companies because it is out there, it is tested.

But if you had an easy way that they could access information, which is what XBRL would give you, they would be able to make a comparison between companies with innovation, ideas, which Mr. Knight, you just mentioned the one area we lead the world in from the beginning of our country is entrepreneurship.

That is the one thing that we do brilliantly and so much better than practically all the other countries combined. But it seems to me, as a small investor, to be able to compare the data that is accurate, assuming it is accurate, then you could see a trend or an idea or an innovation or a management team that was standing out.

And it seems like it would help small companies, because oftentimes investors don't have the time to read through the big investor portfolios, much less the small investor portfolios.

My friend, Mr. Hurt—whom I have missed because he retired—and I had many conversations because I would argue with him that in my opinion as a small investor, the XBRL to smaller companies would increase the flow of money going to smaller companies.

And I represent a large investment community. And they tell me that they would love that data. These angel investors are constantly looking for the next new ideas. And I would like to ask that question because this is an issue before the committee that the chairman pointed out. So would anybody like to comment?

Chairman HUIZENGA. Yes, and yes, reclaiming my time.

Mr. QUAADMAN. Sure.

Chairman HUIZENGA. Go ahead, Mr. Quaadman.

Mr. QUAADMAN. Sure.

Chairman HUIZENGA. And I think the point of my question was though, the cost. If it is costing \$75,000 a year to a small company, I understand how an angel investor would love to have standardized information at no cost to them. It is the cost to that business owner.

So maybe, Mr. Hahn, I will have you just answer that, and then we will go to Mr. Quaadman.

Mr. HAHN. I think from our company, from GlycoMimetics, a biotech company, more emphasis is put on the actual science, the actual technology, more of the scientific publications. We have ASH

in December, EHA in June. And I think most of our investors dig into the scientific aspects of it.

The angel investors aren't really the ones that we see or have conversations with. The amount of capital we need to raise on any given round, we are talking \$20 million, \$30 million, \$40 million, \$50 million. It is the large institutional investors who have the M.D.'s and the Ph.D.'s on staff, who dig in to understand the science.

So, I understand from being able to see the data, but in all of our investor meetings, it is always about the science and what does the data show, what are the risks around the data, not necessarily the overall details in all the filings.

Chairman HUIZENGA. And we are a bit over time.

A bit, but Mr. Quaadman, if you could maybe really quickly address sort of this disproportionate burden that may be hitting small businesses?

Mr. QUAADMAN. Yes. So just a short-term and a medium-range answer. I agree with Mr. Hahn. One is there is a Columbia University study showing that less than 10 percent of investors use XBRL. So in that way, it is not an effective delivery device for investors to get information.

The second is a little longer-term answer, and this actually goes to Mr. Scott's point about technological changes. Companies are looking at a blockchain for settling. If you have companies connected through a blockchain on a common electronic ledger, XBRL is out of date.

That has a real-time component for corporate disclosures and financial reporting. That is what the SEC should be looking at. So I think technology is outstripping this question actually.

Chairman HUIZENGA. Okay. And my time is well over.

But with that, I will recognize the gentleman from Ohio, Mr. Davidson, for 5 minutes.

Mr. DAVIDSON. Mr. Chairman, thank you very much, and thank you all very much for your testimony and the time that you spent here before the subcommittee. It is an honor to just participate in this dialogue.

One of the questions that I had is, with the propagation of exchanges that are out there, how is that affecting small capital, whether it is venture-backed or private companies looking to become public companies? I won't ask anything further to kind of lead the angle, but I'm just curious how you see that affecting small capital?

Mr. KNIGHT. If I could, the purpose of the statutes that created public stock exchanges is to create price discovery. With clear price discovery, you attract liquidity. When you fragment that price discovery across 11 stock exchanges and 40 dark pools, that might work for Google, for Apple in trading.

There is enough liquidity there that the price discovery process goes forward. But for a company that has a market cap of less than \$50 million, it means the price discovery process breaks down and makes it more difficult for large institutions to invest and makes the public company model less attractive.

And that is why we have said that market structure has a cost associated with it. The SEC's approach, although thoughtful, has

not kept up with the needs of the marketplace. And they take a one-size-fits-all approach.

We think there needs to be more flexibility, and that was an idea that wasn't also part of the venture market legislation that was introduced last year that we support.

Mr. DAVIDSON. Thanks. Does that speak for everyone, the same kind of observations?

Mr. GREEN. To be honest, I would have to think about it some more.

Mr. DAVIDSON. Okay. Yes, that is my main question. I think all the others have really been asked pretty extensively.

But I think one of the other key takeaways that I have on, not so much public companies, but maybe you could give some thought to it is, there is a large space between bank debt and mezz financing. And do you see anything out there that bridges that gap?

Do the market rules basically crowd that out? Are there regulations that you see as helpful to creating some gap between the cost of capital in the bank debt world? And then you have a, I don't know, 9 percent plus spread between bank debt financing and mezz financing for most markets, which is a pretty big spread?

Mr. QUAADMAN. Yes, if I can answer it, and this relates back to my answer also with Ranking Member Maloney on Basel III. A lot of the Basel III capital rules are making banks recede from giving business loans.

So therefore we are seeing alternative means of financing grow up or sort of become attractive. This is what I was mentioning before, the legislation regarding business development corporations. Making them a more active participant is something that can help fill that space.

So I think unless the capital rules start to change and the risk weights start to change under Basel III, we are going to have to look at these other alternatives means of financing to help bridge that gap.

Mr. DAVIDSON. All right, thanks.

I yield back.

Chairman HUIZENGA. Actually, will the gentleman yield to—

Mr. DAVIDSON. Yes, sir.

Chairman HUIZENGA. The ranking member has a question.

Mrs. MALONEY. Yes. I am incredibly interested in Basel III and I will ask the chairman if he would have a hearing on it.

I hear from some banks that they feel like it is imposed on them but it is not imposed on other banks around the world. In other words, we have very tough regulation. I think that is one of the reasons people like to invest in our markets. They trust them more.

But on the other hand, they feel like they are held to a higher standard with capital requirements that put them at a disadvantage. But I am fascinated with the fact that Basel III is discouraging two of the main functions that the banking systems was created for: taking deposits; and making business loans.

And now I understand for the first time why some of my constituents, who are extremely profitable, can't get business loans. So this is really bad. If we want to talk about getting capital out for entrepreneurs and businesses, it is figuring out why in the world would Basel III discourage business loans?

It makes no sense. That was the main reason for banks to get out and help start financing homes and financing businesses. So could you comment on that? I am shocked at this.

Mr. QUAADMAN. What Basel III does is it—it is looked at in two different ways. Remember, it is supposed to be an international standard. However, European banking regulators look at it as a ceiling. American banking regulators look at it as a floor. So traditionally, American banking regulators make it very tough.

The other thing it does is it creates an incredibly complex and intricate set of risk weights that investors don't understand what they are looking at.

And then what that does is it creates perverse sets of incentives and disincentives for activities for banks to undertake. And frankly, you get to a point where some banks, some of the larger banks have global presence and can work around those rules and adjust their activities accordingly.

But when you start to get into the regional banks, including the Dodd-Frank systemic risk thresholds, they suddenly have to start to recede from activities where they are in fact the primary liquidity provider for regions in the country. So that is what has caused this disconnection between financing and Main Street businesses.

Mrs. MALONEY. What I don't understand is if you are a regional bank and a community bank, why are you being held to international banking standards, because they are not involved in international banking?

Mr. QUAADMAN. That is a question we have asked as well.

Chairman HUIZENGA. Yes. And one we will continue to ask. I appreciate our witnesses being here today. I feel we had a great hearing.

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.

And with that, again, thank you gentlemen for your time and your patience as we had to break. And our hearing is adjourned.

[Whereupon, at 4:34 p.m., the hearing was adjourned.]

## **A P P E N D I X**

March 22, 2017

**The JOBS Act at Five:  
Examining Its Impact and Ensuring the Competitiveness of the U.S. Capital Markets**

Testimony before the U.S. House of Representatives  
Subcommittee on Capital Markets, Securities and Investment

**Andy Green**  
Managing Director of Economic Policy  
Center for American Progress

**Wednesday, March 22, 2017**

Thank you, Chairman Huizenga and Ranking Member Maloney, for the opportunity to testify on this important topic. I am the Managing Director of Economic Policy at the Center for American Progress, where I help lead our research on financial markets. Today, I aim to offer an evaluation of the JOBS Act at five years, as well as some constructive suggestions on how to improve and expand entrepreneurial opportunity.

***The Impact of the JOBS Act Has Been Mixed At Best, Although Many Results Are Not Yet In***

Five years out from enactment, it is worth taking a moment to recall the context of its passage. On April 5, 2012, House Majority Leader Eric Cantor joined President Barack Obama for a Rose Garden signing ceremony to celebrate the passage of the Jumpstart Our Business Startups (JOBS) Act of 2012.<sup>1</sup> Championed by its advocates as releasing start-ups and small businesses from certain constraints of the federal securities laws, it pulled together a collection of ideas that made it easier for companies to raise money. Some ideas, such as Title I's "IPO On-Ramp" and Title IV's "Regulation A+" focused on loosening the rules, respectively, for large and small initial public offerings (IPO). Other ideas, such as Title II's elimination of the ban on general solicitation (i.e., public advertising) in private offerings and Title V's dramatic raising of

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<sup>1</sup> 112<sup>th</sup> Congress, H.R. 3606, now codified as Public Law 112-106, 126 Stat. 306, available at <https://www.gpo.gov/fdsys/pkg/PLAW-112publ106/content-detail.html>.



the cap on the number of shareholders of record for companies that remained private, focused on making it easier for a company to stay private longer, and not go public. Title III is an innovative new hybrid approach that seeks to “democratize” access to capital, deploying the transparency of the Internet to enable ordinary retail investors to put small amounts of money in higher risk start-ups and small businesses. Ultimately, what tied the JOBS Act together was a desire to increase the amount of capital flowing to small business and start-ups, and thus boost U.S. employment and growth prospects, which in 2012 were still suffering from the lingering effects of the financial crisis and Great Recession. That is a worthy goal, and many of the ideas in the JOBS Act reflect some attempt to address certain on-going issues in the capital markets.

However, the JOBS Act had its critics. They saw it as an exercise in deregulation that would not yield many of its desired results – especially the goal of more initial public offerings – while exposing senior citizens and ordinary mom-and-pop investors to an array of fraud, conflicted research, and high-risk investments they would be ill-prepared to manage effectively.<sup>2</sup> These critics contended that simply loosening the securities laws would not lead to more successful small business creation and growth, and that other tools were better equipped to address those needs. Notably, this legislative debate play out only two years after the passage of the largest effort to re-regulate Wall Street in 80 years, which as of today still has not been fully implemented by the Securities and Exchange Commission (SEC).

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<sup>2</sup> The Editorial Board, “They Have Very Short Memories,” *The New York Times*, March 10, 2012, available at <http://www.nytimes.com/2012/03/11/opinion/sunday/washington-has-a-very-short-memory.html>; Consumer Federation of America, “Statement of CFA Director of Investor Protection Barbara Roper in Response to House Passage of Anti-Investor, Anti-Jobs JOBS Act,” March 8, 2012, available at [http://consumerfed.org/press\\_release/statement-of-cfa-director-of-investor-protection-barbara-roper-in-response-to-house-passage-of-anti-investor-anti-jobs-jobs-act/](http://consumerfed.org/press_release/statement-of-cfa-director-of-investor-protection-barbara-roper-in-response-to-house-passage-of-anti-investor-anti-jobs-jobs-act/); Shepherd Smith Edwards and Kantas LTD LLP, “Will the JOBS ACT Expand Private Offerings But Hurt Public Markets?”, July 6, 2012, available at [https://www.institutionalinvestorsecuritiesblog.com/2012/07/will\\_the\\_jobs\\_act\\_will\\_expand.html](https://www.institutionalinvestorsecuritiesblog.com/2012/07/will_the_jobs_act_will_expand.html)

So who was right? To date, the record appears mixed. And while the preliminary data suggests that the critics are in the lead, with so many rules only operational for a year or so it is still too early to draw an overall conclusion.

***Regulation is Not the Problem: To Improve the Public Markets, Focus on Structural Issues Such as Competition***

One of the principal goals of the JOBS Act was to increase IPOs. Advocates for IPOs argue that they bring outsized benefits, including greater job creation for the economy and benefits to investors such as better oversight and accountability and greater secondary market liquidity. On the IPO front, the record of the JOBS Act is mixed at best.

For better or worse, the IPO market is now dominated by companies going public under the lighter “emerging growth company” (EGC) standards of Title I of the JOBS Act. A full 87 percent of all IPOs since the JOBS Act was enacted occurred under these lighter EGC standards.<sup>3</sup> Being an “Emerging Growth Company” has nothing to do with being exciting or innovative; it is just a regulatory label. As of mid-2016, there were 2,259 EGC filers, of which 312 were inactive, and a full 8 percent of filers are simply blank check companies.<sup>4</sup> 47 percent of EGC filers by assets, as of mid-2016, were real estate investment trusts, state and federally-chartered commercial and savings banks, and pharmaceutical preparations.<sup>5</sup> These percentages are smaller when listed by revenue or number of filers, but the point is still the same: EGC is a regulatory

<sup>3</sup> EY, “Update on Emerging Growth Companies and the JOBS Act,” November 2016, available at [http://www.ey.com/Publication/vwLUAssets/ey-update-on-emerging-growth-companies-and-the-jobs-act-november-2016/\\$FILE/ey-update-on-emerging-growth-companies-and-the-jobs-act-november-2016.pdf](http://www.ey.com/Publication/vwLUAssets/ey-update-on-emerging-growth-companies-and-the-jobs-act-november-2016/$FILE/ey-update-on-emerging-growth-companies-and-the-jobs-act-november-2016.pdf).

<sup>4</sup> Kevin Murphy et al, “White Paper on Characteristics of Emerging Growth Companies as of May 15, 2016,” Staff Paper, Public Company Accounting Oversight Board, 12, available at <https://pcaobus.org/EconomicAndRiskAnalysis/ORADocuments/White-Paper-on-Characteristics-of-Emerging-Growth-Companies-May-2016.pdf>.

<sup>5</sup> Id.

label indicating lighter standards for listing; it is not a statement, one way or another, about the kind of company going public.

In fact, EGC companies tend to be lower in quality from a listing and investment perspective. Out of the 65 percent of active EGC filers that provided a management report on internal controls (which became a permissive requirement under the JOBS Act until *after* filing one annual report), a whopping 46 percent reported material weaknesses in controls.<sup>6</sup> Exchange-listed EGCs reported material weaknesses at only 12 percent, but that was still *twice* the rate of non-EGC exchange-listed filers. This suggests that the JOBS Act provisions eliminating Sarbanes-Oxley auditor attestation for EGCs is having a negative impact on offering quality.

Nor has profitability or operating efficiency made up for these investor protection risks. One study recently found that the financial performance of EGC companies is significantly worse than comparable firms, with on average a 21.8 percent lower return on assets and 3 percent lower stock performance.<sup>7</sup>

Capital formation for companies and market liquidity for their stock also appears negatively affected. One study found that EGCs experienced 7 percent more underpricing than similarly sized companies prior to the JOBS Act.<sup>8</sup> Investors are demanding a bigger bump to accept the risks of what they do not know about companies, meaning less money going to job creation and company growth. Non-EGC experienced 13 percent less underpricing than EGCs.

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<sup>6</sup> Id at 13.

<sup>7</sup> Kai Lu, "The JOBS Act and Post IPO Performance of EGC Firms," Wash. Univ. Olin Business School, Feb. 1, 2017, 20, available at <https://ssrn.com/abstract=2927722>.

<sup>8</sup> Sudip Gupta and Ryan D. Israelsen, "Indirect Costs of the JOBS Act: Disclosures, Information Asymmetry, and Post-IPO Liquidity," Kelley School of Business Research Paper No. 2014-34, Aug. 29, 2014, 3, available at [https://papers.ssrn.com/sol3/Papers.cfm?abstract\\_id=2473509](https://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2473509).

The study also found reduced market liquidity in the form of higher spreads for EGC companies.<sup>9</sup>

Another study was more positive about the JOBS Act's effects, finding on a preliminary basis a 25 percent increase in IPO volume over 2001-2011 levels.<sup>10</sup> By analyzing which provisions firms took advantage of, the study also concluded that the most helpful provisions were the confidentiality and "test-the-waters" provisions that "de-risked" the offering in terms of its outward facing communications that enabled it to more carefully control its reception in the marketplace.<sup>11</sup> In contrast, the "de-burdening" provisions, such as the opt-outs of accounting rule changes, auditor attestation, say-on-pay, reduced compensation disclosure, and future PCAOB rule changes, were not meaningful.<sup>12</sup> This is an important conclusion because it shows that most of the provisions that reduced investor protection were not important in terms of increasing IPO availability.

Overall, the study concluded that firms in biotech and pharma tended to benefit most than other companies, noting a 307 percent increase in those IPOs as of March 2014. The study questioned whether these companies would have staying power since one of the notable value-maximization strategies in this sector, which is dominated by research life cycles, is to conduct an IPO before being acquired by another firm.<sup>13</sup> The study also found limited evidence of improved analyst coverage despite the reductions in investor protections from conflicts of interest.<sup>14</sup>

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<sup>9</sup> Id. at 5.

<sup>10</sup> Michael Dambra, Laura Casares Field, Matthew Gustafson, "The JOBS Act and IPO Volume: Evidence that Disclosure Costs Affect the IPO decision," 21, available at: <http://ssrn.com/abstract=2459591>.

<sup>11</sup> Id. at 25.

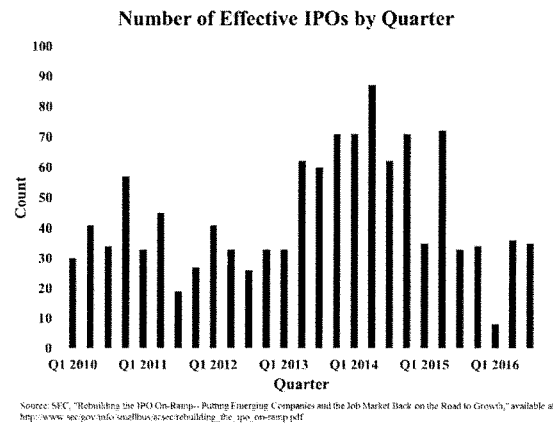
<sup>12</sup> Id. at 24.

<sup>13</sup> Id. at 25.

<sup>14</sup> Id.

The authors noted that the study may not fully reflect the underlying dynamics of overall market conditions, potentially overstating or understating the results. Indeed, as depicted in Figure 1, the increase in IPO activity immediately after the JOBS Act was enacted subsequently gave way in 2015 and 2016 to the lowest level of IPOs since the Great Recession. This may be market clearing behavior, or it may give weight to the principle that many factors influence the IPO market and that compliance requirements on companies are of lesser influential.<sup>15</sup>

Figure 1: Number of Effective IPOs by Quarter



<sup>15</sup> Jay Ritter et al., "A Review of IPO Activity, Pricing, and Allocations", Working Paper 8805, *The National Bureau of Economic Research*, available at <http://www.nber.org/papers/w8805.pdf>; Jay Ritter, "The Long-Run Performance of Initial Public Offerings," *Journal of Finance*, Volume 46, Issue 1 (March 1991), 3-27, available at [http://www.kellogg.northwestern.edu/researchcomputing/workshops/papers/ritter\\_jf1991.pdf](http://www.kellogg.northwestern.edu/researchcomputing/workshops/papers/ritter_jf1991.pdf).

The question then is whether the lighter compliance requirements of Title I still make sense. Confidential filings and “test the waters” provisions seem to be the most useful, and also least harmful, and so are worth keeping for now. The other “de-burdening” provisions of Title I both less impact on IPO volume and raise more serious investor protection concerns. For example, allowing an IPO with only two years of financial statements represents a 33 percent reduction in core financial disclosure and a departure from comparable jurisdictions internationally. Permitting the types of conflicts of interest between research analysts and investment banking that characterized the frauds of the “Dot Com” era also seems troubling. As noted above, the provisions that eliminate auditor attestation have had a demonstrably negative impact on the reliability of a company’s internal controls.

Given the dramatic decline in IPOs in 2016 and the limited positive impact of deregulation, if Congress wishes to boost the viability of the public markets, it must clearly turn its attention to other factors. One factor to consider is the impact of the JOBS Act itself, as the provisions of Title II and Title V work at cross purposes with Title I’s goal of boosting IPOs. Those titles, respectively, permitted public advertising for non-public companies and dramatically loosened the requirement for a company to go public when it hits a certain growth level determined by the number of shareholders. Data in this area is limited, but anecdotal evidence dating back to the passage of the JOBS Act itself is that companies are staying private longer.<sup>16</sup> Moreover, as discussed below, the nearly doubling in the size of the private market

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<sup>16</sup> Jamie Hutchinson, “Why Are More Companies Staying Private?” February 15, 2017, available at <https://www.sec.gov/info/smallbus/acsec/hutchinson-goodwin-presentation-acsec-021517.pdf>; Begum Erdogan, Rishi Kant, Allen Miller, and Kara Sprague, “Grow Fast or Die Slow: Why Unicorns Are Staying Private” (McKinsey, 2016), available at <http://www.mckinsey.com/industries/high-tech/our-insights/grow-fast-or-die-slow-why-unicorns-are-staying-private>.

(offerings under Rule 506(b) of Regulation D) indicates that the private markets are making large amounts of capital available as needed.

In addition, greater attention should be paid to the role of mergers and acquisitions (M&A) in the health of the public capital markets. According to a notable study, M&A is now the biggest reason for the marked decline in public listings in the U.S.<sup>17</sup> The study rejects a number of the usually cited reasons – the level of regulatory standards, reduced investment bank analyst coverage or trading, economies of scale – and instead points to reduced antitrust enforcement and resulting greater market concentration as causes.<sup>18</sup> Ask any entrepreneur in Silicon Valley and he or she will tell you that M&A is the most prominent exit strategy for start-ups in recent years.

In this context, market concentration impacts the capital markets in at least two ways. First, if large firms can extract above-market rents owing to their size, market dominance, or other reasons, they may be able to share those rents with founders through M&A, making the M&A exit more attractive than doing the hard work of growing a successful stand-alone company. At the same time, if markets are not sufficiently competitive, founders may increasingly believe that they have little real chance to compete against the largest firms, and so sell out through M&A rather than compete on their own.

With growing evidence of market concentration across the economy, it is worth asking the question whether the 30-year trend towards permissive enforcement of antitrust laws and

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<sup>17</sup>Craig Doige, G. Andrew Karolyi, and Rene M. Stulz, “The U.S. Listing Gap,” July 2015, available at [https://www8.gsb.columbia.edu/faculty-research/sites/faculty-research/files/finance/Finance%20Seminar/Fall%202015/Doige\\_Karolyi\\_Stulz\\_Listing\\_Gap\\_July2015.pdf](https://www8.gsb.columbia.edu/faculty-research/sites/faculty-research/files/finance/Finance%20Seminar/Fall%202015/Doige_Karolyi_Stulz_Listing_Gap_July2015.pdf).

<sup>18</sup> Doige, 4-6; on antitrust also citing to Gustavo Grullon, Yelena Larkin and Roni Michaely, “The Disappearance of Public Firms and the Changing Nature of U.S. Industries,” 2015, Working Paper, Rice University.

other factors leading to market consolidation are hampering the ability or willingness of companies to become and remain independent public companies.<sup>19</sup> Much of the focus should rightly be placed on the antitrust agencies, and additional enforcement can make a real difference by deterring anti-competitive deals.<sup>20</sup>

The SEC too has a role to play. The Exchange Act section 23(a) mandates the SEC consider competition as part of its rulemakings, and directives to promote competition are sprinkled throughout the federal securities laws.<sup>21</sup> Competition mandates have generally lay dormant or interpreted narrowly for years. Competition is about more than simply lowering costs, and it may be time to rediscover them and apply them more broadly. The SEC shouldn't be in the business of duplicating the work of the antitrust agencies, but it does have a unique role to play in boosting transparency across the market. And, it may be appropriate to consider other steps in areas under its control to tilt the playing field away from concentrated private markets and towards competitive public markets. I do not have specific recommendations to offer today, but this is a topic that I encourage us all to do more thinking about. Overall, it is important for Congress to remember that the health of the capital markets is intimately connected to the vibrancy of competition in our industrial landscape.

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<sup>19</sup> Marc Jarsulic, Ethan Gurwitz, Kate Bahn, and Andy Green, "Reviving Antitrust: Why Our Economy Needs a Progressive Competition Policy" (Center for American Progress, 2016), available at <https://cdn.americanprogress.org/wp-content/uploads/2016/06/28143212/RevivingAntitrust.pdf>.

<sup>20</sup> See, e.g., Joseph Clougherty, Tomaso Duso, Miyu Lee, and Jo Seldeslachts, "Effective European Antitrust: Does EC Merger Policy Generate Deterrence?", DIW Berlin Discussion Paper 1523, 2015, available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2695314](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2695314), finding that immediate actions on mergers generated "robust deterrence," reducing merger notifications in years following.

<sup>21</sup> Securities and Exchange Act of 1934 as amended, section 23(a) and other provisions.



***The Small Business Access to Capital Impact Has Been Mixed, and Risks to Investors Remain: A New Focus on the Wealth, Skills, and Network Gaps Is Needed***

After boosting the number of IPOs, the second major promise of the JOBS Act was that it would increase access to capital for start-ups and small businesses. However, those two groups of companies tend to access capital differently. Start-ups in growth sectors tend to raise money – at first from friends and family, and perhaps angel investors – with an eye towards future fundraising rounds and a market exit of some sort. Here, think of the computer software designer who has an idea. She will probably think about the securities laws and their implications from an early stage, and if she has a network of wealthy backers, may use the capital markets from day one.

Ordinary small businesses raise money from friends and family, credit cards, the equity in the entrepreneur's own home, and perhaps a loan from a community development financial institution (CDFI). Here, think of a young man starting a small vegan bakery that he aims to operate on a popular street. As he develops a track record, he might get funded through an SBA-guaranteed bank loan too. As a community-focused enterprise, the bakery's initial foray into the capital markets may take the form of a local or regional offering, as opposed to national offering. If successful, the bakery might morph into a vegan baked-goods manufacturer, where national capital markets funding may become relevant.

The JOBS Act aimed to have an impact on both forms of capital-raising. Title II made it easier for the software designer to instead tap an audience beyond her limited angel network. For example, Title II's crowdfunding provisions facilitates accredited investors to come together online. Although data is limited, this appears to be one of the more successful parts of Title II.

The main thrust of Title II, which enabled public advertising for these private deals, is much more problematic in scope. Most companies are not taking advantage of this route and instead are sticking to tried and true way of soliciting private investors. But to the extent that some of the less scrupulous actors are already taking to the airwaves – which it appears they are – this channel for capital raising becomes a venue for fraud.

Expanded general solicitation for private offerings has unfortunate implications all around. Not only are senior citizens, immigrant communities, and plain ordinary people at greater risk of falling victim to securities fraud, but if the public comes to associate general solicitation for private securities offerings with fraud, it may undermine their confidence as investors across the board. A recent study on investment fraud vulnerability by the AARP also yielded striking results, with implications for the risks associated with general solicitation. For example, investment fraud victims were more likely to agree that “The most profitable financial returns are often found in investments that are not regulated by the government.”<sup>22</sup> And almost six out of ten victims received at least one telephone call each month selling securities, nearly twice the level of non-fraud victims. Victims also tended to be older, male, married, and veterans (at varying rates.) A lot more study is needed to understand where investment fraud vulnerabilities lie and what more can be done to protect against acts that rob the elderly and others of their hard-earned savings.

It is also clear that SEC resources are simply not sufficient to monitor and crack down on these small-scale offerings after the fact. That is why moving towards stricter enforcement of the filing requirement of Form D with the SEC and the state securities regulators and a strong

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<sup>22</sup> Doug Shadel and Karla Pak, “AARP Investment Fraud Vulnerability Study,” AARP, 2017, 5-6, available at <http://www.aarp.org/research/topics/economics/info-2017/investment-fraud-survey.html>.

approach to “bad actor” disqualification, along with FINRA’s supervision of the broker-dealer marketplace, are more important than ever.<sup>23</sup> To the extent that general solicitation seeks to make private offerings look more like public offerings, the only reasonable solution to protect the public is to make investors protections look more like those in public offerings.

Unfortunately, the SEC has not made progress on advancing proposed new investor protections for Rule 506(c) offerings.<sup>24</sup> At a minimum, the SEC should carefully monitor the market and continue to make data available so we can all evaluate the results.

The JOBS Act offered other avenues to make it easier for start-ups and small businesses to raise capital. As staff to the Senate’s lead author on what became Title III crowdfunding, I believe crowdfunding is one of the most interesting of these paths. Crowdfunding fills a somewhat in-between niche. It will never be a true alternative to angel or venture capital for start-ups with high growth potential, if for no other reason than that by its very nature it requires disclosure to the public of the venture’s “big idea.” But for some ideas it may make sense. Perhaps the entrepreneur lives far away from Silicon Valley or Silicon Alley, or the idea is focused on serving a local community. Crowdfunding may then offer a genuinely valuable way to expand the pool of capital available for worthy projects. The rules were only fully operational about nine months ago and take-up appears to be growing.<sup>25</sup> One of the biggest challenges is a lack of awareness by small businesses and investors. Educating small business attorneys,

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<sup>23</sup> On this topic, see also Commissioner Kara M. Stein, “Remarks before The North American Securities Administrators Association 2014 Public Policy Conference,” April 8, 2014, available at <https://www.sec.gov/news/speech/2014-spch040814kms>.

<sup>24</sup> See Securities and Exchange Commission, Proposed Rule, Amendments to Regulation D, Form D and Rule 156, Release No. 33-9416, July 10, 2013, available at <https://www.sec.gov/rules/proposed/2013/33-9416.pdf>.

<sup>25</sup> See Crowdfunding Indices, Crowdfunding Capital Advisors, available at <http://crowdfundcapitaladvisors.com/cca-regulation-crowdfunding-indices/>.

accountants and entrepreneurs, as well as investors, of both the availability of and how to properly use this opportunity should be a priority.

One of the critiques of Title III crowdfunding is cost. However, costs to issuers are only one part of the equation. Across the federal securities laws, we only place requirements on issuers because they benefit investors and promote the public interest, which are critical to having any market at all. Costs could be zero, but if investors do not show up, no capital will be raised at all. Congress decided that it was worthwhile to invest, so to speak, upfront in building investor confidence in this market. Small companies do fail at a high rate even when their founders have the best of intentions.

Costs are also not set in statute. I believe it is worth seeing whether the market itself, through innovative technologies or simply through scale, can help bring those costs down over time. I have seen firsthand how a range of new, eager service providers offering smart technologies to make Title III much more cost-efficient. In addition, the SEC was smart to build into its rule a review period to look back at whether it struck the right balance. To support that lookback, the SEC should deploy its new investor testing tools that the Office of the Investor Advocate has been pioneering.<sup>26</sup> A better appreciation of what works effectively for retail investors could help refine this and other markets.

Some have argued that cost is a function of the offering size. To that end, it is worth noting that approximately 30 percent of Rule 506 offerings are \$1 million or less, and \$1 million is the median offering size for non-financial issuers. It is thus perfectly reasonable to have set

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<sup>26</sup> See Rick A. Fleming, Investor Advocate, U.S. Securities and Exchange Commission, "Improving Investor Engagement: The SEC Speaks in 2017," Feb. 24, 2017, available at <https://www.sec.gov/news/speech/fleming-improving-investor-engagement.html>.

the Title III crowdfunding cap there.<sup>27</sup> Higher levels appear to largely serve the interests of those that seek to use crowdfunding for real estate investment, rather than small business start-ups. We should be open to re-evaluating this approach, though, as additional data becomes available.

The SEC can also watch the natural experiments occurring through the several new channels it has opened to permit crowdfunding via Regulation A+ and through rules overseen by the states, specifically Rule 147, new Rule 147A, and updated Rule 504. One note of caution, though. The SEC should guard against investor confusion, should problems that occur in one market taint the reputation for crowdfunding under other rules. Ultimately, it is also important to remember that there is a high risk of fraud, as well as plain old loss in these types of investments.<sup>28</sup> While we all hope these new markets can succeed, we should take a clear-eyed, objective approach to whether they are or not. We should not permit them simply to linger on and become problems.<sup>29</sup>

Before wrapping up our analysis, however, I would like to consider the relationship between the JOBS Act and its baseline goal of expanding access to capital for startups and small businesses. As Figure 2 below shows, the amount of capital raised under Regulation D, the primary private offering channel, *doubled* between 2009 (\$595 billion) and 2014 (\$1.3 trillion).

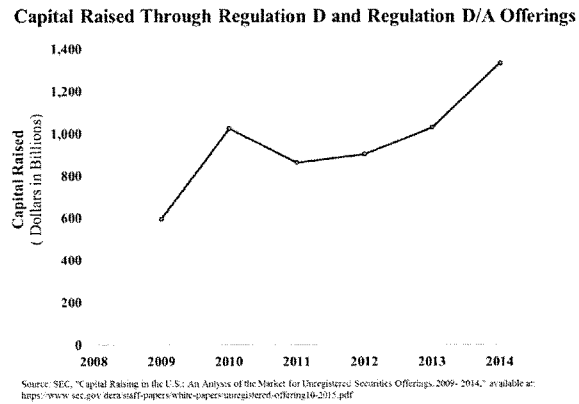
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<sup>27</sup> Scott Bauguess, Rachita Gullapalli, and Vladimir Ivanov, "Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2014," Securities and Exchange Commission Staff White Paper, Oct. 29, 2015, 15, 24, available at [https://www.sec.gov/dera/staff-papers/white-papers/30oct15\\_white\\_unregistered\\_offering.html](https://www.sec.gov/dera/staff-papers/white-papers/30oct15_white_unregistered_offering.html).

<sup>28</sup> Nathaniel Popper, "Doubts Arise as Investors Flock to Crowdfunded Start-Ups," *The New York Times*, January 24, 2017, accessed at: <https://mobile.nytimes.com/2017/01/24/business/dealbook/crowdfunding-fraud-investing-startups.html?ref=dealbook&r=0&referer>.

<sup>29</sup> See, e.g., Joshua White, "Outcomes from Investing in OTC Stocks," Securities and Exchange Commission Staff White Paper, December 16, 2016, available at [https://www.sec.gov/dera/staff-papers/white-papers/16dec16\\_white\\_outcomes-of-investing-in-otc-stocks.html](https://www.sec.gov/dera/staff-papers/white-papers/16dec16_white_outcomes-of-investing-in-otc-stocks.html); see also Commissioner Luis A. Aguilar, Securities and Exchange Commission, "Addressing Known Risks to Better Protect Investors: SEC Speaks," Feb. 21, 2014, available at <https://www.sec.gov/news/speech/2014-spch020421aa>.

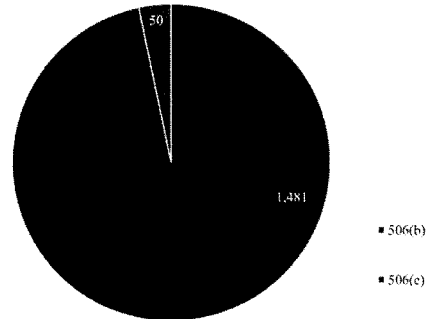
Figure 2: Capital Raised Through Regulation D and Regulation D/A Offerings



The overwhelming majority of that occurred under the old Rule 506(b). See Figure 3 below. This suggests that the old tools for capital raising were sufficient to support a very large expansion of investor and company demand.

Figure 3: Capital Raised Through Regulation D

**Capital Raised Through Regulation D: 506 (b) and 506 (C)**  
September 2013- December 2015 (\$ Billions)



Source: Scott Bauguess, "Private Securities Offerings Post JOBS Act," Securities and Exchange Commission, February 25, 2016, available at: <http://www.sec.gov/info/smallbus/secs/private-securities-offerings-post-jobs-act-bauguess-022516.pdf>

This is not to say that access to capital is ubiquitous or equitable. A recent Center for American Progress report, "[A Progressive Agenda for Inclusive and Diverse Entrepreneurship](#)" found that even at the same levels of education, income, and wealth African American households, Hispanic households, and single female-headed households had lower rates of business ownership. The report found that (1) African American households are 5 percent less likely to own a business than white households, even at the same levels of education, income, and wealth; (2) Hispanic households are 6.7 percent less likely to own a business than white households, even at the same levels of education, income, and wealth; and (3) business ownership is also much lower among single women headed households, indeed 3.9 percent less likely than among single men. The report identified several interrelated challenges underlying these disparities: wealth, skills, and network gaps. None of them are amenable to a deregulatory

solution. Instead, CAP encourages policymakers to adopt innovative, targeted policies such as the State Small Business Credit Initiative (SSBCI), which supports a wide range of credit enhancement initiatives run by state small business development programs. With bipartisan support at both the federal and state level, SSBCI succeeded at leveraging \$1.5 billion in federal dollars yielding \$15 billion in economic activity. It currently pending reauthorization.<sup>30</sup>

Public investments in apprenticeships, entrepreneurship training and education among young people, local “one stop shops”, and Self-Employment Assistance Programs (SEAPs) all will yield dividends at closing the wealth, skills, and network gaps that are the real barrier to access to capital for would-be entrepreneurs. Broader “middle out” policies that ensure small business customer demand are also extremely important to small businesses success and the ability for the next generation of entrepreneurs to thrive.

***Conclusion: We Need to Rebuild Middle Class Economic Security and Restore Trust in Public and Private Institutions***

The JOBS Act had noble purposes: boosting IPOs and helping small businesses and start-ups thrive. No one argues with those goals. As this testimony suggests, the toolkit that the JOBS Act deployed has, however, yielded mixed results for companies and poses new challenges for investors and the public. Some of the tools, such as crowdfunding, offer genuine potential, and we should monitor them over the next two to three years, evaluate the results, and then make tweaks as needed. I have offered at several places above various suggestions for how Congress and the SEC can improve our capital markets so that they can better achieve to the goals found in the JOBS Act. And, I have offered additional suggestions for policies, such as

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<sup>30</sup> U.S. Department of the Treasury, “State Small Business Credit Initiative (SSBCI),” October 27, 2016, available at <https://www.treasury.gov/resource-center/sb-programs/Pages/ssbci.aspx>.



enhanced antitrust enforcement, and programs, such as SSBCI and small business training programs, that can help enhance the dynamism and equity of our economy and its ability to sustainably support – and in some cases, re build – the long-term health of American middle class.

In the end, let's not forget what we have been through. Between 2001 and 2010, the average middle class household in America saw its real wealth collapse by 49 percent.<sup>31</sup> And while it rebounded under President Obama by 16 percent to 2013 and under the growing Obama economy more since, ordinary American families were hit extraordinarily hard by the 2008 Financial Crisis and Great Recession, as well as policies that concentrated and hollowed out our manufacturing industries.<sup>32</sup> Family budgets are still squeezed by the high costs of big-ticket items such as child-care and college, and the opportunities to save for retirement are slim to none. Health care progress is under threat. And what's more, trust in American institutions overall, including business, is at deep lows. A succession of post-Financial Crisis scandals has left Wall Street's reputation more tarnished than ever. While the inability of prosecutors or regulators to fully hold culprits accountable or bar bad actors from markets going forward leaves the public deeply distrustful of the effectiveness of government, business, and markets generally.

The solution is not to keep doing what has been done before. Rather than seeking to handcuff the SEC with even more "regulatory reform" burdens, eliminate the government's ability to bar "bad actor" institutions, and let dealer-banks get back in the business of betting against customers – all of which seem to be on the table in this Congress – it is time to develop

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<sup>31</sup> Carmel Martin, Andy Green, and Brendan Duke, eds. "Raising Wages and Rebuilding Wealth: A Roadmap for Middle Class Economic Security, (Center for American Progress, 2015), 2, available at <https://www.americanprogress.org/issues/economy/reports/2016/09/08/143585/raising-wages-and-rebuilding-wealth/>.

<sup>32</sup> *Id.* at 3.

strong approaches that ensure the financial markets accomplish their critical mission of supplying capital to competitive businesses in a fair and efficient manner while protecting investors, consumers, and the taxpaying public.



**Brian Hahn**

**Chief Financial Officer, GlycoMimetics, Inc.**

On behalf of the Biotechnology Innovation Organization

Before the United States House of Representatives Committee on Financial Services,  
Subcommittee on Capital Markets, Securities, and Investment

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*The JOBS Act at Five:*

*Examining Its Impact and Ensuring the Competitiveness of the U.S. Capital Markets*

*March 22, 2017*

**Executive Summary**

- GlycoMimetics is a clinical-stage biotechnology company based in Rockville, Maryland. The Biotechnology Innovation Organization (BIO) represents GlycoMimetics and 1,100 other innovative biotech companies, the vast majority of which are pre-revenue small businesses.
- GlycoMimetics undertook a successful IPO in January 2014 using key provisions in the Jumpstart Our Business Startups (JOBS) Act. In the five years since the JOBS Act became law, 212 biotech companies have gone public as emerging growth companies (EGCs).
- The next generation of medical advances is being funded by capital raised through JOBS Act IPOs. JOBS Act biotechs have 696 therapies currently in development, and the FDA has approved 18 new treatments from JOBS Act companies.
- The JOBS Act has supported IPOs from companies across a wide range of therapeutic areas and stages of development. Notably, the law has led to increased funding for early-stage research and certain disease areas that have historically been difficult to finance.
- BIO supports policies to build on the success of the JOBS Act that *increase* the flow of capital to innovative small businesses and *decrease* capital diversions from the lab to unnecessary compliance burdens.
- BIO supports the Fostering Innovation Act, which would extend the JOBS Act's Sarbanes-Oxley (SOX) Section 404(b) exemption for an additional five years for former EGCs that maintain a public float below \$700 million and average annual revenues below \$50 million.
- BIO supports the Corporate Governance Reform and Transparency Act, which would provide for SEC oversight of proxy advisory firms and foster accountability, transparency, responsiveness, and competition in the proxy advisory firm industry.
- BIO supports targeted capital formation provisions in the Financial CHOICE Act, including the Fostering Innovation Act, the Corporate Governance Reform and Transparency Act, the Small Company Disclosure Simplification Act, the Small Business Capital Formation Enhancement Act, and the proposed Small Issuer Exemption from Internal Control Evaluation.
- BIO supports enhanced short selling transparency in order to shine a light on manipulative trading behaviors that disincentivize long-term investment in innovation.

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### **Testimony of Brian Hahn**

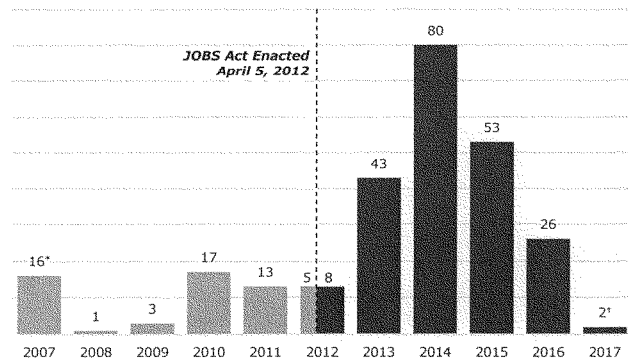
Good afternoon Chairman Huizenga, Ranking Member Maloney, and Members of the Subcommittee. My name is Brian Hahn, and I am the Chief Financial Officer of GlycoMimetics, Inc., a 45-employee public biotech company based in Rockville, Maryland. I am also the Co-Chair of the Finance and Tax Committee at the Biotechnology Innovation Organization (BIO), which represents GlycoMimetics and over 1,100 other growth-stage biotechs that are driving the search for the next generation of cures and breakthrough medicines.

I am thrilled to be here today to talk about the successes of the Jumpstart Our Business Startups (JOBS) Act, which over the last five years has spurred a surge of IPOs in the biotech industry, allowing emerging companies developing a wide range of potential therapies to raise the capital necessary to bring life-saving treatments to patients. The Financial Services Committee should be commended for its hard work on the JOBS Act five years ago – which is still paying dividends – and I would further like to applaud the ongoing bipartisan efforts to build on the successes of JOBS in order to support the next generation of emerging growth companies (EGCs).

### **The JOBS Act and the Biotech Industry**

Since the JOBS Act was signed into law five years ago, 212 emerging biotech companies have used provisions in the law to go public. (For comparison, there were just 55 biotech IPOs in the five years leading up to the JOBS Act.) The ability of growing businesses to access the public markets, as supported by the JOBS Act, is of paramount importance to biotechnology innovation because investment capital is the lifeblood of scientific advancement. It costs over \$1 billion to develop a single life-saving treatment, and most companies spend more than a decade in the lab before their first therapy is approved. During this long development process, virtually every dollar spent by an emerging biotech comes directly from investors. Expenses ranging from buy-in-bulk beakers to \$150 million clinical trials are all funded by investment capital because biotechs remain pre-revenue through their entire time in the lab and the clinic.

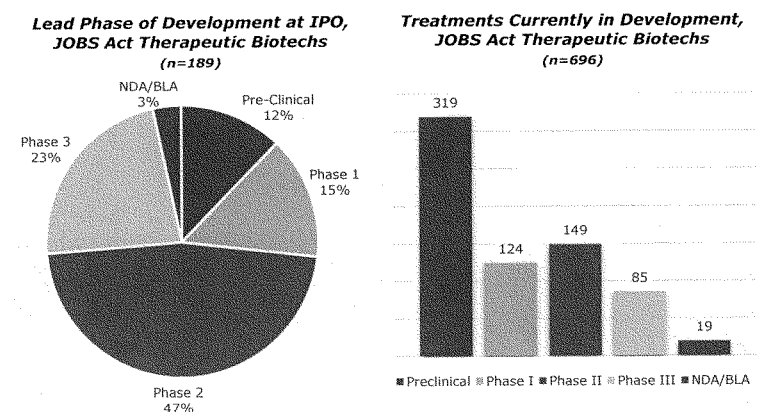
***Biotech IPOs Per Year, April 2007–March 2017***





Early-stage innovators do not have the luxury of funding their product development through sales revenue. Instead, the groundbreaking research that leads to a company's first product is funded by a series of financing rounds from angel investors, venture capitalists, large pharmaceutical companies, and, eventually, public market investors. The capital burden of a pivotal clinical trial – which can require hundreds of patients in the clinic to meet the stringent safety and efficacy standards necessary to ensure patient care – often necessitates an IPO to fund this critical stage of the research process. The 212 IPOs undertaken using the JOBS Act are the clearest indication of its success.

The next generation of medical advances is being funded by capital raised through these JOBS Act IPOs. JOBS Act biotechs have 696 therapies currently in development, and the FDA has approved 18 new treatments from JOBS Act companies.



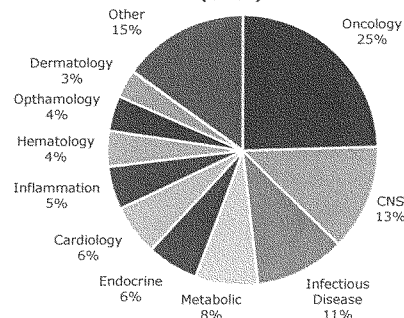
Importantly, the success of the JOBS Act has supported a surge of financing for early-stage research. In the last five years, there have been 48 IPOs by biotechs in the earliest stages of research (pre-clinical R&D and Phase I clinical trials), compared to just three preclinical and Phase I IPOs in the five years before the JOBS Act. Biotech investment is riskiest during the early stages of development – scientists discover thousands of compounds for every one that makes it through the FDA approval process – but early-stage innovation is critical to the health of the biotech industry and to patients waiting for breakthrough treatments and cures. The JOBS Act has allowed younger companies to access public financing, driving capital to early-stage research that holds the potential to lead to the next generation of innovative medicines.

The promise of JOBS Act biotechs is also spread across a wide range of therapeutic areas. The largest percentage of companies are working in the oncology space, advancing cutting-edge treatment approaches like immuno-oncology, targeted antibodies, and selective kinase inhibitors to treat deadly cancers that impact families across America. Other therapeutic areas that have seen a large number of IPOs over the last five years include central nervous system (CNS) and infectious disease companies, which are leading the charge on pressing health care challenges like Alzheimer's disease and antibiotic-resistant bacteria, respectively.



Notably, the JOBS Act has also allowed companies advancing therapies in often-overlooked disease areas to access capital. For example, there were just two IPOs from endocrine-focused companies from 2007 to 2011, but there have been 13 under the JOBS Act. The most common therapeutic focus for endocrine companies is diabetes, which is the 7<sup>th</sup> leading cause of death in the U.S. The increased funding for diabetes research will hopefully lead to scientific advancements that save and improve millions of lives.

**Therapeutic Focus of JOBS Act Biotechs**  
(n=212)



#### **Why the JOBS Act works**

The many JOBS Act success stories in the biotech industry are attributable to the one-two punch at the core of the law: First, it allows small companies enhanced access to investors, increasing the capital potential of an offering. It then institutes a relaxed regulatory burden, decreasing the amount of capital diverted from research. This combination is critical for biotech innovators and has increased the viability of the public market for growing companies looking to fund their capital-intensive development programs.

GlycoMimetics was a key beneficiary of the new approach to a public offering created by the JOBS Act's IPO On-Ramp. During our 2014 IPO, which raised \$64.4 million to fund our clinical research into treatments for sickle cell disease, acute myeloid leukemia, and multiple myeloma, we took full advantage of the law's testing-the-waters, confidential filing, and regulatory relief provisions.

In the lead-up to our IPO, the ability to conduct testing-the-waters meetings and increase our dialogue with potential investors was a game-changer. More than half of our testing-the-waters meetings eventually resulted in the investor participating in the IPO, and across the board we saw substantially increased investor awareness of our company and interest in the offering. Biotech companies like GlycoMimetics have complicated technology, an opaque regulatory pathway, and a complex commercial story – and the additional time with investors gave us time to clarify questions about these aspects of our business in a more robust way that would not have been possible in a traditional half-hour roadshow meeting.

This entire process took place while we were on file confidentially with the SEC. The JOBS Act's confidential filing provision allowed us to conduct our investor meetings out of the glare of the media spotlight and without the heightened scrutiny that could have placed an undue expectations burden on the company or our potential investors. Filing confidentially also allowed us to effectively time our offering, enabling us to wait until the market was strong before we made our S-1 public and began our roadshow.

Both at the time of our IPO and continuing for our first five years as a public company, the JOBS Act's regulatory relief provisions have helped preserve capital for R&D and allowed us to focus on our research. The Act takes a significant step away from costly one-size-fits-all regulations by reducing the regulatory burden on EGCs, ensuring that the capital raised in an



offering is not subsequently diverted from R&D and company growth. In particular, the five-year exemption from Sarbanes-Oxley (SOX) Section 404(b) continues to save us hundreds of thousands of dollars per year.

Because pre-revenue small businesses like GlycoMimetics utilize only investment dollars to fund our work, we place a high value on policies like the JOBS Act that incentivize investment in innovation and prioritize resource efficiency. Any policy that increases the flow of innovation capital to emerging companies could lead to funding for a new life-saving medicine – while any policy that diverts capital to unnecessary and costly regulatory burdens could lead to the same treatment being left on the laboratory shelf. The JOBS Act has been an unqualified success, enhancing capital formation and allowing companies to focus on science rather than compliance.

#### **Building on the success of the JOBS Act**

Given the strong impact that the JOBS Act has had on biotech capital formation, I am encouraged that the Financial Services Committee has made progress over the past several years to continue to support the growth of small public companies. The 212 newly public biotech EGCs benefitted greatly from the IPO On-Ramp, but they now face the day-to-day challenges of being a public company. BIO appreciates the ongoing work to build on the success of the JOBS Act, and we look forward to working with the Subcommittee to ensure that emerging biotechs can continue to access innovation capital on the public market. BIO supports many of the capital formation provisions found in Chairman Hensarling's Financial CHOICE Act, along with other targeted reforms that will support funding for life-saving cures and treatments.

#### *The Fostering Innovation Act*

The most direct policy impact of the JOBS Act has been the five-year exemption from Section 404(b) of SOX. Section 404(b) requires an external auditor's attestation of a company's internal financial controls that provides little-to-no insight into the health of an emerging biotech company – but is very costly for a pre-revenue innovator to comply with, making the JOBS Act exemption extremely valuable.

Biotech investors demand information about the growth-stage companies in which they invest – and spend countless hours learning as much as they can about the company's science, the diseases it is treating, the patient population, the FDA approval pathway, and a hundred other variables that will determine the company's ultimate success or failure. The testing-the-waters process created by the JOBS Act has been so successful for the biotech industry because it allows companies a platform to disseminate *more and more detailed* information to potential investors. But the information that these investors want and need does not align with what is required by SOX – and yet virtually all biotechs are subject to this one-size-fits-all mandate that can cost them over \$1 million per year once their EGC exemption expires.

Over the last three years since our IPO, GlycoMimetics has benefitted from being able to spend dollars on R&D and job creation that otherwise would have been earmarked for SOX compliance, and we still have two years of IPO On-Ramp eligibility remaining. However, it remains the case that the biotech development timeline is a decades-long affair. It is extremely likely that GlycoMimetics will still be in the lab and the clinic when our EGC clock expires – which is to say that we will still not be generating product revenue. Our audit fees increased by roughly \$400,000 after our IPO due to the existing regulatory environment for public companies, and we expect our SOX 404(b) compliance obligations alone to further increase costs by more than \$350,000 annually starting in year 6 post-IPO. Those valuable



funds could cover clinical costs for a more than a dozen patients, but our innovation capital will instead be spent on unnecessary reporting burdens.

Most biotechs that went public under the JOBS Act will find themselves in the same predicament at the dawn of year 6 on the market – still reliant on investor capital to fund their research, but facing a full-blown compliance burden identical to that faced by commercial leaders and multinational corporations.

In the 114<sup>th</sup> Congress, Rep. Kyrsten Sinema introduced the Fostering Innovation Act, which would extend the JOBS Act's SOX 404(b) exemption for certain small companies beyond the existing five-year expiration date. This important bill recognizes that a company that maintains the characteristics of an EGC but has been on the market beyond the five-year EGC window is still very much an emerging company.

The Fostering Innovation Act would apply to former EGCs that have been public for longer than five years but maintain a public float below \$700 million and average annual revenues below \$50 million. These small businesses would benefit from an extended SOX 404(b) exemption for years 6 through 10 after their IPO. The additional five years of cost-savings would have the same impact as the first five years – emerging companies would be able to spend investor capital on growing their business. In the biotech industry, that means small business innovators can remain laser-focused on the search for breakthrough medicines.

If a company eclipses \$50 million in average annual revenues, its full SOX 404(b) compliance obligations would kick in. The Fostering Innovation Act does not grant a carte blanche exemption – it is targeted specifically at pre-revenue companies, because revenue is the key indicator of company size, and of the ability to pay for expensive compliance obligations like Sarbanes-Oxley. Maintaining the JOBS Act's public float test of \$700 million while drastically lowering the revenue test from \$1 billion to \$50 million limits the Fostering Innovation Act to a specific universe of truly small companies – instituting a company classification regime for years 6 through 10 post-IPO that accurately reflects the nature of small businesses while also supporting their growth.

Under current law, small, pre-revenue companies are often required to file the same reports as revenue-generating, profitable multinational corporations. Under the Fostering Innovation Act, these emerging companies will save millions of dollars that can be utilized to fund groundbreaking R&D and life-saving medical research. BIO commends Rep. Sinema for her continued leadership in support of this vital legislation, which last year was approved on a bipartisan basis by the House Financial Services Committee and then passed by the House via voice vote. The bill is also included in the Financial CHOICE Act. I am hopeful that the Subcommittee will support the Fostering Innovation Act in the 115<sup>th</sup> Congress in order to enhance capital formation and company growth at America's pre-revenue businesses.

#### *The Corporate Governance Reform and Transparency Act*

Proxy advisory firms often have outsized influence on the decision-making processes of emerging companies and their shareholders. The firms' influence has grown in recent years, with their rise to prominence largely coinciding with the rise in institutional ownership of American stocks. Institutional investors currently own more than 70% of shares in public companies, and 91% of these investors regularly vote their shares. Institutional investors' reliance on proxy firms, combined with an overall rise in shareholder activism, has dramatically increased the firms' ability to influence proxy votes and company decisions. Recent studies have shown that a firm's recommendation can swing the shareholder vote by as much as 25%.





Despite their significant influence on emerging companies, proxy advisory firms (the universe of which is functionally limited to just two firms) generally refuse to engage in a productive or transparent dialogue with smaller issuers, instead relying on one-size-fits-all recommendations that do not take into account a company's or its shareholders' unique circumstances. Furthermore, the conflicts of interest inherent in the business model of those firms which engage in business consulting in addition to providing proxy recommendations raise serious concerns.

For growing biotech companies, these issues are particularly acute. Biotech small businesses operate in a unique industry that values a strong relationship with investors, yet they often are held to standards that are not applicable to their company and forced to engage in proxy fights over issues that do not add value for shareholders. When a proxy firm issues a recommendation that is not applicable to an emerging biotech and remains unwilling to consider alternative approaches or methodologies, it can harm a company's relationship with its shareholders and distract management from the core business of the company. Even in instances where a proxy firm has not yet made a recommendation, their influence is felt in boardrooms across the industry as companies strive to structure their corporate policies to satisfy the firms – rather than making decisions in the best interest of the company's growth.

BIO believes that proxy advisory firms should be more transparent and open to input in their standard-setting process, particularly with regard to issues unique to small businesses. We also believe that the firms with conflicted business models should be required to avoid potential conflicts of interest.

In the 114<sup>th</sup> Congress, Rep. Sean Duffy introduced the Corporate Governance Reform and Transparency Act, which would provide for SEC oversight of proxy advisory firms; the bill was also incorporated into the Financial CHOICE Act. The Corporate Governance Reform and Transparency Act is designed to foster accountability, transparency, responsiveness, and competition in the proxy advisory firm industry. By ensuring that firms have adequate resources to provide accurate recommendations on emerging companies as well as processes in place engage in a dialogue with smaller issuers, the legislation would make it more likely that a firm's recommendation is relevant to a company's business model. Further, the bill's regulation of conflicts of interest would ensure that the proxy firms are actually acting in the best interests of shareholders.

BIO strongly supports the Corporate Governance Reform and Transparency Act, which last year passed the House Financial Services Committee on a bipartisan basis. We applaud Rep. Duffy for his continued interest in this important bill, and we are hopeful that the Subcommittee will support it in the 115<sup>th</sup> Congress.

#### *The Financial CHOICE Act*

BIO appreciated the inclusion of both the Fostering Innovation Act and the Corporate Governance Reform and Transparency Act in the Financial CHOICE Act in the 114<sup>th</sup> Congress, and we are hopeful that they will both remain an important part of the CHOICE Act when Chairman Hensarling re-introduces the legislation this year. These bipartisan bills would support small company growth and capital formation across the biotech industry. BIO also supports other key provisions included in the Financial CHOICE Act in the 114<sup>th</sup> Congress that incorporate the work done by the Financial Services Committee to ensure that America's capital markets allow for the capital formation necessary to fund the decades-long, billion-dollar development timeline faced by emerging biotech companies, including:



- **Small Issuer Exemption from Internal Control Evaluation.** Many emerging biotechs have high public floats despite being small businesses without any product revenue. The Financial CHOICE Act would reflect that reality by expanding the existing small issuer exemption from SOX Section 404(b) to companies with a public float below \$250 million. We understand that the bill introduced for the 115<sup>th</sup> Congress may be updated to include an expanded exemption for companies up to \$500 million in public float. BIO supports expanding the exemption beyond the current \$75 million public float cap in order to allow these growing companies to focus their precious innovation capital on science rather than compliance.
- **Small Company Disclosure Simplification.** BIO believes that growing companies should not have to bear the costs of the eXtensible Business Reporting Language (XBRL) reporting requirement until it has been demonstrated to be cost effective and useful to investors. The Financial CHOICE Act would exempt EGCs and certain low-revenue issuers from XBRL while requiring the SEC to study and improve the compliance mechanism.
- **Small Business Capital Formation Enhancement.** The annual SEC Government-Business Forum on Small Business Capital Formation has historically been adept at suggesting policies that have a real impact on growing companies, including many of the provisions that made up the JOBS Act. An enhanced role for the Forum, as directed by the Financial CHOICE Act, would provide an important opportunity for small businesses to recommend policy changes to the SEC that would reduce regulatory burdens and enhance capital formation.

#### *Short Selling Transparency*

The unique business model of groundbreaking innovation leaves emerging biotechs particularly vulnerable to stock manipulation via abusive short selling strategies. Biotech companies depend on the public market for the capital necessary to fund late-stage clinical trials. However, the high-stakes nature of their research, their often-thinly-traded stocks, the limited publicly available information about ongoing trials, and their dependence on a small portfolio of products or product candidates can be exploited by short sellers who prioritize short-term profits over the long-term health of patients. Abusive short trading strategies harm growing companies and disincentivize long-term investment in innovation.

BIO acknowledges that appropriate shorting can support the stable, liquid markets that fuel the growth of emerging biotech innovators. However, we strongly believe that the current lack of transparency related to short positions is enabling trading behaviors that unfairly harm growing companies, long-term investors, and, most importantly, patients. BIO members face a consistent and significant risk of manipulation by short sellers, who are protected by the lack of disclosure required of short positions.

Specifically, growing innovators face campaigns mounted by manipulative short investors who spread online rumors about small biotech companies, or publish false or misleading data about clinical trials or marketed therapies, in order to drive down their stock price. The end goal of this manipulation is to generate a quick profit for short sellers at the expense of the long investors who support life-saving innovation. Recently, a new strategy has emerged wherein hedge fund managers take a short position in a biotech company's stock and then immediately file a series of spurious patent challenges through the Patent Office's *inter partes* review (IPR)



process, initiating a stock drop that, again, benefits short sellers but harms long-term innovation.

BIO believes that increased short transparency, designed to complement the existing long disclosure regime, would shine a light on manipulative behaviors, allow market participants to make informed trading decisions, and ensure equitable rules for all types of investments. As the Subcommittee continues to consider how to support the growth of EGCs and other small business issuers, we look forward to continuing to discuss the manipulation that growing biotech face and how to ensure that long-term investment in innovation is encouraged.

### **Conclusion**

The bipartisan JOBS Act showed that targeted policymaking designed to support job creation and capital formation at small businesses can have a dramatic real world impact. The 212 biotech companies that have gone public over the last five years are living proof that Congress can make a difference for emerging innovators. Many of these companies are conducting promising early-stage research that might have been overlooked by investors before the JOBS Act; others are working in a therapeutic area that has historically been difficult to finance. Under the JOBS Act, they were able to raise the capital necessary to fund their life-saving R&D, bringing the next generation of medical advances closer to patients.

The extraordinary success of the JOBS Act in the biotech industry means that the work of the Subcommittee has taken on increased import for emerging biotech companies. The search for capital in our industry is always ongoing – it does not end at the IPO. As such, BIO and I strongly support the efforts of the Subcommittee build on the success of the JOBS Act. Legislation designed to enhance the capital formation ecosystem, reduce regulatory burdens, and incentivize funding for the next generation of breakthrough medicines can have a dramatic impact on pre-revenue biotech companies.

BIO and I believe that important reforms like the Fostering Innovation Act, the Corporate Governance Reform and Transparency Act, the capital formation provisions in the Financial CHOICE Act, and enhanced short selling transparency will support the growth of emerging innovators beyond the IPO On-Ramp, incentivizing scientific advancement and sustaining small innovative businesses as they continue their efforts to bring life-saving treatments to patients who desperately need them.

I am thankful that Congress was able to pass the JOBS Act five years ago, which supported GlycoMimetics's public offering, and I am hopeful that it will be able to enact further legislation that could support the search for breakthrough treatments at the next generation of emerging growth biotech. I appreciate your dedication to these vital issues, and I look forward to supporting your work in any way I can.



***The JOBS Act at Five:  
Examining Its Impact and Ensuring the Competitiveness of the U.S. Capital  
Markets***

**Testimony by  
Raymond J. Keating  
Chief Economist  
Small Business & Entrepreneurship Council**

**Before the  
Subcommittee on Capital Markets, Securities, and Investment  
Committee on Financial Services  
U.S. House of Representatives**

**The Honorable Bill Huizenga, Chairman  
The Honorable Carolyn Maloney, Ranking Member**

**March 22, 2017**

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sbecouncil.org • @SBECouncil*

***Protecting Small Business, Promoting Entrepreneurship***

Chairman Huizenga, thank you for hosting this important hearing today on the JOBS Act and the competitiveness of U.S. capital markets. The Small Business & Entrepreneurship Council (SBE Council) is pleased to submit this testimony.

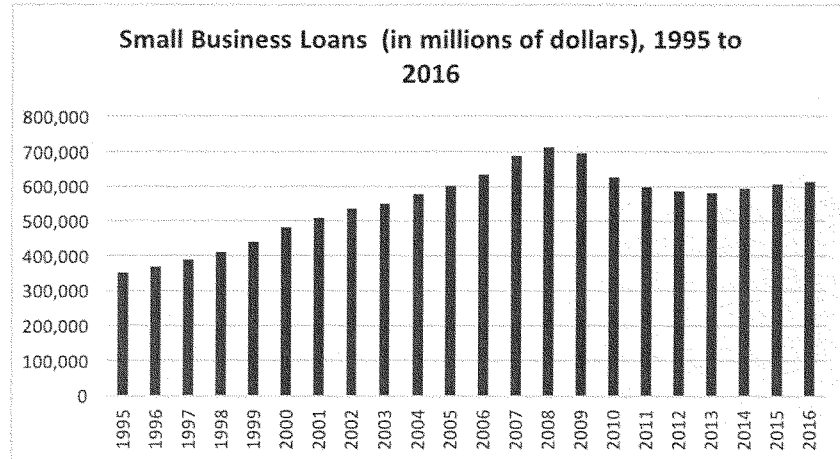
My name is Raymond J. Keating, and I am the chief economist for SBE Council, the author of several books, including *Unleashing Small Business Through IP: The Role of Intellectual Property in Driving Entrepreneurship, innovation and Investment*, and for a decade, I was an adjunct professor teaching MBA students in the business school at Dowling College.

SBE Council is a nonpartisan, nonprofit advocacy, research and training organization dedicated to protecting small business and promoting entrepreneurship. With some 100,000 members and 250,000 small business activists nationwide, SBE Council is engaged at the local, state, federal and international levels on policies that enhance competitiveness, and improve the environment for business start-up and expansion, and economic growth.

#### **Small Business Challenged on Raising Financial Capital**

Gaining access to financial capital – whether via equity or debt – is essential to the creation and growth of businesses. At the same time, access to capital remains a major challenge for entrepreneurs starting up and building enterprises across our economy. And since the financial crisis and Great Recession, it arguably has become more difficult to access capital from institutional banks and various capital market players.

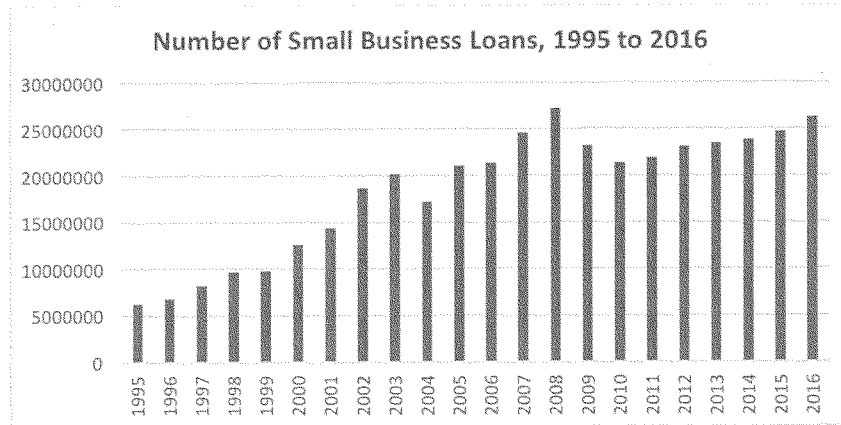
Consider the trend in bank small business loans (less than \$1 million) over the past several years (as highlighted by the graph below). The value of small business loans outstanding hit a high of \$711.5 billion in 2008, and subsequently fell for five straight years (to a recent low of \$581.9 billion in 2013), with growth subsequently resuming in the following three years. The 2016 level came in at \$614.2 billion, which is roughly where the small business loan level was in 2005-06. So, in effect, we've seen no growth for a decade.



Data Source: Federal Deposit Insurance Corporation, Quarterly Banking Profile

It's also worth noting that the small business share of commercial and industrial loan value outstanding registered, for example, 33 percent in 1995, 35 percent in 2004, and 30 percent in 2007. As of the second quarter of 2015, however, it had fallen only 20 percent, and has remained there since. Looking at nonfarm nonresidential loans, the small business share came in at 52 percent in 1995, and had declined to 39 percent in 2007. At the end of 2016, the small business share further declined to 21 percent.

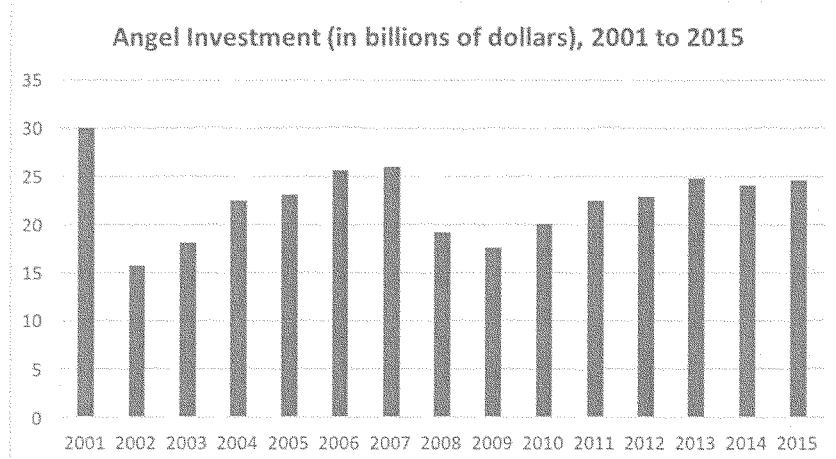
As for the number of small business loans, these rose steadily up to 2008 (hitting 27.1 million in 2008 compared to 6.3 million in 1995), and subsequently declined and struggled to recover. (See graph below.) A recent step up in growth in 2015 and 2016 meant that the number of small business loans hit 26.3 million in 2016 – which, however, was still below the 2008 level.



Data Source: Federal Deposit Insurance Corporation, Quarterly Banking Profile

Meanwhile, on the equity side, angel investment is a critical source of funding for start ups and early-stage businesses. Unfortunately, the story has been troubling in recent years. According to the Center for Venture Research at the University of New Hampshire, after a big drop in 2002, coinciding with the aftermath of the 2001 recession (as well as the post “tech bubble”), growth resumed from 2003 through 2007, with angel investments increasing from \$15.7 billion in 2002 to \$26 billion in 2007. With the recession, a big drop-off followed in 2008 and 2009, and subsequent growth has been underwhelming or, in effect, nonexistent. For all of 2013, angel investment registered \$24.8 billion, followed by \$24.1 billion in 2014 and \$24.6 billion in 2015. And the center offered the following description for the first two quarters of 2016 (latest available in “The Angel Investor Market in Q1Q2 2016: Caution Prevails” by Jeffrey Sohl, director, Center for Venture Research):

“Angels continue to reduce their investment allocations in the seed and start-up stage, with 27% of Q1,2 2016 angel investments in the seed and start-up stage. The trend has been a steady decrease in seed and start-up distributions when compared to similar periods in 2014 and 2015. In the first half of 2014 36% of the angel deals were in the seed and start-up stage followed by 31% in the first two quarters of 2015. There was an accompanying shift to early stage (post seed and start-up) financing to 53% of investments in Q1,2 2016 from 51% in Q1,2 2015 and 42% in the first two quarters of 2014. Expansion stage financing also increased from 15% in Q1,2 2015 to 19% in Q1,2 2016. Historically angels have been the major source of seed and start-up capital for entrepreneurs and while that stage remains over a quarter of angel investments, angel seed/start-up investments have remained consistently below the pre-2008 peak of 55%. This steady decline in allocations signifies that there continues to be a need for seed and start-up capital for both new venture formation and job creation.”

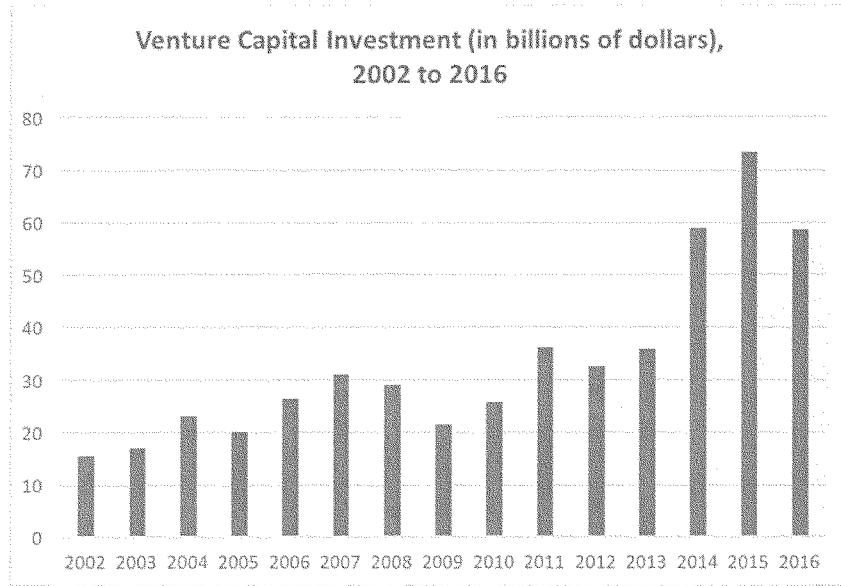


Source: Center for Venture Research at the University of New Hampshire

It also is worth taking a look at the recent trend in venture capital investment. Venture capital is not really about start-up or early-stage investment, but it plays a vital role in subsequent growth stages. Venture capital is about firms or funds that invest in enterprises that have reached a certain level of development, often after reaching the “proof of concept” stage. The trend in venture capital in recent years has been similar to what has already been noted in other areas – such as growth from 2002 to 2007, followed by a big drop off in 2008 and 2009, followed by uneven growth from 2010 to 2013. However, venture capital experienced welcome strong growth in 2014 and 2015, followed by a notable decline in 2016. As explained in the PWC/Global Trends *MoneyTree Report* for Q4 and Full-year 2016:

“Investor caution prevailed as Q4’16 saw a 14% slowdown in deals and 17% decline in total funding from the prior quarter. 2016 saw a total of \$58.6B invested across 4,520 deals, down 20% and 16%, respectively from 2015.”





Source: PWC/Global Trends

So, to sum up, the value and number of traditional small business loans are still down from pre-recession levels. Angel investment also remains down from its 2008 level, while also experiencing stagnation over the last two years. Also, venture capital has shown the most life post-recession, but the decline in 2016 is troubling. (By the way, it should be noted that all of the trends cited above are quoted in nominal dollars, so when inflation is added into the mix, any growth trend is narrowed.)

These trends speak to primary phenomenon. First, it is about reduced levels of entrepreneurship. As noted in an August 2016 SBE Council report – “Gap Analysis #3 - Entrepreneurship in Decline: Millions of Missing Businesses” – according to various measures of the number of businesses, the U.S. economy has suffered an estimated gap or shortfall of anywhere from 867,000 to 4.8 million businesses in the U.S. economy. For example, if we look at incorporated and unincorporated self-employed, and employer firms as shares of the relevant population, we see a significant gap in the number of businesses compared to where we should be. Indeed, these numbers point to some 3.7 million missing businesses in the U.S. in 2015. Reduced levels of entrepreneurial activity – due to an assortment of factors, but largely a policy environment hostile to entrepreneurship and investment – naturally means reduced loan and investment demand.

Second, these trends speak to the struggles for entrepreneurs to gain access to the financial resources needed to start up and grow.

Why does any of this matter? Quite simply, entrepreneurship is the engine of innovation, productivity and income growth, and job creation. And entrepreneurship depends upon the willingness and ability of investors and lenders to supply investment and credit.

Consider the broadest measure of our economy. Since the recession officially ended in mid-2009, real GDP growth has averaged only 2.1 percent during this period of recovery/expansion. That compares miserably to the average real growth rate of 3.1 percent prevailing over the past six decades, and an average real rate of 4.3 percent during periods of recovery/expansion. That is, on average, economic growth has been running at less than half of where it should be. The reason for this woeful growth largely is anemic private investment. Consider that private fixed investment peaked in the first quarter of 2006, declined dramatically through the fourth quarter of 2009, and only climbed back to the first quarter 2006 level in the fourth quarter 2014 – more than eight years of no growth. And the fourth quarter 2016 level (most recent) was only 3.7 percent higher than the first quarter 2006 – again, there’s been barely any growth in private fixed investment in the U.S. economy for more than a decade. In addition, for all of 2016, private nonresidential fixed investment declined versus the previous year for the first time since 2009.

Make no mistake, entrepreneurship, business expansion, investment and economic growth are all tied together.

Therefore, providing small businesses with more options or avenues to expand access to financial capital is a clear positive for the economy.

### **The JOBS Act**

In response to broad concerns about business startup levels and the significant challenge entrepreneurs continued to experience accessing capital, Congress passed and President Barack Obama signed the JOBS Act into law in April 2012. The overwhelmingly bipartisan bill, strongly supported by SBE Council, focused on helping to stimulate the U.S. economy by promoting capital formation.

Two important parts of the JOBS Act focused on opening up new avenues for individuals to invest in entrepreneurial ventures, such as via crowdfunding. Title II of the JOBS Act allowed “accredited investor” crowdfunding and Title III crowdfunding for everyone else, if you will. Title II allows for, as phrased by the SEC, a company to “broadly solicit and generally advertise” a private offering to “accredited investors.” Meanwhile, Title III “provides an exemption from registration for certain crowdfunding transactions,” with a business limited to raising “a maximum aggregate amount of \$1 million in a 12-month period,” while investors having annual income or net worth of less than \$100,000 are limited during a 12-month period to the greater of \$2,000 or 5 percent of the lesser of annual income or net worth (if both annual income and net worth top \$100,000 then the limit is 10 percent of the lesser of income or net worth).

As for investment under Title II, according to Crowdnetic's report "Title II Turns Three: Crowdnetic's Annual Title II Data Analysis for the period ending September 23, 2016":

"Through CrowdWatch—Crowdnetic's centralized platform for the analysis of private offerings conducted online—Crowdnetic has aggregated and normalized 6,613 Title II offerings from 16 leading platforms since September 23, 2013. These offerings have generated more than \$1.47 billion in capital commitments in the aggregate. Although the number of new offerings has declined from year to year, the annual aggregate amount of recorded capital commitments has increased each year, with more than 40% of the 3-year total having been recorded during the previous 12-month period."

Specifically, the number of new offerings came in at 4,712 in year one, 1,351 in year two, and 550 in year three, while annual recorded capital commitments registered \$385.8 million in year one, \$484.2 million in year two, and \$603.4 million in year three.

Meanwhile, according to Crowdfund Capital Advisors, since Title III launched in May 2016 (unfortunately it took four years to implement this section of the JOBS Act), capital commitments registered \$29.7 million as of March 10, 2017.

#### **Reforms and Improvements to Fully Leverage JOBS Act Crowdfunding**

Even given the significant and positive changes being brought about for entrepreneurs and investors with the JOBS Act, areas in need of improvement always exist, including government over-regulating or placing too many limitations on the ability of entrepreneurs to gain access to capital, and/or on investors' abilities to make investments in entrepreneurial ventures.

For example, the following reforms would expand opportunities for entrepreneurs and investors when it comes to crowdfunding:

- Crowdfunding opportunities should be expanded for businesses of different sizes and stages, and therefore, the limit of raising \$1 million during a 12-month period under Title III crowdfunding should be raised, for example, to \$5 million.

According to Sherwood Neiss and Jason Best, co-founders and principals of Crowdfund Capitol Advisors (and SBE Council members) writing in Crowdfundinsider.com on November 11, 2016 ("How Donald Trump Can Leverage Crowdfunding Under Reg CF to Double GDP Growth"):

"More capital means more ability for these entrepreneurs to hire Americans. Our research found that 2.2 jobs are created within the first 90 days after a company is successful with a securities-crowdfunding campaign."

- Expand the ability of investors to invest by shifting income/net worth limits.

As noted earlier, investors having annual income or net worth of less than \$100,000 are limited during a 12-month period to the greater of \$2,000 or 5 percent of the lesser of annual income or

net worth (if both annual income and net worth top \$100,000 then the limit is 10 percent of the lesser of income or net worth). The application of the percentages should be altered from “lesser of income or net worth” to the greater of income or net worth.

- Clarify that funding portals cannot be held liable for material misstatements and omissions by issuers, unless portals are guilty of fraud or negligence.

This assurance would reduce unnecessary risks for crowdfunding portals. Again, Neiss and Best explained:

“Reduce bureaucracy and create a statutory safe harbor for online platforms, similar to what traditional broker dealers have had for decades. As it currently stands, platforms are liable for any false statements made by an issuer. While that might seem logical, a platform is just a technology-enabled way for entrepreneurs to connect with investors. The platforms do not have the domain expertise of the issuer’s company or technology and cannot verify the accuracy of all statements made by issuers. Part of the role of the crowd (and the job that investors like Angels and VCs perform) in crowdfunding is to do the diligence and verification of a company’s offering documents. This role should remain with the investors and not be the role or liability of the platform. By creating this safe harbor, more platforms will emerge to support different verticals of the market (i.e.: Veterans, Women and Minority business, etc). More platforms in more vertical means more businesses and more economic output.”

- Neiss and Best call for allowing syndicate/lead investor models for crowdfunding.

They noted: “Increase efficiencies and allow ‘syndicate/lead investor models’ for all forms of crowdfunding. Today, accredited investors can do this (sites like AngelList have used this method very successfully). We believe that all investors should have the option to use investment methods that enable a lead investor to validate a company’s valuation, strategy and investment worthiness. Traditionally, angel investors have operated in groups and often follow a lead. This recommendation puts all investors on a level playing field and will allow more capital to flow into the space which will further economic development.”

- Vincent Bradley, CEO and co-founder of FlashFunders in a January 16, 2017, Entrepreneur.com article, also pointed out the following items that can be improved:

- “Reg CF [Regulation crowdfunding] requires that businesses raising more than \$500K have GAAP Standard financials prepared and ready to share. While it’s important to provide potential investors with transparency into your business, the reality is that early stage companies generally don’t have GAAP financials prepared. And spending \$5-10K on a CPA to prepare them is excessive.

- “Reg CF requires businesses to file a Form C with the SEC before they can solicit investors. A Form C is a 25-page document that can require upward of 50 hours of work to complete. You’re

going to want a lawyer to review and help prepare some of it, so expect anywhere from \$1-5K in legal costs, which most startups don't have."

- 12(g) rule "stipulates that if a business uses Reg CF to successfully raise capital and crosses \$25 million in assets, they'll be required to begin reporting as a public entity. This potentially creates a situation where a company could be forced to go 'public' whether they're ready to or not."

### **Conclusion**

Few better understand the costs of government regulations, rules and restrictions than entrepreneurs and small businesses owners, as they are on the front lines of having to deal with the burdens of government red tape and costs. That is the case not only when it comes to regulations that impact day-to-day operations, but also when government rules impede their ability to access needed financial capital.

In many ways, the U.S. truly does have the "gold standard" of financial capital markets. But the threat always looms that government overreach will undermine the efficacy of these markets. Regulatory policy needs to protect against fraud and abuse, but it also needs to reflect the reality that free markets provide the foundation upon which entrepreneurship, investment, innovation and business can flourish, thereby providing a breathtaking array of goods and services that improve all of our lives in seemingly countless ways.

It is vital that financial regulation recognize these realities, the transparency that technology has imposed upon the system, and be built on a respect to free enterprise. Thank you for your time and the opportunity to provide testimony today. I look forward to our discussion and your questions.

### **About Raymond J. Keating**

Raymond J. Keating serves as chief economist with the Small Business & Entrepreneurship Council (SBE Council), a nonpartisan, nonprofit advocacy, research and training organization dedicated to protecting small business and promoting entrepreneurship.

He writes, speaks and testifies on a wide range of issues affecting the entrepreneurial sector of the economy. In addition to assorted policy papers and reports, he pens the weekly analyses on SBE Council's "Small Business Insider" blog at [www.sbecouncil.org](http://www.sbecouncil.org) covering areas such as taxation, regulation, the state of the economy, energy, capital and credit issues, state policy and economic developments, telecommunications, and much more.

Keating also writes a regular column for RealClearMarkets.com, and wrote a newspaper column for *Long Island Business News* for seven years, previously for *Newsday* on Long Island for more than 11 years, and for the *New York City Tribune* for two years.

Keating has written five nonfiction books – *Unleashing Small Business Through IP: The Role of Intellectual Property in Driving Entrepreneurship, innovation and Investment* (2016 revised edition), *“Chuck” vs. the Business World: Business Tips on TV* (2011), *U.S. by the Numbers: What’s Left, Right, and Wrong with America State by State* (2000), *New York by the Numbers: State and City in Perpetual Crisis* (1997), and *D.C. by the Numbers: A State of Failure* (1995). He also has contributed essays to four other books. For good measure, Keating is a novelist. He has written six thrillers in his Pastor Stephen Grant novels series – *Warrior Monk* (2010), *Root of All Evil?* (2012), *An Advent for Religious Liberty* (2012), *The River* (2014), *Murderer’s Row* (2015), and *Wine Into Water* (2016).

Keating has written hundreds of articles, with pieces published in such periodicals as *The Washington Post*, *The Wall Street Journal*, *The New York Times*, *Boston Globe*, *National Review*, *Investor’s Business Daily*, *Chicago Tribune*, *The Washington Times*, *New York Post*, *Daily News*, and many more.

In addition, for a decade, Keating was an adjunct professor in the Townsend Business School at Dowling College, where he taught a wide variety of courses in the MBA program, including Advanced Innovation and Entrepreneurship, International Business, Public Sector Economics, and Organizational Theory.

His areas of expertise include taxation; federal, state and city budget issues; monetary policy; regulation; energy policy; supply-side economics; the economics of sports stadiums and arenas; the U.S. economy; trade; intellectual property and property rights in general; and a host of other small-business issues.

Keating holds an MA in economics from New York University, an MBA in banking and finance from Hofstra University, and a BS in business administration and economics from St. Joseph’s College.



Testimony of Edward S. Knight  
 Executive Vice President,  
 General Counsel and Chief Regulatory Officer,  
 Nasdaq, Inc.  
 Before the House Financial Services Committee  
 Subcommittee on Capital Markets and GSEs

**“The JOBS Act at Five:  
 Examining Its Impact and Proposals to Further Enhance Capital Formation”**

March 22, 2017

Chairman Huizenga and Ranking Member Maloney,

Thank you for the opportunity to testify on “The JOBS Act at Five: Examining Its Impact and Ensuring the Competitiveness of the U.S. Capital Markets.”

Almost one year ago, Nelson Griggs, Nasdaq’s Head of Listings, testified before this subcommittee that, despite the success of the JOBS Act, “there (were) dark clouds still affecting the private company view of the public markets.” Unfortunately, those dark clouds still exist today.

I will review in my testimony how the JOBS Act affected the “going public” decision. There is no doubt that the JOBS Act did ease some unneeded strictures that applied to public companies. Still, despite these improvements and the benefits of going public to private companies, their employees and the investing public, many private companies remain reluctant to take the next step and go public. We believe these companies may view the public markets as too costly and overburdened by ill-suited regulation. However, we feel that, with certain measured changes, the public markets can be modernized and revitalized. We will then see the markets realize their full potential to create jobs, increase the savings of the public investor and contribute to improved productivity.

**What we learned from the JOBS Act:**

One of the most consequential examples of bipartisanship in the 112<sup>th</sup> session of Congress was the JOBS Act. By trimming unwarranted or outdated regulation, the JOBS Act enabled deeper and vibrant markets without sacrificing investor protection. As we testified last year, we identified several benefits to investors, and did not detect any investor protection concerns that resulted from the JOBS Act.

It is also important to understand that Nasdaq does not benefit from taking a company public before its time. Our strength as a global listing venue, which is home to five of the six largest



companies in the world and the destination of 70% of all IPOs today, is due to our regulatory integrity.<sup>1</sup>

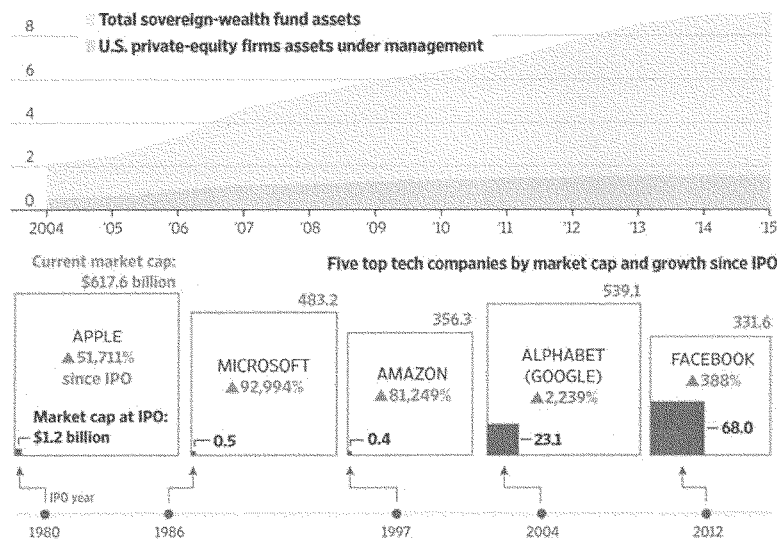
That said, investors do not benefit from an overregulated public market. Indeed, they are impacted when companies choose to avoid a public listing in order to escape unnecessary regulation. Let me illustrate that point by referring to the growth experienced by Nasdaq's largest listed companies. As you can see in Chart 1, most of the growth of these companies was experienced while being listed on Nasdaq. Why is that important? It means that hundreds of billions of dollars of wealth were created for the millions of individuals (including rank and file employees) who invested in these companies through the public market.

Chart 1: Private-Investing Climate<sup>2</sup>

### Private-Investing Climate

As more money has accumulated in private-equity firms and sovereign-wealth funds, companies are tapping them for capital and delaying going public, sometimes delivering sizable early investment gains to private rather than public investors.

\$10 trillion

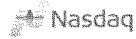


Sources: Sovereign Wealth Fund Institute (assets); PitchBook (PE assets); Thomson Reuters (market cap) THE WALL STREET JOURNAL.

<sup>1</sup> In 2016, as part of our Listing Qualifications regulatory program, we reviewed 46,140 SEC filings, conducted over 4,100 background reviews of officers and directors, and delisted 63 companies for regulatory non-compliance.

<sup>2</sup> <https://www.wsj.com/articles/americas-roster-of-public-companies-is-shrinking-before-our-eyes-1483545879>.





Amazon is a dramatic example of this benefit: Amazon grew from a company with a market cap of less than a billion dollars to one with a market cap of over \$350 billion all while a public company. Furthermore, Amazon grew from Jeff Bezos' garage to a company with 341,000 employees, adding over 100,000 jobs last year alone<sup>3</sup>.

If these companies had stayed private, many investors would be less financially secure with the inevitable adverse impact to the funding of their children's education and their own retirements.

As the decline in Nasdaq IPOs over the last three to four years shown in Chart 2 demonstrates, it appears companies are not fully embracing the public markets. This chart also shows the decline in the number of Nasdaq-listed companies over the last several years, as IPOs declined.<sup>4</sup>

Chart 2: Current State of Public Markets<sup>5</sup>



Let's look more closely at the JOBS Act. The JOBS Act contained three primary areas of focus:

1. Supporting certain technology-enabled micro-financing known as crowd funding;
2. Allowing companies to stay private longer by increasing the threshold number of shareholders before the company must register; and

<sup>3</sup> <http://www.geekwire.com/2017/amazon-soars-340k-employees-adding-110k-people-single-year/>

<sup>4</sup> The same trend is found on the NYSE.

<sup>5</sup> Source: Nasdaq data.



3. Providing tailored regulatory exemptions for emerging growth companies (EGCs) to ease their path to a public company.

The provisions of the JOBS Act that allows companies to stay private longer were successful, enabling private markets that are global and deep. Private funding is plentiful for many private companies that need capital at this time. Today, private capital has its source not just from venture capital firms but also from private equity, corporate-controlled venture capital, hedge funds, sovereign wealth funds and mutual funds. (Chart 1 shows how sovereign wealth funds have grown from less than \$2 trillion in assets to over \$8 trillion in 10 years.) Many private companies can also access the debt markets easily in today's lower rate environment. Also, raising the shareholder threshold from 500 to 2,000 holders (and by excluding employees from that count) gave private companies more flexibility. Thus, the JOBS Act allows more companies to take advantage of the private environment for much longer.

In response to the developments in the private market, Nasdaq created the Nasdaq Private Market (NPM). Through NPM, Nasdaq leveraged its technological know-how and regulatory experience to create a better experience for private companies.<sup>6</sup>

Yet, our focus on being the home of hundreds of companies that were once start-up's and now are multi-billion dollar enterprises still compels us. The continued health of the modern IPO market, especially for early stage, high growth companies, is central to our corporate mission. In our view, as the economic cycle shifts and the potential for liquidity in the private markets abates, the need for a vibrant public market may become crucial to our economic health and we need to prepare for that stage.

What we see clearly today, more than we did a year ago, is that the JOBS Act had a positive impact on companies, particularly those that have been eager and ready to go public after the 2008 financial crisis and only needed a slight push. As it turned out, the JOBS Act's more significant exemptions were those that allowed EGCs to "test the waters" and file confidentially. Other regulatory exemptions are not relied upon as much, because the marketplace (which includes investors, accountants, bankers, board members and the investment community) made its own evaluation of the best practices for companies, as it always does. Whether or not there is a government mandate, demand in the marketplace continues to impose certain regulations, especially as they relate to financial disclosure and controls.

Significantly, the JOBS Act also allowed companies that are focused on going public to do so. Soon after passage, Nasdaq saw an initial surge by hundreds of companies to list on the public markets. This was most pronounced in the Healthcare sector. However, despite a favorable environment in terms of volatility and valuation, the last year has seen a significant reduction in new IPOs - almost to a near standstill.

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<sup>6</sup> Since 2014, NPM, has facilitated \$4.3 billion in liquidity for 80 companies.



**Costs of compliance and mitigation of legal risks are too high:**

Being a public company establishes a brand identity and credibility with customers, suppliers and governments. As a public company, its stock obtains a liquid value that can be used to fund critical R&D, update plants and equipment, upgrade technology, hire talented employees and provide the currency for strategic mergers and acquisitions.

We believe "Listed on Nasdaq" resonates with the global marketplace and with companies that list on Nasdaq, including Apple, Microsoft, Alphabet, Facebook, Herman Miller, which, Mr. Chairman, is a great \$1.8 billion manufacturer based in your hometown of Zeeland, Michigan, and Macatawa Bank Corporation, a \$345 million community bank with locations throughout your district. Nasdaq believes that these inherent benefits are both deep and transformative for everyone, including the company's employees, officers and directors, and investor owners. Therefore, we believe in the public company model.

Nevertheless, there are challenges that are unique to the public company experience, and, over the years, it has become more costly. Being public is not for everyone, but it could and should be for more.

We are privileged to talk to thousands of companies each year: some private and many already public. What their CEOs tell us is that the primary challenge is not about going public. The challenge today is *being public*. Being a public company is a major achievement. The company self-selects to take on more regulation because it views the benefits as offsetting the burdens, most of which are designed to promote transparency, facilitate a secondary market for shares and protect investors. Public companies are the best of the best, choosing to live their corporate lives with a high degree of discipline, scrutiny and transparency.

But, increasingly over the past decade, there is a new cost for public companies: that the government will intervene into their business models (and not into their private competitors) to impose mandates unrelated to core investor protection or financial performance - for example, certain policy issues like conflict minerals disclosure and pay ratio and political activity disclosure are encroaching on the public company model. The idea that, by choosing to be a public company, you are expected to accept the mingling of unrelated policy goal within the public company structure is of concern to many.

Furthermore, the impact of new obligations on a public company includes not just costs of the lawyers, accountants and technology support to comply but also expenditure of valuable time and attention from senior management and the board. In a highly competitive global marketplace, costs that do not relate to the core operations of the company are hard to justify.

Legal risks are another area where costs are exploding for public companies. As every study points out, shareholder lawsuits tend to punish long term shareholders to the benefit of short term holders. Despite Congressional action in the 1990s, the number of securities class action cases



has risen to its highest level in 20 years, according to Stanford University Law School's Securities Class Action Clearinghouse.

Let me cite a few examples where simple reforms could restore balance to the current rules. First, as Congress has properly focused more recently, there are hidden costs associated with a proxy advisory system that does not always balance standard-setting with a fair and transparent process. Also, Nasdaq has petitioned the SEC to address the lack of disclosure by short term investors with significant stakes, who may be pursuing well-funded strategies to invisibly drive down a share price, in contrast to the significant disclosure requirements imposed on long term investors. Further, the anachronistic regime currently in place for a public company to communicate with its investors, characterized by "street name shares" that are mostly held by brokers at DTCC, seems ripe for the application of modern technology.

The SEC on its own or through Congressional action can update old standards that no longer make sense in a digitized/internet capable world where information flows continuously and immediately. We should address issues like the proxy access rules where investors with just nominal ownership can advance a specific agenda that may detract from the creation of long-term shareholder value. The SEC disclosure regime should be updated to eliminate unnecessary duplication and provide more timely information to investors. For instance, many disclosures in Forms 10-K and 10-Q are repeated quarter after quarter with no real investor benefit.

The SEC has also created a trading environment for public companies that fails to take into account the size and needs of smaller public companies. Market structure is a real cost. Mr. Chairman, a small regional bank in your district is expected to attract liquidity and trading volume under the same rules that apply to trading Apple or Google. The smallest company listed from Michigan has its trading spread out among 11 exchanges and about 40 dark pools. CEOs and CFOs see the trading characteristics of small issues and are dismayed to observe that price discovery is shredded over 50 venues in order to comply with a national standard designed for the trading of billion dollar plus companies. Simply put, regulation that applies a one-size-fits-all market structure does not serve investors well.

#### **Consequences of companies shunning the public markets:**

In the past, we have listed many reasons to support a vibrant runway for companies to go public through an IPO on Nasdaq or another exchange. These include the truly eye-opening figure that, as indicated in the IPO Task Force's Report, the post-IPO job growth for a company is an amazing 92%.<sup>7</sup> Other studies put the job growth 156%.<sup>8</sup>

Simply put, public companies create more jobs. Mergers and acquisitions have many benefits but they often lead to initial job losses. Often overlooked is the fact that, in many cases, the R&D

<sup>7</sup> "Rebuilding the IPO On-Ramp," available at: [https://www.sec.gov/info/smallbus/acsec/rebuilding\\_the\\_ipo\\_on-ramp.pdf](https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf)

<sup>8</sup> Kenney, Patton and Ritter (2012) surveyed 1,700 companies that went public from June 1996 to 2010.



and strategic direction of the acquired company is fundamentally different from the acquirers, so new and novel products and ideas are abandoned.

Today's market, where companies elect to wait much longer to go public or choose never to go public, also robs a group that is rarely mentioned in the debate about over-regulation. Remember the investors who the rules are supposed to protect? They lose the opportunity to grow their savings through investment in these companies. Companies no longer go public early in their life-cycle. Today's investors are often missing participation in the significant early growth that occurs in a company's life cycle or miss the investment opportunity altogether because the public markets are not as attractive as they could be. Millions of Americans are depending on their 401(k) and investments to help them pay for homes, education for their children and retirement. But, they are missing the opportunities that their parents had when they bought Apple in the 1980s or Microsoft in the 1990s or Google in the 2000s.

On the other hand, the SEC's policies allow accredited investors to invest in companies early, and be able to enjoy the growth phase of the company life-cycle. We need to reexamine this system and ensure it is also fair to average investors.

#### **Recommendations:**

This Subcommittee has worked diligently to propose new initiatives that would modernize and streamline regulation while preserving important investor protections. Many were included in the Financial Choice Act released late last year.

- For instance, included in the Choice Act is former Chairman Scott Garrett's venture exchange legislation, the Main Street Growth Act. This bill would lay the foundation for a modern market structure for early stage, high growth companies, by allowing companies to choose a market structure that aggregates liquidity for their shares and allows exchanges to adopt intelligent tick sizes.
- Second, Nasdaq remains supportive of Rep. Sean Duffy's proxy advisory firm transparency legislation, the Corporate Governance Reform and Transparency Act, which among other things, requires proxy advisory firms to register with the SEC, disclose any potential conflicts of interest and be more transparent about their methodologies for formulating proxy recommendations.
- Third, we renew our call from our testimony last year that Congress allow companies of all sizes to file for their IPO on a confidential basis and permit other types of registration statements, besides IPOs, to be initially submitted on a confidential basis. We also believe the testing the waters flexibility could be extended to all companies without harming investors.
- Forth, the proxy access rules can be modernized and updated.
- Fifth, the corporate disclosure rules could be streamlined, and modern technology could be utilized to bring that system and shareholder record keeping and communication into the 21<sup>st</sup> Century.



We have worked constructively with this Committee, the Chamber of Commerce, TechNet, the Business Roundtable and others in the past to add to this discussion. We are engaged internally to identify the most complete range of solutions and the full policy implications of any proposed solution. In the near future, we plan to release our full blueprint to revitalize the public company model and incentivize more IPOs. We will certainly share that with the Committee.

**Conclusion:**

Nasdaq believes that the JOBS Act was a success, but the job is not over. We look forward to continuing our collaboration with this Subcommittee to work towards a balanced public policy that encourages capital formation through both the private and public markets.

We remain committed to advocating policies and legislation that foster efficient markets for investors. We support business growth for companies large and small, public and private.

Thank you again for your invitation to testify. I look forward to your questions and discussion on this critical topic.



## Statement of the U.S. Chamber of Commerce

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**ON: The JOBS Act at Five: Examining Its Impact and  
Ensuring the Competitiveness of the U.S. Capital Markets**

**TO: House Committee on Financial Services,  
Subcommittee on Capital Markets, Securities and  
Investment**

**BY: Thomas Quaadman, Executive Vice President, Center  
for Capital Markets Competitiveness, U.S. Chamber of  
Commerce**

**DATE: March 22, 2017**

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1615 H Street NW | Washington, DC | 20062

The Chamber's mission is to advance human progress through an economic,  
political and social system based on individual freedom,  
incentive, initiative, opportunity and responsibility.

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

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

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

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



Chairman Huizenga, Ranking Member Maloney and members of the Subcommittee on Capital Markets, Securities, and Investment: My name is Tom Quaadman, executive vice president of the Center for Capital Markets Competitiveness (“CCMC”) at the U.S. Chamber of Commerce (“Chamber”). The Chamber is the world’s largest business federation, representing the interests of more than three million businesses and organizations of every size, sector, and region. I appreciate the invitation to testify today on behalf of the businesses that the Chamber represents.

This hearing, “The JOBS Act at Five: Examining Its Impact and Ensuring the Competitiveness of the U.S. Capital Markets” is the latest iteration of the good work done by this subcommittee and the full Financial Services Committee over the last six years to modernize securities regulation for the benefit of small and medium-sized businesses, investors, and the U.S. capital markets. The Chamber also commends the full committee for its markup of six bills last week, many of which will help open up funding channels for businesses that need capital, and create opportunities for low- and middle-income American families to build wealth.

The 2012 Jumpstart our Businesses Startups (“JOBS”) Act, as described in greater detail below, has provided significant capital-raising opportunities for both public and private enterprises. But beyond its specific policy impacts, the JOBS Act has also unleashed a new and positive way of thinking about the future of securities regulation. Indeed, since the law’s passage in 2012, we have seen this committee move dozens of “JOBS Act 2.0” measures, and market participants ranging from “garage start-ups” to venture capital funds to secondary market makers have collaborated with members of Congress, securities attorneys, and others to develop ideas for how to get capital to the businesses in our country that most need it.

But the JOBS Act was just an initial step toward bringing our nation’s securities laws into the 21<sup>st</sup> Century, and some of the provisions in the law (as well as subsequent freelancing by regulators) need to be revisited if it is going to achieve its full potential. Congress should also continue to examine the reasons for the dramatic decline in public companies over the last two decades, and the role that corporate governance laws and regulation have in capital formation and the incentives for companies to go public. The Chamber is eager to continue working with Congress on these issues and to ensure our capital markets continue to play their vital role in promoting American entrepreneurship.

## **1. Our Financial Regulatory Structure is in Need of Serious Reform**

The 2008 financial crisis and the ad-hoc legislative and regulatory response that followed the crisis made clear that the financial regulatory system in the United States is badly out of date and in need of serious reform. Elements of our regulatory framework date as far back as the Civil War, and many agencies that were created in response to a particular historical event have struggled to meet the modern needs of an economy as dynamic as the United States. It is little wonder that instead of a strong rebound to the 2008-2009 financial crisis—which typically occurs after a severe financial downturn—our economy has meandered along between one and two percent growth over the last decade.

Action is needed to promote policies that will spur economic growth. To put our economic potential into perspective, if our economy moved from 2% to 3% annual growth, that would mean doubling gross domestic product (GDP) per capita 12 years faster (23 years vs. 35 years); it would also reduce our annual deficit by over \$3 trillion over the next decade. If our economy went from 2.5% growth to 3% growth, average annual incomes would rise by \$4,200 and 1.2 million jobs would be created over the next decade. These are mere statistics, but underlying them is the opportunity for millions of Americans to create a better life for themselves and their families. The time to pursue pro-growth policies is now.

In September 2016, the Chamber released a reform plan entitled *Restarting the Growth Engine: A Plan to Reform America's Capital Markets*<sup>1</sup> (*Restarting the Growth Engine Plan*), which has over 100 recommendations for creating a regulatory system that embraces stability and growth. The Chamber was pleased to see that the Financial CHOICE Act approved by the Financial Services Committee during the 114<sup>th</sup> Congress included a number of the recommendations in the *Restarting the Growth Engine Plan*, including but not limited to:

- Structural and managerial reforms to the Securities and Exchange Commission (SEC), as well as streamlining SEC enforcement authorities to ensure fair treatment and due process during the course of investigations.
- Congressional oversight of the regulatory policy functions for all financial regulators through the appropriations process.
- Recognition that several provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, including capital, liquidity, and other requirements,

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<sup>1</sup> <http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/Restarting-the-Growth-Engine-A-Plan-to-Reform-Americas-Capital-Markets.pdf?x48633>

are creating a severe drag on the economy and damaging the health of the capital markets.

- Structural and authority modifications to the Financial Stability Oversight Council (FSOC), in addition to greater transparency requirements for U.S. participants in Financial Stability Board (FSB) decisions and actions, as well as the actions of other international standard setters and regulators that report to the FSB.
- Repeal of the Volcker Rule, as it has created impediments for non-financial businesses to enter the debt and equity markets. The Volcker Rule has placed market participants operating in the U.S. at a global competitive disadvantage.
- Incorporation of several bills that passed this Committee or the full House of Representatives during the 114<sup>th</sup> Congress. These bills would help foster capital formation by expanding opportunities for investors and ensuring that regulators focus on the need of small and growing businesses.

The Chamber is especially supportive of Title X of the CHOICE Act, which would modernize securities regulation in a manner similar to the JOBS Act. We would also note that there were several recommendations in the Restarting the Growth Engine Plan that were not included in the previous version of the CHOICE Act. As the Financial Services Committee develops the latest version of the CHOICE Act for the 115<sup>th</sup> Congress, we look forward to collaborating with you on many of these important issues.

## **2. The Decline of Public Companies in the United States and Its Consequences**

The Chamber remains very concerned about the long-term decline in the number of public companies in the United States, a development that has endured through varied market and political cycles. As a recent article pointed out, the United States is now home to roughly *half* the number of public companies as twenty years ago, and we have only slightly more public companies than existed in 1982.<sup>2</sup>

This is a tragic outcome for our economy, particularly given the body of evidence which shows that both job and revenue growth increase significantly once a

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<sup>2</sup> “America’s Roster of Public Companies is Shrinking Before our Eyes.” Wall Street Journal January 6, 2017  
<https://www.wsj.com/articles/americas-roster-of-public-companies-is-shrinking-before-our-eyes-1483545879>

company goes public. For example, a 2012 study done by the Kaufmann Foundation found that from 1996-2010; the 2,766 companies that completed an initial public offering (“IPO”) during that period cumulatively increased their employment by over 2.2 million jobs.<sup>3</sup> Other studies have similarly shown the importance of IPOs to employment as well as revenue growth. Whatever the exact economic consequences may be, it is indisputable that fewer public companies means less jobs, less growth, and less opportunity for American businesses and American workers.

Beyond the impacts on job creation and economic growth, there’s also the issue of investor protection and investor choice. Less public companies means there are fewer opportunities for non-accredited investors to diversify their portfolios and invest in companies with varying business models. The public markets are the only means by which lower and moderate income households may invest in U.S. equities, so an environment that encourages companies to go public can also help produce downstream effects in terms of investor choice and wealth creation.

The 2011 report of the IPO Task Force—which heavily influenced the provisions which ultimately made up Title I of the JOBS Act—noted that “the cumulative effect of a sequence of regulatory actions, rather than one single event, lies at the heart of the [IPO] crisis.”<sup>4</sup> Then-Commissioner of the SEC Dan Gallagher said in a 2013 speech: *“With the benefit of hindsight, we see that many of the SEC’s rules...have been the progeny of a one-size-fits-all approach unsuited to today’s markets...their effect may have been to create barriers for small and emerging growth companies that want to enter the capital markets.”*<sup>5</sup>

The Chamber could not agree more with these sentiments, as we have long warned that the regulatory environment faced by companies serves as a deterrent to going public. To emphasize this point, the IPO Task Force report included a survey in which 92% of public company CEOs reported that the “administrative burden of public reporting” was a significant challenge for their company becoming public.

Despite the clear evidence that regulation was negatively impacting the ability of companies to raise capital or undergo an IPO, the SEC for years took little action to address the problem. It was the SEC’s neglect of their statutory mission to “facilitate capital formation” that led Congress to intervene and pass the JOBS Act in

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<sup>3</sup> Post-IPO Employment and Revenue Growth for U.S. IPOs June 1996-2010  
<http://innovation.ucdavis.edu/people/publications/kenney-m.-patton-d.-ritter-j.-2012.-post-ipo-employment-and-revenue-growth>

<sup>4</sup> Report of IPO Task Force [https://www.sec.gov/info/smallbus/acsec/rebuilding\\_the\\_ipo\\_on-ramp.pdf](https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf)

<sup>5</sup> Commissioner Dan Gallagher Remarks at FIA Futures and Options Expo, November 6, 2013  
<https://www.sec.gov/News/Speech/Detail/Speech/1370540289361>

2012. And while the “on-ramp” provisions included in Title I of the JOBS Act have helped increase the number of IPOs in the immediate years following passage, the market has since cooled and many long-term issues still remain.

The Chamber would urge Congress to consider whether further exemptions from regulations for emerging growth companies (“EGCs”) are warranted. The SEC has estimated, for example, that the average initial regulatory cost associated with an IPO is \$2.5 million, a significant amount for a company that may have modest revenues.<sup>6</sup> Congress should consider further simplifying disclosure obligations for EGCs in a manner that does not compromise transparency and investor protection.

### **3. Corporate Governance and the Incentive to Go or Stay Public: An Inextricable Link**

To be sure, there are several factors that a company takes into consideration when deciding whether or not to go public. These include factors that cannot—and should not—be controlled by policymakers, such as market conditions, competitive pressures, and cost of capital. However, many of the hurdles to going public are self-inflicted and include the complexity of the SEC’s disclosure regime, recent attempts by special interests to co-opt corporate disclosures in order to advance their agendas, and the outsized influence that proxy advisory firms have on corporate governance in the United States.

In 2014, CCMC released a report that included a number of recommendations which would modernize SEC disclosures for the benefit of both issuers and investors.<sup>7</sup> In addition to the average of \$2.5 million in regulatory costs for undergoing an IPO, the SEC has estimated that annual compliance costs for public companies averages \$1.5 million<sup>8</sup>—again, a not-insignificant amount of money for a company that is focused primarily on growth. Much of this cost stems from the SEC’s overly complex and confusing disclosure regime, which even institutional investors have a difficult time understanding.<sup>9</sup> Under its Disclosure Effectiveness

<sup>6</sup> See SEC 2013 proposed rules on crowdfunding <https://www.sec.gov/rules/proposed/2013/33-9470.pdf>

<sup>7</sup> Corporate Disclosure Effectiveness: Ensuring a Balanced System that Informs and Protects Investors and Facilitates Capital Formation [https://www.uschamber.com/sites/default/files/021053\\_ccmc\\_disclosure.pdf](https://www.uschamber.com/sites/default/files/021053_ccmc_disclosure.pdf)

<sup>8</sup> SEC 2013 proposed rules on crowdfunding <https://www.sec.gov/rules/proposed/2013/33-9470.pdf>

<sup>9</sup> A 2014 study by the Rock Center for Corporate Governance at Stanford University found that only 38% of institutional investors believe disclosures related to executive compensation are “clear and easy to understand” <https://www.gsb.stanford.edu/faculty-research/publications/2015-investor-survey-deconstructing-proxy-statements-what-matters>

Initiative and recent mandates from Congress, the SEC must work to modernize disclosures to fit the needs of today's businesses and investors.

More troublingly, there has been an increased push over the last decade—led by well-funded special interests—to use the disclosure regime in order to advance a political or social agenda. These efforts have included provisions in the Dodd-Frank Act mandating immaterial disclosures such as pay ratio and conflict minerals, as well as continued efforts to mandate political spending disclosures. To help counter this alarming trend, the CCMC issued a report last month emphasizing the need for policymakers to adhere to the Supreme Court-articulated materiality standard, which has effectively governed corporate disclosure for decades.<sup>10</sup>

Congress should outright reject any further attempts to turn the SEC into an arbiter of political or social causes, no matter their merit. American entrepreneurs don't want to spend years building a business and completing their dream of going public—only to find a cottage industry of activists waiting for them once they do, looking for ways to embarrass the company or to have it adopt their idiosyncratic agendas. The potential long-term damage that will be done to America's capital markets if the SEC's independence is compromised cannot be overstated.

One area that has been particularly prone to abuse by special interests is the shareholder proposal rules under Rule 14a-8 of the Securities Exchange Act. These rules were originally intended to facilitate communication and collaboration between management and shareholders to help solve matters of importance related to the company. Instead, the outdated rules under Rule 14a-8 have devolved into a vehicle for activists to push pet issues which are often wholly unrelated to enhancing the underlying value of a company's stock. This has been a tremendously detrimental development for corporate governance in the United States, and only serves as another deterrent for companies to go public.

The SEC has exacerbated the problem in recent years by creating a high level of uncertainty in the “no-action” process that companies rely on to exclude shareholder proposals from their proxy. The sudden decision by then-SEC Chair Mary Jo White in January 2015 to reverse a staff decision regarding a proxy access proposal at Whole Foods was a consequential and unfortunate moment in the long history of Rule 14a-8.<sup>11</sup> A first step towards reform would be for the SEC to

<sup>10</sup> Essential Information: Modernizing Our Corporate Disclosure System [http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/U.S.-Chamber-Essential-Information\\_Materiality-Report-W\\_FINAL-1.pdf](http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/U.S.-Chamber-Essential-Information_Materiality-Report-W_FINAL-1.pdf)px48633

<sup>11</sup> Corporate Governance Coalition for Investor Value Letter to Chair White regarding Whole Foods Decision <http://www.centerforcapitalmarkets.com/wp-content/uploads/2015/02/2015-2-23-Coalition-letter-to-SEC-re-whole-foods-decision.pdf>px48633

withdraw Staff Legal Bulletin 14H (CF) which has created a great deal of uncertainty for the market.<sup>12</sup> The SEC could also revive a 1997 proposed rulemaking to raise the “resubmission thresholds” under Rule 14a-8, so that activists cannot force shareholders to pay for the dissemination of the same proposal in multiple years, even if that proposal gains meager support.<sup>13</sup>

The Chamber has long called for reform of the shareholder proposal rules under Rule 14a-8 so that they can be restored to their original intent, and shareholders are not forced to pay so that a vocal minority may have their day in the spotlight. The hearing held by this subcommittee in September 2016 highlighted a number of the problems with Rule 14a-8, and helped educate Congress and the public about the vital need for reform.<sup>14</sup> The Chamber welcomes any opportunity to work with this committee during the 115<sup>th</sup> Congress in order to modernize these rules.

Another pressing issue is the outsized influence that proxy advisory firms have on corporate governance in the United States. The proxy advisory industry has been dominated by two companies—Institutional Shareholder Services (“ISS”) and Glass Lewis & Co. (“Glass Lewis”), which collectively control 97% of the proxy advice market.<sup>15</sup> It has been estimated that ISS and Glass Lewis effectively “control” 38% of the shareholder vote because if the two firms make the same proxy voting recommendation, it moves that percentage of the vote absent a vocal campaign against their position.<sup>16</sup>

ISS and Glass Lewis also continue to operate with an alarming lack of transparency and accountability, which has the effect of undermining confidence in the system of proxy voting in the United States. These two firms have yet to take steps to ensure that their voting recommendations are developed on clear, objective, and empirically-based corporate governance standards to help management and investors evaluate and improve governance as a means of increasing shareholder value. They are also riddled with conflicts of interest and internal processes that have not kept up with other changes in the proxy system.

<sup>12</sup> <https://www.sec.gov/interps/legal/cfslb14h.htm>

<sup>13</sup> <https://www.sec.gov/rules/proposed/34-39093.htm>

<sup>14</sup> “Corporate Governance: Fostering a System that Promotes Capital Formation and Maximizes Shareholder Value” Capital Markets and GSE Subcommittee, September 21, 2016 <http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=401019>

<sup>15</sup> There are other firms such as Egan Jones which provides a full array of proxy advisory services and Manifest which provides only research. However, these firms are negligible in their market impact.

<sup>16</sup> ISS 24.7% Glass Lewis 12.9% Source: Ertimur, Yonca, Ferri, Fabrizio and Oesch, David, Shareholder Votes and Proxy Advisors: Evidence from Say on Pay (February 25, 2013). 7th Annual Conference on Empirical Legal Studies Paper.

For these reasons, the Chamber strongly supported H.R. 5311, the “Corporate Governance Reform and Transparency Act of 2016” during the 114<sup>th</sup> Congress. This legislation would require proxy advisory firms to register with the SEC and become subject to a robust and entirely appropriate oversight regime. We commend Congressman Duffy for his work on this issue, and look forward to working with him on the legislation during this Congress.

The Chamber raises these corporate governance concerns in the context of the JOBS Act because we strongly believe they must also be viewed as “capital formation” issues and be addressed if we are truly going to arrest the long-term decline of public companies in the United States. The fact of the matter is that the public company regulatory regime remains inhospitable for many businesses, but we welcome the opportunity to work with Congress and the SEC to change that reality.

#### **4. The JOBS Act in Practice**

##### **Title I—IPO “On-Ramp”**

To date, the most impactful provisions of the JOBS Act have been those included in Title I, which established the EGC as a new class of issuer. Title I helped turn around what had been a moribund IPO market in the years leading up to passage of the JOBS Act. The number of IPOs jumped to 133 in 2012 (up from 101 in 2011). In 2013, the first full year that the JOBS Act was in place, IPO listings increased to 226, then to 291 in 2014.<sup>17</sup> The majority of these companies filed as EGCs and took advantage of the provisions that Title I had to offer. While the IPO market has cooled since 2014, there is no doubt that conducting an IPO is an easier process now than it was before the JOBS Act.

The success of Title I also holds an important lesson for Congress as it considers additional capital formation-related legislation. Unlike many of the other provisions in the JOBS Act, Title I became effective the minute that President Obama signed the legislation into law. This “self-effectuating” mechanism helped avoid some of the regulatory discretion that has gummed up other parts of the JOBS Act (described in more detail below). As it takes steps to further modernize securities regulations, Congress should make every effort to assert its Article I powers under the U.S. Constitution and leave as little discretion to the SEC or other regulators as possible.

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<sup>17</sup> “Why are more companies staying private?” Ernst & Young report at meeting of SEC Advisory Committee on Small and Emerging Companies <https://www.sec.gov/info/smallbus/acsec/giovannetti-presentation-acsec-021517.pdf>



## **Title II—General Solicitation for Offerings under Regulation D**

The private offering market under Regulation D has long been an attractive vehicle for businesses to raise capital. In fact, the Reg. D market has grown to well over \$1 trillion as issuers find it a more cost-effective alternative than undergoing an IPO, and are not subject to the arbitrary caps that exist with other exemptions, such as Regulation A.

The concept of Title II was simple: Allow private businesses to solicit investments in their company to the general public, with the stipulation that those who ultimately purchase the securities be deemed “accredited investors.” This would allow businesses to expand their investor base outside of their geographic area and lead to a significant increase in private investment. In July 2013, the SEC issued rules to implement Title II and created a new “Rule 506(c)” class of offerings that allow for general solicitation.

In practice, however, the general solicitation provisions have become needlessly complex and uncertain, effectively putting a lid on the Reg. D market. This is due in no small part to some of the liberties taken by the SEC with their Title II mandates, many of which would add burdens on investors and issuers that are simply unnecessary. For example, when the SEC finalized its general solicitation rules, it concurrently issued proposed rules—uncalled for by the JOBS Act—that would impose further restrictions on Reg. D offerings, and would impose harsh penalties on issuers that make even minor mistakes when completing SEC forms. Although these proposals have not been implemented, their mere existence has caused many issuers to think twice about undergoing a 506(c) offering. Indeed, post-implementation data shows that the 506(c) market pales in comparison to the entire Reg. D market.<sup>18</sup>

For these reasons, the Chamber last Congress fully supported H.R. 4852, the “Private Placement Improvement Act”, which would prohibit the SEC from acting upon some of these ill-advised proposals. We urge the committee to take up this legislation during this Congress, or at the very least seek assurances from the SEC that the agency has no intention of moving forward to implement the proposals.

The Chamber also supports updating the definition of an accredited investor so that more Americans have an opportunity to invest in private offerings. The current definition allows only those with \$1 million in net worth or \$200,000 in annual income (or \$300,000 in joint income with a spouse) to be deemed accredited. In

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<sup>18</sup> <https://www.sec.gov/dera/staff-papers/white-papers/unregistered-offering10-2015.pdf>

other words, only very wealthy people are afforded the opportunity to invest in private offerings. These arbitrary thresholds have the effect of being both under-inclusive and over-inclusive at the same time: They allow someone who inherited a fortune—but has no concept of financial markets—to invest in private offerings, but they won’t allow someone with a Ph.D. in economics or finance to invest if their net worth and income happen to be below the thresholds.

This makes little sense, and has the effect of contributing to disparities in income and wealth across our country. And as Acting SEC Chair Michael Piowar recently pointed out, allowing retail investors to invest in both public and private companies can actually have the effect of *reducing* risk in their overall portfolio.<sup>19</sup>

The Chamber supports efforts to include more qualitative criteria for determining who is an accredited investor. We support the “Fair Investment Opportunities for Professional Experts Act,” which passed the House by a vote of 347-8 during the 114<sup>th</sup> Congress, and urge the committee to take the legislation up again this year.

### **Title III: Crowdfunding**

While companies or individuals have “crowdfunded” monetary contributions from a large number of people for years, the JOBS Act provided—for the first time—the legal framework for equity crowdfunding under the federal securities laws. But much like general solicitation, what began as a simple and promising concept looked completely different once it had gone through the legislative process.

Ever since the passage of the JOBS Act, the Chamber has been concerned that the final provisions of Title III would limit the potential of crowdfunding in the United States. Indeed, recent data from the SEC indicate that since the crowdfunding rules went “live” in May of 2016, 163 crowdfunding deals have been initiated, and only \$10 million of funding has actually been raised.<sup>20</sup>

It is very possible some of what is contributing to these muted statistics are the growing pains related to new rules as issuers struggle to understand—or even be informed—about what the rules are and how they can use crowdfunding in practice. However, the paternalistic view of American investors portrayed by Title III (and

<sup>19</sup> “Remembering the Forgotten Investor” Speech by Acting Chairman Michael S. Piowar February 24, 2017  
<https://www.sec.gov/news/speech/piowar-remembering-the-forgotten-investor.html>

<sup>20</sup> “U.S. securities-based crowdfunding under Title III of the JOBS Act” SEC Division of Economic Risk and Analysis  
[https://www.sec.gov/dera/staff-papers/white-papers/RegCF\\_WhitePaper.pdf](https://www.sec.gov/dera/staff-papers/white-papers/RegCF_WhitePaper.pdf)

subsequent SEC rules)—with arbitrary limitations on how much be raised and the amount an individual can invest—has no doubt dampened the utility of undergoing a crowdfunding offering. The legal landmines that exist for issuers and crowdfunding portals also present serious challenges.

In order to “fix” Title III and make these rules workable for businesses and their investors, the Chamber is fully supportive of Congressman McHenry’s aptly named “Fix Crowdfunding Act” (H.R. 4855 in the 114<sup>th</sup> Congress) and urges the committee to take up similar legislation this Congress. We are also fully supportive of Congressman Emmer’s “Micro Offering Safe Harbor Act” (H.R. 4850, 114<sup>th</sup> Congress) which would provide a safe harbor for small businesses that are looking to raise very small amounts of capital.

#### **Title IV: Modernization of Regulation A**

Regulation A is an exemption that has long existed in securities regulation for issuers that may be seeking public financing, but are not prepared to undergo the full costs of an IPO. However, prior to the JOBS Act, the eligibility criteria under Regulation A had not been updated since 1992, rendering the exemption useless for the vast majority of companies that would otherwise be interested in using it. A 2012 GAO report found that the low offering threshold (\$5 million and under), as well as a conflicting maze of state “blue sky” laws contributed to the unpopularity of Regulation A.<sup>21</sup>

Title IV sought to address this by raising the offering threshold from \$5 million to \$50 million, and directing the SEC to implement rules that would ultimately address some of the blue sky issues. The SEC’s final rules—which became effective in June 2015—establish two tiers for new “Regulation A+” offerings. Tier I offerings may not exceed \$20 million and are required to meet state registrations requirements; Tier II offerings may not exceed \$50 million, are exempt from blue sky requirements, but are still subject to both auditing and ongoing reporting requirements.

As of October 31, 2016, approximately 81 offerings—seeking up to \$1.5 billion in financing—had been deemed “qualified” by the SEC. Approximately \$190 million had actually been raised using the new rules, with Tier 2 offerings being more common than Tier 1. Notably, the vast majority of Reg. A+ offerings were direct

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<sup>21</sup> “Factors That May Affect Trends in Regulation A Offerings” Government Accountability Office July 3, 2012  
<http://www.gao.gov/assets/600/592113.pdf>

offerings made by the issuers to the public, with only 18% of offerings involving an underwriter.<sup>22</sup>

While Regulation A has become exponentially more popular than it has been in the past, Congress should monitor its progress and examine whether further steps are necessary to ensure that Title IV reaches its full potential.

Congress and the SEC should also consider whether the secondary trading environment for Reg. A+ companies is appropriate given the characteristics of the companies that use Reg. A+ and their differences with large, established public companies. One concept worth further exploring is the idea of “venture exchanges”, which could be specifically tailored to support the secondary market trading of Reg. A+ issuers, EGCs, and even possibly companies that are currently listed on a national securities exchange.

The Financial Services Committee passed H.R. 4868, the “Main Street Growth Act” last year, an innovative and positive bill which we believe could provide healthy competition with existing systems, such as the Over the Counter (“OTC”) markets and Alternative Trading Systems (“ATS”). The overall goal should be to increase liquidity, research coverage, and efficiency in the secondary market for small public companies, and we welcome opportunities to work with Members particular ideas moving forward.

## 5. Exploring Further Ways to Facilitate Capital Formation

In addition to necessary fixes to the JOBS Act, 2017 presents a great opportunity for both Congress and the SEC to advance bold capital formation agenda. As mentioned previously, the Chamber fully supports many of the capital formation-related provisions included in Title X of the Financial CHOICE Act, including:

- Allowing mergers and acquisitions brokers to electronically register with the SEC and not be subject to the full requirements for registration imposed upon a full-service broker, provided that such M&A brokers limit their activities to transactions involving an “eligible privately held company”;
- Exempting small issuers and EGCs from the requirement that they file their financial information in XBRL format;

<sup>22</sup> “Regulation A+: What Do We Know So Far?” SEC Division of Economic and Risk Analysis  
[https://www.sec.gov/dera/staff-papers/white-papers/Knyazeva\\_RegulationA-.pdf](https://www.sec.gov/dera/staff-papers/white-papers/Knyazeva_RegulationA-.pdf)

- Expanded eligibility for use of Form S-3 so that more companies can take advantage of “short-form” registration;
- Modernizing the regulatory environment for business development companies (BDCs) which have become an even more important source of capital for small and medium-sized businesses in the wake of the Dodd-Frank Act;
- Clarifying the definition of an angel investor group for purposes of general solicitation under Title II of the JOBS Act.

The newly created Office of the Advocate for Small Business Capital Formation at the SEC also presents an opportunity for the SEC to re-focus on its statutory mandate to “facilitate capital formation,” a mandate that the SEC has all too often neglected. The Office will help provide a permanent voice for small business at the SEC, and will serve as an important conduit between companies looking to raise capital and the Chair of the SEC who sets the agenda.

## 6. Conclusion

The Chamber views the continued efforts of this subcommittee as an important factor in providing the diverse capital structure our free enterprise system needs and to allow for the dynamic changes that make our economy and our capital markets the envy of the world. We believe that the next few years present Congress, the SEC, and the private sector with a golden opportunity to achieve great victories for American businesses and investors, and we stand ready to assist in any way we can.

# RESTARTING THE GROWTH ENGINE:

A PLAN TO REFORM AMERICA'S CAPITAL MARKETS



CENTER FOR CAPITAL MARKETS  
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**RESTARTING THE GROWTH ENGINE:**  
A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

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INTRODUCTION AND  
PRINCIPAL RECOMMENDATIONS



## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### INTRODUCTION AND PRINCIPAL RECOMMENDATIONS

**All Americans have a vested interest in strengthening America's financial services industry, and the time has come to rally support for this effort."**

Former New York Mayor Michael R. Bloomberg and U.S. Senator Charles Schumer, Sustaining New York's and the US' Global Financial Services Leadership, January 2007.

**U.S. capital markets are the lifeblood of our economy."**

Former U.S. Treasury Secretary Henry M. Paulson, Conference on U.S. Financial Competitiveness, March 13, 2007.

**Over the past two decades, markets have become global—corporations, accounting firms, investment banking firms, law firms and now stock exchanges—all have become internationalized. Yet, the U.S. regulatory structure is deeply rooted in the reforms put in place in the 1930s, a period that is closer in time to the Civil War than it is to today."**

Commission of the Regulation of U.S. Capital Markets in the 21st Century, U.S. Chamber of Commerce, Report and Recommendations, March 2007.

**Policymakers and thought leaders [must] address these problems now before a crisis arises. We have it within our power to take sensible, effective steps to ensure that U.S. markets are the most efficient, transparent and attractive in the world. The question is, can we find the political will to take them."**

Commission of the Regulation of U.S. Capital Markets in the 21st Century, U.S. Chamber of Commerce, Report and Recommendations, March 2007 (emphasis added).



Of course, a crisis did arise—as did a massive legislative and regulatory response—but those prescient words are truer today than they were in 2007. The challenges of 2007 still remain, but they have become more complex. New challenges have arisen as well.

Since the 2008 financial crisis erupted, the United States has seen a massive response to promote financial stability—the passage of the Emergency Economic Stabilization Act of 2008 and the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act" or "Dodd-Frank") and the development and implementation of Basel III, to name a few. A massive new layer of regulation was added in the hopes of making our financial system



more stable, but it has constrained credit and sapped liquidity from our capital markets. This has impacted the businesses that rely on our capital markets for funds. Are the generators of growth and jobs—American businesses—more empowered now? Sadly, the answer is “no.”

Regulators have more regulatory powers than ever and engage in a micromanagement-style of oversight, but they are unable—or unwilling—to consider the implications of their actions on the markets they regulate.

This has resulted in policies that have led to more inefficient markets that are a drag rather than a boost for the economy. Today, corporate treasurers must deal with less liquid and more inefficient markets. Since 1996, the number of public companies has decreased by 50%. Economists are confounded by low productivity, and while unemployment rates have dropped, labor participation has hit all-time lows. All of this is happening while economic growth seems stuck at 2%—a growth rate sufficient to stave off a recession, but not sufficient to provide Americans with the level of prosperity they expect or can pass on to the next generation.

While the responses to the financial crisis did address some of the root causes of the crisis, many were left unaddressed. The 1930s regulatory system remains in place with layers added to it. Regulators were not provided with the tools to keep up with dynamic, evolving global capital markets. New agencies and rules were created, but obsolescence was never addressed. There is a troubling pattern of systemic risk oversight and consumer protection enforcement that “end-runs” the transparency, efficiency, and quality controls of the Administrative Procedures Act (“APA”). Rulemaking, in some areas, became more opaque and disregarded the very real, adverse consequences that new rules sometimes heap upon the economy. Tools needed for smart regulation are often ignored. Rather than ensuring an even playing field that promotes competition, regulation has become a game of “gotcha” designed more to address governmental reputational risk rather than enforcing the law in a fair and balanced way.

The American economy remains the most resilient and nimble in the world and rewards prudent risk takers.

Yet the picture is not all doom and gloom.

The American economy remains the most resilient and nimble in the world and rewards prudent risk takers. We have seen new markets and companies grow and thrive even in these tough times. The American economy is still growing, while many economies around the world are in a recession. Unfortunately, the tepid growth is occurring in spite of, rather than due to, the regulatory structures currently in place.

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

It is imperative that we make progress now—with an increasingly global economy, businesses must have the ability to compete and our regulators must be able to coordinate with their counterparts.

The issue facing the next administration—regardless of party affiliation—is this: how to ensure that the United States has the modern financial regulatory system needed so that fair and efficient capital markets can provide the resources for businesses to compete and for consumers to have affordable, accessible, and fair financial products that they need.

The hallmarks of the U.S. financial system have been diversity, competition, and innovation.

The hallmarks of the U.S. financial system have been diversity, competition, and innovation. This dynamic system has benefited businesses and investors alike. We need an efficient nonbank financial sector to coincide with a stable banking system. Safety and soundness must be paramount, but innovation and growth must also be encouraged.

The next administration has the opportunity to fix the mistakes of the past and address the structural shortfalls that may limit the future horizons of growth. The right solutions will allow resources to be deployed in the manner needed to achieve the rates of growth and job creation we expect.

We believe that the focus for the next administration should be on the following subject areas:

- Regulatory reform of agencies to promote efficient capital markets;
- International coordination and process;
- Systemic risk monitoring and management to fit the circumstances and business model;
- Retirement security to provide investors with transparency, options, and certainty;
- Financial reporting and corporate governance modernization to meet the needs of businesses and their investors;
- Capital formation and Financial Technology (“FinTech”), fostering innovation and growth;
- Litigation reform and restoring due process; and
- Consumer protection.



With this agenda for the next administration, we provide some answers and suggestions for the executive and legislative branches and regulatory agencies, both domestic and global. While we do not expect to have all the answers, we think it is important to have a debate of ideas, instead of competing sound bites, so we can make 2017 the year of progress rather than another year of plodding along.

#### PRINCIPAL RECOMMENDATIONS:

- Create a Presidential Commission on Financial Regulatory Restructuring;
- Reform and place the regulatory processes of the Federal Reserve and other banking regulators on par with other agencies;
- Reconstitute the Financial Stability Board through a treaty to create transparent and accountable regulatory and designation processes;
- Modernize rule writing through enhanced economic analysis and examination of existing regulations before creating new ones;
- Reform the Financial Stability Oversight Council and clarify use of systemic risk designations and regulation;
- Provide relief for small, medium and regional banks from enhanced regulations and systemic risk regulations and tailor systemic risk regulation to the nonbank business model;
- Conduct a study of major regulatory initiatives for cumulative impacts on all financial institutions, their customers and economic growth;
- Restructure the Consumer Financial Protection Bureau into a commission and place it under congressional oversight through appropriations;
- Congress should create a special bi-cameral committee to study the FinTech landscape and its policy recommendations;
- Repeal the Department of Labor's Fiduciary Duty Rule and replace it with a Security and Exchange Commission (SEC) uniform fiduciary standard rule;

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A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

- Create a Financial Reporting Forum to identify and address emerging financial reporting issues;
- Reform corporate governance 14a-8 rules and modernize shareholder resubmission thresholds;
- Congress and the SEC should create fair due process by creating rights of discovery, right of removal in complex cases, and preservation of right to jury trial; and
- Congress should enhance capital formation by passing a JOBS Act 2.0 package.

STRUCTURAL  
REGULATORY REFORM

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### STRUCTURAL REGULATORY REFORM

#### Presidential Commission on Financial Regulatory Restructuring

Throughout U.S. history, the common response to a financial crisis has been the creation of new agencies to address the real or perceived underlying causes of the emergency. This has led to a patchwork regulatory system where agency jurisdictions overlap, turf battles are common, and regulatory dead-zones lead to insufficient oversight. This patchwork system was a problem before the 2007-2008 financial crisis and may have contributed to the crisis.

The response to the 2007-2008 financial crisis exacerbated these problems and led to the rise of new agencies instead of regulatory streamlining. Since 2008, we have seen the creation of the Financial Stability Board (FSB), the Financial Stability Oversight Council (FSOC), the Office of Financial Research (OFR), the Federal Insurance Office (FIO), and the Consumer Financial Protection Bureau (CFPB). Existing agencies such as the Federal Reserve Board ("Federal Reserve"), the Federal Deposit Insurance Corporation (FDIC), and the Commodities Futures and Trading Commission (CFTC) have seen an expansive increase in their powers as well.

For instance, both the CFTC and SEC regulate derivatives, and the FIO, Federal Reserve, and state regulatory bodies oversee insurance, yet no single regulator oversees FinTech.

The next administration should create a pathway to streamlining the U.S. regulatory structure to minimize conflicts and ensure appropriate oversight and regulation needed for vibrant capital markets. No regulatory issue has proved as difficult as the actual restructuring of our regulatory system. The current overlapping and redundant framework stands as testament to a history of ad hoc responses to crises dating back to the financing of the Civil War. Various efforts have been made to address our regulatory collage, to no avail. The Chamber believes that regulatory restructuring can be a truly bipartisan accomplishment if sufficient political capital is dedicated to launching an effort. Any restructuring must encourage safety and soundness of the financial system, as well as policies to foster innovation and growth. Too often, these have been treated as mutually exclusive goals, but the truth is that one cannot be achieved without the other.

The next administration should create a pathway to streamlining the U.S. regulatory structure to minimize conflicts and ensure appropriate oversight and regulation needed for vibrant capital markets.



In past administrations, the Treasury Department has prepared reports on how to restructure America's financial regulatory architecture. We believe that the incoming administration should make this policy a priority and put the clout of the Oval Office behind it.

#### RECOMMENDATIONS:

- **ESTABLISH A PRESIDENTIAL COMMISSION:** The incoming administration should seek legislation establishing, or create by Executive Order ("EO"), a Presidential Commission (the "Commission") on Financial Regulatory Restructuring.
- **DEVELOP A PLAN FOR RESTRUCTURING THE FINANCIAL REGULATORY SYSTEM:** The Commission should be truly bipartisan and work toward formulating a plan for restructuring. The Commission should be made up of 10 members, evenly split between the two parties, drawn from academia, business, and former regulators. The Commission's work should be limited solely to restructuring and should not opine on regulatory policies. If 60% of the Commission concurs, an official report embodying a formal proposal for restructuring should be issued.
- **BALANCE SAFETY AND SOUNDNESS WITH GROWTH:** In developing this plan, the Commission should demonstrate how the new financial regulatory structure will meet the policy goals of safety and soundness of the financial system and achieve balanced policies for encouraging competition and growth.



## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### Modern Rulemaking

The current financial services regulatory system is unwieldy and overlapping, and at times operates inconsistently with the principles of transparency, accountability, and effectiveness embodied in the APA and the bipartisan Executive Orders on regulatory reform.

What follows is not a critique of the substance of any particular regulation; rather, these proposals address unnecessary burdens that result from duplicative oversight and redundant responsibilities and rulemaking processes that are unnecessarily opaque and unaccountable. Bipartisan agreement on policy may be difficult; agreeing on processes that ensure transparent, fair, and effective rulemaking should not be.

#### Improve the rulemaking process to promote effective and efficient rulemaking

In 1981, President Reagan issued Executive Order no. 12291, requiring cabinet-level departments and regulatory agencies to engage in broad-based cost/benefit reviews of regulation. In 1993, President Clinton revoked EO 12291 and issued its successor, EO 12866. EO 12866, along with the supporting Office of Management and Budget (OMB) Circular A-4, remains in effect today. The logic of the reviews required by these EOs is self-evident—when regulation is necessary to address some market dysfunction, corrective actions should take the least invasive form possible. Any economic regulation entails some drag. Regulators should make sure that the regulatory objective is met with as little drag as possible. Clearly, the logic of such analyses applies to financial regulatory agencies' rulemaking no less than to Cabinet agency rules.

Unfortunately, these EOs do not apply to independent regulatory agencies, including the SEC, CFTC, or the federal banking agencies (the Office of the Comptroller of the Currency (OCC), as an office within Treasury, was subject to these orders; the Dodd-Frank Act re-designated the OCC as an independent regulatory agency in order to remove it from the review process). While financial regulatory agencies have been encouraged to undertake economic analyses like those mandated by EO 12866, they have not shown a great appetite for doing so. Nor have they directed sufficient resources toward complying with the cost/benefit analyses that are required under their organic statutes (absent compulsion by federal courts to do so).



#### RECOMMENDATIONS:

- **REQUIRE ALL AGENCIES TO CONDUCT ECONOMIC ANALYSES:**

Congress should enact legislation requiring financial regulators to undertake economic analyses. Given the demonstrated reluctance of regulators to undertake and publish such analyses, the legislation should mandate the methodology, based largely on the principles embodied in EO 12866. Nevertheless, because the independence of these regulatory agencies is of utmost value, they should be exempt from submitting rules to the OMB for review. As part of an economic impact analysis, regulators should explicitly consider and address the following issues, as appropriate:

- The impact that a regulatory proposal may have on availability of credit to businesses or consumers, including a discussion of alternative sources of credit that currently exist to replace any capacity lost as a result of the rulemaking;
- The extent to which the proposed regulation would add increased costs for businesses, adversely impact capital formation for businesses, or harm investors;
- The marginal benefit of the proposed regulation to the financial stability of the U.S. economy after taking into account the effect of existing rules;
- The marginal benefit of the proposed regulation to the safety and soundness and resolvability of bank holding companies after taking into account the effect of existing rules;
- Whether the proposed regulation would conflict with the objectives of any existing regulations and, if so, the need for the proposed regulation despite such conflict;
- The impact of the proposed regulation on market liquidity; and
- The impact of the proposed regulation on economic growth and the competitiveness of U.S. financial institutions operating in global markets.

- **AMEND THE ADMINISTRATIVE PROCEDURE ACT:** Rigorous economic analysis can be a time-consuming process that regulators might be tempted to rush. With this in mind, we recommend that the APA be amended to clearly state that a meaningful economic analysis must be undertaken if a rule is to pass muster under the

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arbitrary and capricious standard. The courts should be specifically charged with being the arbiter of whether vibrant economic analysis has occurred.

- **PERIODICALLY STUDY EXISTING REGULATIONS:** In order to ensure that the regulator considers a proposal in its real-world context and is mindful of the possibility of regulatory accretion, there should be a recurring mandatory analysis detailing existing regulatory schemes that already apply to the conduct or issue that is the subject of the proposed regulation, any gaps that exist in the current regulatory scheme, the need for additional regulation, and the cumulative impact of the overlapping regulatory schemes.
- **REQUIRE A THREE-YEAR LOOK-BACK:** Each financial services regulator shall establish an office of regulatory review that will be tasked with reviewing every economically significant rulemaking three years after its final effective date and reporting to Congress. This review will include solicitation of public comments regarding the following questions:
  - Did the rulemaking accomplish its stated goals?
  - What is the basis for this determination? Are there quantitative data that support the findings?
  - Were there any unintended consequences, either on the regulated institutions or otherwise?
  - Was the actual cost of implementation and compliance for business in line with the agency's estimates?
  - Is there a need for continued regulation in this regard? Are there alternate regulatory approaches that would have accomplished the goals of the subject regulation at a lower cost?



#### Consolidate data collection with other regulators

Many financial institutions are subject to examination by multiple federal and state regulators. While some of these regulators focus on different functions and their examinations look at different business lines, there is tremendous overlap of regulatory responsibility, particularly with respect to depository institutions. Regulatory overlap results in redundant, expensive, and time-consuming supervisory visits. It can also result in conflicting directions from different regulators.

The Federal Financial Institutions Council has worked to improve the coordination of on-site examinations and should be encouraged to continue to constantly improve coordination. Regulators should also be mindful of the burden imposed by data requests. Institutions receive multiple requests for data and records from multiple agencies—often the same data but in different formats.

#### RECOMMENDATION:

- **CONSOLIDATE DATA COLLECTION REQUESTS AND ADOPT A SINGLE FORMAT:** This will reduce duplication and potential conflict without denying regulators access to data they need. In particular, the banking regulators should work with the OER, which was specifically created by the Dodd-Frank Act to streamline and coordinate data collection among financial regulators.

#### Require memorandums of understanding (MOUs) among functional regulators

Just as banks and nonbanks find themselves subject to examinations from multiple agencies, they are also subject to an increasingly complicated web of regulation across the government. Often, regulatory agencies with different goals send conflicting signals to companies, making good-faith compliance a challenge. Systematic, front-end regulatory coordination would ensure a consistent regulatory approach, help avoid conflicting regulatory mandates, and avoid unnecessary and unintended market disruption. Regulators should be mindful of the need to continue their work in this area.

... regulatory agencies with different goals send conflicting signals to companies, making good-faith compliance a challenge.

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### Federal Reserve Reform

The Federal Reserve has four important functions: it is the central bank of the United States charged with setting monetary policy, it is the supervisory regulator for bank holding companies and banks that are members of the Federal Reserve System, it is the supervisory and prudential regulator of systemically important banks and nonbank financial institutions, and it is one of the primary interlocutors for international financial regulatory bodies, including the FSB and the Bank for International Settlements (BIS).

The Chamber has and will continue to strongly support the Federal Reserve's independence in setting monetary policy. Current recommendations to dictate monetary policy from Capitol Hill not only are dangerous and unnecessary, but also fail to recognize how political pressure in the 1970s led to stagflation. Over the past several years, the Federal Reserve has taken steps to give the public more insight into its monetary policy decisions after the fact, but some lawmakers are proposing to go much further, by imposing front-end conditions, formulas, or limitations on the Federal Reserve's ability to manage the money supply. While it is appropriate that Congress has set the broad objectives of U.S. monetary policy—full employment and stable prices—managing to these goals requires very strong analytical expertise, a long-term view, and flexibility, all of which argue for the Fed maintaining its unique independence in this area.

The Chamber strongly believes that all regulators must be fully transparent in their deliberations and decision-making ...

However, the Federal Reserve in its role as a supervisor of the banking system, and as the systemic risk regulator, should have to abide by the same basic principles as other regulators—transparency, accountability, and due process in writing rules. The Chamber strongly believes that all regulators must be fully transparent in their deliberations and decision-making, and invite and address public input as part of the policymaking process. And the Federal Reserve should be no exception. The Federal Reserve's role as a regulator in the financial sector, both domestically and internationally, makes transparency and process important, as its rules not only affect the financial institutions it regulates, but also directly impact Main Street businesses. Those Main Street businesses have seen a reduction in access to capital and liquidity. The Federal Reserve needs to take into account factors such as competition and growth as well as financial stability when writing rules. We therefore support both structural and process changes that will make the Federal Reserve a more transparent and accountable regulator.

These reforms will ensure that the Federal Reserve can continue to identify and address systemic risk, but in a more targeted, coordinated way that more carefully considers the individual and collective impacts on Main Street companies and the economy as



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COMPETITIVENESS

a whole. Some of these recommendations will require legislation, but the Fed may unilaterally implement many of these recommendations.

These principles for reform are centered on the Federal Reserve because of the broad new powers granted under the Dodd-Frank Act and its central role in the increasingly important FSB. We believe that many of the recommendations listed below could be adopted by the FDIC and OCC as well.

#### RECOMMENDATIONS:

##### • CREATE A TRANSPARENT STRATEGIC REGULATORY PLAN:

- Subject the Federal Reserve to the Government Performance and Results Act, which would require the Fed to prepare a strategic plan for its regulatory programs.
- Require the Federal Reserve to submit an annual regulatory report to Congress, including the following:
  - Its plan for the upcoming year;
  - Its success in implementing its program for the past year.

##### • SUBJECT REGULATION TO TRANSPARENT, ROBUST ECONOMIC ANALYSIS:

When writing regulations, the Federal Reserve should publish an economic analysis that is subject to public scrutiny and comment. This includes the publication of consideration of alternatives, opportunity for public participation, and periodic review of their rules. As the Chamber's Center for Capital Markets Competitiveness (CCMC) has noted in a number of comment letters, under the Riegle Community Development and Regulatory Act of 1994 ("Riegle Act"), banking regulators, including the Federal Reserve, are required to consider the costs and benefits of their regulatory proposals. Courts have held that this requires the publication of an economic analysis that is subject to public commentary and scrutiny.

Given the impact that the Federal Reserve's rules can have on Main Street America, it is important that the Federal Reserve also consider the "downstream" impact of its actions. As part of its cost/benefit analysis, the Federal Reserve should assess the following:

- The impact that a regulatory proposal may have on availability of credit to businesses or consumers, including a discussion of alternative sources of credit

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

that currently exist to replace any capacity lost as a result of the rulemaking;

- The marginal benefit of the proposed regulation to the financial stability of the U.S. economy after taking into account the effect of existing rules;
- The marginal benefit of the proposed regulation to the safety and soundness and resolvability of bank holding companies and banks after taking into account the effect of existing rules;
- Whether the proposed regulation would conflict with the objectives of any existing regulations and, if so, for what reasons the proposed regulation should move forward despite such conflict;
- How the proposed regulation would affect market liquidity;
- How the proposed regulation would affect the competitiveness of U.S. financial institutions or duplicate comparable regulation in a foreign bank's home country; and
- The extent to which the proposed regulation would add increased costs for businesses, adversely impact capital formation for businesses, or harm investors.

- **TAILOR RULES FOR NONBANK SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS (SIFI):** When regulating nonbank financial institutions, as authorized under law, the Federal Reserve should tailor regulations to fit the business model of the institution. Forcing nonbanks to conform to a regulatory template designed for banks is impracticable and expensive and produces no discernible benefit. In fact, it may prove harmful to the economy. In 2014, Congress passed and the president signed a bill that clarified the Federal Reserve's flexibility to tailor capital standards to fit the business model of SIFI-designated insurance companies. The Chamber strongly supported this legislation, and the Federal Reserve should use this type of flexibility both in setting prudential regulations and in designing its supervisory frameworks for nonbank systemically important financial institutions. Where the Federal Reserve does not have the authority to act, it should clearly call upon Congress to grant this authority. The next administration should also support amending Dodd-Frank to strengthen the role of state insurance regulators in the SIFI insurance company regulatory process. State supervisors have a long history in insurance company solvency issues, and have insurance industry expertise. They should have an explicit role in fashioning rules for SIFI insurance companies.



- **SHINE MORE LIGHT ON INTERACTIONS WITH THE FSB, THE INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS (IAIS), THE BIS, AND THE BASEL COMMITTEE ON BANKING SUPERVISION (BCBS):** The Federal Reserve works through international regulatory bodies to set policies that bind member countries and require domestic implementation. Normally, a regulatory mandate comes from the U.S. Congress, but acting under the aegis of international mandate, the Federal Reserve, in effect, creates its own legal mandate for some of the rules it writes. Therefore, the Federal Reserve should be required to do the following:
  - ° Notify Congress and the public prior to entering international negotiations;
  - ° Report to Congress regarding formulation of American positions on matters before the FSB;
  - ° Publish the text of any completed FSB, BCBS, or IAIS agreement and provide a notice and public comment period no less than 60 days before signing it;
  - ° Brief members of Congress on the status of negotiations; and
  - ° Post summaries regarding all meetings with other FSB, BCBS, and IAIS members and their staff on the Federal Reserve's website. Other regulators now do this regarding meetings on proposed rules.
- **HOLD PUBLIC MEETINGS TO CONSIDER REGULATIONS AND INTERNATIONAL REGULATORY AGREEMENTS:** The meeting schedule and agenda should be published in advance, subject to Government in the Sunshine Act ("Sunshine Act") notices. Other independent regulatory agencies, including the SEC, CFTC, and FDIC, generally approve proposed and final rules in open meetings. These meetings should also give the agency's voting members the ability to give public statements of support or opposition that become part of the regulatory record.
- **FILL THE POSITION OF VICE CHAIR OF SUPERVISION:** Dodd-Frank established a new position at the Federal Reserve—vice chair for supervision—to create more regulatory accountability in the senior leadership of the Federal Reserve. Unfortunately, more than five years later, the president has yet to even nominate someone for the Senate's consideration.



## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### SEC Reform

During the past 10 years, the Chamber has undertaken a series of reports on the SEC, its regulatory policies and practices, and its relationship to capital markets and capital formation in the United States. These reports have taken a constructive approach, providing recommendations on how the SEC can better achieve its tripartite mission—protecting investors, ensuring fair and orderly markets, and facilitating capital formation. While the SEC has taken a number of steps that address specific recommendations from these reports, there is much more that could be done. Rather than restate the analysis contained in these reports, we have extracted several recommendations that we believe should be priorities for the next administration.

#### Revamp the diverse ways the SEC interprets and applies its rules

While rulemaking is the foundation of SEC regulatory policy, it is augmented by a wide range of other instruments used to interpret and apply statutory and regulatory policies. Policy interpretations and applications are often found in SEC interpretive releases, exemptive orders, no-action letters, frequently asked questions (“FAQs”), speeches by commissioners and senior staff, and, of course, settled enforcement orders and releases. The continued use of this disparate array of policy pronouncements, some of which are carefully negotiated by a single party or intended to apply to a single transaction, imposes a substantial burden on regulated persons.

The Chamber studies have proposed several recommendations on how the SEC could regularize these policy statements and provide clear guidance to the financial industry, financial markets, and investors.

#### RECOMMENDATIONS:

- **INCREASE THE ROLE OF COMMISSIONERS:** Too often, staff interpretations carry the weight of a rule, but have no input from commissioners. The five-member commission should play a greater ongoing role in the interpretation and application of regulatory policy. This may require Congressional action to amend the Sunshine Act.
- **UTILIZE EXEMPTIVE RULES:** Expanding the use of exemptive rules could substantially reduce the number of routine applications. Rule-writing authority for exemptive rules should be reassigned to the same staff that acts on exemptive applications.



- **REFORM THE USE OF NO-ACTION LETTERS:** A no-action letter should be viewed as informal guidance rather than a method of setting regulatory policy. Because it is often difficult to distinguish interpretation from policy on a prospective basis, the SEC should annually issue interpretive statements that review, adopt, and codify significant staff positions contained in no-action letters. These releases could also be used to withdraw or revise a no-action position previously taken, based upon new facts or an analysis of how it has been interpreted. In its deliberations on potential further action, the SEC should consider the particular circumstances around the no-action letters and the potential for further engagement. The SEC should issue these interpretive statements following an opportunity for public notice and comment. The original recipient of a no-action letter could continue to rely upon the assurances provided in the letter. Any revisions or changes reflected in the SEC's interpretive release would apply prospectively to third parties.
- **CONDUCT RULEMAKING ON BEST PRACTICES:** While industry best practices may be effective techniques to promote regulatory compliance, the failure to adopt these practices should not be viewed as a regulatory deficiency. To the extent best practices should be codified, the SEC should do so through the rulemaking process.
- **AVOID REGULATION BY ENFORCEMENT, EXAMINATION, AND SPEECH:** The SEC should periodically alert those subject to its regulations about emerging trends. New standards, or new interpretations of existing standards, should be addressed through agency rulemaking or formal interpretive guidance, not through negotiated settled enforcement proceedings, examinations, or speeches outlining policies.

#### Refocus the SEC's role in promoting capital formation, innovation, and market efficiency

The U.S. capital markets and America's investors reap substantial benefits when new investment products and services are developed. The days when an individual saved through a savings account, invested by buying individual stocks from a broker, and retired with a defined benefit pension offered by an employer are largely over. Today, the typical American often saves in a money market fund, invests in mutual funds, and prepares for retirement by investing in an individual retirement account, a 401(k) plan, or an employer-sponsored defined contribution program.

Investment vehicles such as money market funds and exchange-traded funds are examples of beneficial innovation that rely on SEC regulatory relief. Because of the

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

substantial benefits that result from these innovations, an effective regulatory process that fulfills its legal obligations and applies sound and prudent judgment in exercising discretion should also appreciate and reflect the substantial benefits of timely action to promote responsible innovation.

The SEC possesses broad statutory authority under the Investment Company Act of 1940 to exempt specified collective investment products from specific requirements of the act. This authority has been the vehicle for profound changes in the mutual fund industry. Because of the progressive use of this authority, investors have been provided with a wide range of highly successful investment products, such as variable annuities, money market funds, multiple classes of mutual funds, funds of funds, and exchange-traded funds. Notwithstanding the successful creation of these new products, the exemptive application process for a new product can be expensive and time-consuming. For example, SEC approval of the first exchange-traded fund took more than four years.

The Chamber has in the past recommended the creation of an optional alternative process that would provide expedited approval of a new investment company product or a new exchange-traded product on a conditional or time-limited basis. A conditional order would have to be structured to provide the applicant with sufficient time so that it could justify the time and expense required to develop a new product, market it, and operate it profitably. Furthermore, the conditionality of the order would have to be structured and limited sufficiently so that an applicant could assess realistically the likelihood of permanent approval and the requirements that would have to be met to obtain final approval. Conversely, the SEC would have to be comfortable that it retains sufficient authority under the order to take necessary regulatory action in the event that the product or service fails to provide the necessary investor protections required by the law.

### RECOMMENDATION:

- **REVAMP THE APPROVAL PROCESS:** The SEC should create an accelerated conditional approval process for new investment products or services.



### Reorganize the SEC and its management structure

During the past decade, the breadth and complexity of the capital markets regulatory landscape has grown. The SEC's legal authority has expanded substantially. The size of the SEC staff has grown by roughly 33% since the turn of the century, and the agency strongly believes that it is still understaffed. The agency has also begun to recognize that to be effective it requires a staff that is composed of more than just lawyers. Today, the development of effective regulatory policy requires staff with firsthand knowledge of the markets, economics, financial risk calculation and management, and accounting.

The SEC is long overdue for a careful reorganization. Its current structure is complicated, confusing, and inefficient. Even after the reconsolidation of the Executive Director and Chief Operating Officer's offices into a single unit that oversees the five administrative support offices, there are still nearly two dozen divisions and offices that report directly to the chairman and an additional 11 regional offices that report to the chairman for certain purposes and jointly to the directors of enforcement and the Office of Compliance, Inspections, and Examinations for other purposes. No organization's chief executive should be burdened with so many direct reports.

The SEC is long overdue for a careful reorganization.

The chairman of the SEC has too many demands on his or her time. One person cannot be responsible for supervising an agency of 4,000 with a budget of more than \$1 billion and simultaneously vote as one member of a collegial body on every enforcement action, rule proposal and rule adoption, and disciplinary opinion—while also serving as the public face of the agency, giving numerous public speeches, testifying before Congress, and, post Dodd-Frank, participating as a voting member of the FSOC.

The organizational structure of the SEC is not just confusing. It is also antiquated, built on a functional regulation model that was created to mirror the clear separations in the capital markets of the 1970s. These clear separations are now a relic of the past. The dual problems of a convoluted reporting structure and a functional regulation model that no longer comports with the regulated industries have directly contributed to the SEC's operational challenge. Frequently, new products and new business models do not easily fit into the old regulatory structures. When the divisions compete to protect their turf, decisions are delayed and innovation is stifled.

The reorganization of the SEC is decades overdue.

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### RECOMMENDATIONS:

- **HIRE OFFICERS FOR FIVE-YEAR TERMS:** Senior officers should be hired for renewable five-year term appointments. A public personnel recruitment competition for the position should be a mandatory component of the renewal process.
- **CREATE AN EXECUTIVE DEVELOPMENT PROGRAM:** The SEC should develop a comprehensive executive development program for its most promising staff who are interested in staying at the agency.
- **REALIGN DIVISIONS:** The Division of Trading and Markets and the Division of Investment Management should be realigned into a Division of Financial Intermediary Oversight and a Division of Market Oversight and Operations. The Examination Programs of the Office of Compliance, Inspections, and Examinations should be assigned to these new divisions.

INTERNATIONAL COORDINATION  
AND PROCESS

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### INTERNATIONAL COORDINATION AND PROCESS

One of the major difficulties of the financial crisis was the failure of adequate cross-border cooperation. Perhaps the biggest change in capital markets regulation since the crisis was the enhanced Group of Twenty (G20) consultation and the rise of the FSB. The FSB has taken a lead role in developing policies, based upon G20 communiqués, for domestic regulators to implement. The FSB is not a treaty organization, and the FSB's pronouncements are not legally binding on the United States or any other member state. The track record of the G20 members in implementing FSB proposals varies wildly and, as result, we continue to see discordant regulation. This dynamic is not confined to the FSB. For instance, European banking regulators view the Basel III capital rules as a ceiling, while U.S. regulators view them as a floor.

No one denies the need for international dialogue and coordination. However, international directives can be used for back-door regulation; that is, to formulate policy (behind closed doors) that U.S. regulators then are "compelled" to implement. The Federal Reserve has a central role in the FSB, BIS, and BCBS. Through these organizations, the Federal Reserve creates its own legal rationale for some of the rules it writes, without the procedural safeguards or quality controls built into the APA. These shortcomings are akin to the shortcomings surrounding the FSOC and its processes.

When policy can be formulated behind closed doors, and without public input that regulators are obligated to address, the end result will be rules that the public will view with suspicion

When policy can be formulated behind closed doors, and without public input that regulators are obligated to address, the end result will be rules that the public will view with suspicion, and that may be unnecessarily complex, burdensome, or unfeasible.

#### Financial Stability Board

The G20 established the FSB at its 2009 summit, to succeed the Financial Stability Forum. According to its website, the FSB:

(W)orking through its members, seeks to strengthen financial systems and increase the stability of international financial markets. The policies developed in the pursuit of this agenda are implemented by jurisdictions and national authorities.

The FSB was established to assess potential sources of systemic risk, make proposals as to how to best address these risks, and encourage coordinated responses to such threats and member country implementation of proposed regulatory schemes to address identified risks.



The FSB has been a driver of global regulatory policy. However, Congress has not authorized U.S. participation in the FSB by treaty (which requires approval by a two-thirds vote of the Senate) or by Congressional-Executive agreement (which requires a majority vote of both the House and the Senate). This has been done for major trade agreements, such as the North American Free Trade Agreement. FSB pronouncements do not have the force of law. This is why, unlike the United States, some other G20 members have declined to vigorously implement these pronouncements, resulting in a lack of global coordination and competitive disadvantage to U.S. firms. Again, the FSB is not a treaty organization and lacks the power to ensure uniform implementation of its directives.

To the extent that U.S. regulators treat FSB pronouncements as legally binding, it raises separation-of-powers concerns, and heightens concerns regarding the opaque process that the FSB uses to formulate policy.

In 2012, the G20 formalized the FSB structure on what the FSB describes as “an enduring organisational [sic] basis.” Unfortunately, the G20 established the FSB with a governance structure that puts a low priority on transparency. Article 3 of the FSB Charter states that the “FSB *should* have a structured process for public consultation on policy proposals” [emphasis added]. Nevertheless, the FSB Procedural Guidelines put a priority on confidentiality and provide complete discretion regarding public consultations.

As its name indicates, the focus of FSB directives has been global financial stability. While financial stability is a goal we all share, it should not be forgotten that stability comes at a price, and regulatory efforts in this regard need to be fine-tuned through a strong, inclusive regulatory review process. It should be recognized that the FSB has the ability to initiate regulation that could severely constrict economic growth. This is why the FSB’s opaque deliberations are so problematic.

But how can we be certain that the FSB considers alternative approaches, or adopts the best possible approach to ensure stability? In the United States we have dealt with this dilemma through transparency, encouraging public input and holding regulators accountable. Because of its important mission and its ramifications on growth, the FSB’s proposals should always be tested through public comment. Passing this test will help to ward off detractors when the proposals are implemented at the national level, and help to support the final implementing rules.



## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### RECOMMENDATIONS:

- MAKE THE FSB MORE TRANSPARENT AND ACCOUNTABLE:** The Chamber recommends that the FSB be reconstituted through a treaty negotiated among its member countries, and the enabling treaty could be subject to congressional approval. The approval process would permit Congress to ensure that the FSB was transparent and that its directives were subject to APA-styled procedural safeguards. These procedures should be subject to public comment, including a published economic analysis. Given that the FSB designates particular institutions as systemically significant, without deference to U.S. treatment of those same institutions, the FSB should be reconstituted by treaty, with an appeals process. Further, a reconstituted FSB must have the means to ensure that all members implement its directives in substantially similar ways.
- SUBJECT THE U.S. REPRESENTATIVE TO PRESIDENTIAL APPROVAL AND SENATE CONFIRMATION:** We further recommend that the U.S. representative of the FSB be a presidential appointee, subject to the advice and consent of the Senate. U.S. regulators have used the FSB to drive domestic regulation. Regulators should not treat the FSB as being legally binding on the United States without explicit congressional authorization to do so. Given the central role of the United States in the FSB, and the organization's reach, it is proper that the Senate be able to review the credentials of our representative, and get necessary and appropriate commitments regarding his or her service at the FSB.



### International Policy Organizations

The Chamber believes domestic regulators should provide Congress and the public at large more meaningful notice and disclosure regarding international regulatory negotiations. This will provide for a better understanding of U.S. positions and provide for more meaningful input when domestic implementing rules are developed. Regulators will also benefit from more informed commentary providing for better rules and more efficient oversight.

#### RECOMMENDATIONS:

- **NOTIFY CONGRESS:** Regulators should notify Congress and the public prior to entering international negotiations.
- **REPORT TO CONGRESS:** Report to Congress regarding formulation of American positions on matters before the FSB and other international regulatory bodies.
- **PUBLISH THE TEXT OF AGREEMENTS:** Publish the text of any completed FSB, BCBS, International Organization of Securities Commissions (IOSCO), or IAIS agreement and provide a notice and public comment period no less than 60 days before signing it.
- **PROVIDE UPDATES REGARDING STATUS OF NEGOTIATIONS:** Brief members of Congress on the status of negotiations.
- **PROVIDE PUBLIC SUMMARIES OF MEETINGS:** Post summaries regarding all meetings with other FSB, BCBS, IOSCO, and IAIS members and their staff on federal agency websites. Other regulators now do this regarding meetings on proposed rules.

SYSTEMIC RISK

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### SYSTEMIC RISK

The 2007-2008 financial crisis exposed the inability of financial regulators to identify, regulate, and mitigate systemic risk. Cross-border coordination among regulators was also difficult at best. Domestically and globally, regulators were granted new powers to monitor and handle systemic risk. Despite these efforts, problems remain and the tools to regulate systemic risk are primarily bank-centric and are not tailored to the varying business models of nonbank financial companies. The rule-writing apparatus for systemic risk regulation is opaque, and the rules are, at times, cumbersome. We believe that cross-border issues and systemic risk can be handled in an open and flexible manner to allow for reasonable risk-taking and oversight to provide businesses and their investors with certainty. This agenda provides reforms to these systems to increase transparency and effectiveness through a balanced approach of stability and pro-growth policies.

#### Financial Stability Oversight Council

The Dodd-Frank Act has fundamentally changed the regulatory landscape. Clearly, regulators did not appreciate the confluence of events that caused the financial crisis, nor did they take action to prevent it. Dodd-Frank tried to create an early warning system for detecting sources of systemic risk, as well as a means of regulating firms or activities that could be a source of systemic risk. This was done by creating yet another regulatory layer in the form of the FSOC and the OFR. Unfortunately, the FSOC has relied on the same regulatory platform that failed to foresee the last financial crisis, while it is unclear how the OFR, which was established to assist the FSOC in its effort to “look over the horizon” for systemic risk, has performed. Much of the OFR's work, however, has been done through a bank-centric lens, for which it was roundly criticized in its asset management study.

This new system has serious deficiencies.

First, the FSOC is not transparent or accountable for its actions and lacks procedural protections associated with APA rulemakings.

Second, the FSOC is flawed in its design. In the case of regulators with a board structure, the FSOC member is the head of the agency rather than the board, thereby preventing the articulation of diverse viewpoints. The FSOC's makeup includes many regulators with no institutional expertise with systemically significant institutions or activities. The FSOC's member voting powers ensure that the Treasury Department controls the apparatus while the Federal Reserve controls its workflows.



The FSOC makes determinations, but does not have the legal authority to promulgate rules. It is tasked with a forward-looking mandate intended to prevent future financial crises. It selects individual companies for special, onerous Federal Reserve oversight, even though the Federal Reserve has experience only with banking regulation. The FSOC also can change the landscape of financial services by recommending that certain activities receive special oversight. The FSOC can order highly disruptive regulation that impacts the provision of financial services and the businesses that depend on those services. Yet the FSOC's decision-making is opaque, and public comment is not sought. More transparency would help the FSOC avoid the pitfalls of "groupthink" and policy tunnel vision to which any organization can fall victim.

Companies that are designated for systemic risk regulation are not given an opportunity to engage the FSOC until the decision to designate is, as a practical matter, made. A designee has scant opportunity to argue its case before the FSOC, and the grounds for an appeal of the designation are very limited. Given the compliance expense associated with designation and the resulting competitive impact, this is fundamentally unfair and also unnecessary. Some companies would willingly divest of risky assets or withdraw from certain business lines to avoid designation. The FSOC process does not afford a designee this opportunity until the decision has been made to move forward with a designation. The FSOC needs to establish a formal "off-ramp" process for designated companies that restructure to have their designation removed. Moreover, giving companies an opportunity to "de-risk" would further the FSOC goal of mitigating potential systemic risk.

#### RECOMMENDATIONS:

- **ENCOURAGE TRANSPARENCY:** The FSOC should make all memoranda, analysis, work papers, and emails that agency staff produces in support of FSOC publicly available.
- **ALLOW FOR DIVERSE AGENCY PERSPECTIVES:** FSOC meetings should be open to all members of agency boards or commission and not just the chair of an agency. The vote of an agency should be determined through majority vote of the board or commission.
- **ASSIGN RULEMAKING TO FUNCTIONAL REGULATOR:** Rulemaking for, and regulation of, designated companies should be the responsibility of the agency responsible for functional regulation of the conduct under scrutiny.

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

- **REFORM THE DESIGNATION PROCESS:** The process for designating financial institutions for systemic risk regulation should provide potential designees with an opportunity to address FSOC concerns and, if appropriate, decide to take steps to de-risk.
- **EMBRACE DUE PROCESS:** Designee targets should be provided with an opportunity to review the record for the determination recommendation and an opportunity to rebut the record. Designee targets should have an opportunity for a hearing prior to an FSOC determination, with the opportunity to compel the production of records and call witnesses.
- **IMPLEMENT AN EFFECTIVE VOTING STRUCTURE:** Any action taken by the FSOC should require the affirmative vote of at least three-quarters of the council to ensure that a diverse set of views is representative. In the case of a designation vote, the primary regulator or independent council member must vote in the affirmative along with the Secretary of the Treasury for the designation to be effective.
- **EXPAND THE GROUNDS FOR APPEAL:** The grounds for appeal of an FSOC decision should be expanded to provide a designee with the same grounds for appeal as anyone subject to an administrative tribunal.
- **ESTABLISH A DESIGNATION OFF-RAMP:** A strong "off-ramp" process must be put in place for designated companies that wish to be considered for de-designation. This off-ramp should clearly lay out each individual step a company must take in order to clear itself of SIFI designation.
- **LIMIT INTERNATIONAL DESIGNATION POWERS:** The FSB and other interested international entities cannot designate a firm for enhanced systemic risk regulations if the home domestic regulator has not designated said firm as a systemically important financial institution.



### Systemic Risk Considerations

Dodd-Frank extended the Federal Reserve's regulatory reach to certain FSOC-designated nonbank financial companies. To be designated, the statute requires that a company be "*predominantly engaged in financial activities*." Congress did not want to cast the net too wide—they realized that an expansive reading of this term would open the door to regulate just about any company. With this in mind, the Senate adopted, and the conference committee endorsed, language in paragraph 102(a)(6) of Dodd-Frank that tightly defined "*predominantly engaged in financial activities*." Only activities that are "*financial in nature*" as such term is defined in subsection 4(k) of the Bank Holding Company Act constitute financial activities for the purpose of paragraph 102(a)(6). Despite this, the Federal Reserve in its implementing regulations used the clear statutory limitations of Dodd-Frank as little more than rough guideposts, and expanded the universe of financial activities that could determine that the predominance test had been met. This is willful avoidance of a clear statutory mandate.

For example, under a plain reading of Dodd-Frank, certain asset managers, such as mutual funds, would not be subject to the designation process. However, the FSOC and FSB have moved forward with the consideration of such entities for potential SIFI designation even though their activities do not fall within the parameters of the predominantly engaged test.

#### RECOMMENDATION:

- **CONFORM NONBANK SYSTEMIC CONSIDERATIONS WITH REGULATION Y:** The next administration should commit the Secretary of the Treasury, as Chair of the FSOC, to work with the Fed to ensure that its definition of "*predominantly engaged in financial activities*" conforms with the requirements of Dodd-Frank, and employs the precise language of Regulation Y, thereby implementing the precise requirements of 4(k) of the Bank Holding Company Act. Accordingly, the regulatory powers would conform to congressional intent and only consider those firms or activities for designation as enumerated under Dodd-Frank and those provisions incorporated by reference.

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### Tailored Regulation

A common complaint regarding Dodd-Frank and other initiatives is that they take a one-size-fits-all approach to financial institutions of differing sizes. This creates regulatory mismatches and regressive compliance costs. While regulators often have discretion to tailor certain mandates, regulators have resisted using such authority. This reluctance is unfortunate since the law uses asset size as an imprecise proxy for complexity or systemic significance. Because of this, many banks that are not systemically significant are required to comply with regulations intended for institutions that are. And compliance is not cheap—for instance, the Federal Reserve's 2015 proposal to require banks over \$50 billion to maintain a minimum amount of unsecured long-term debt comes with a \$1.5 billion price tag. Other provisions, like the Volcker rule, prohibit activities that are so hard to delineate, banks are forced to demonstrate that their trading activities are not “proprietary trading”; in other words, they must prove a negative. Furthermore, the application of bank-centric tools upon nonbank financial models ignores stark differences in business models that grew out of different solvency regimes.

In short, regulatory oversight must be nuanced and appropriate to the risk profile of a given industry, activity, or firm. Additionally, a balance must be struck between stability and economic growth in rulemaking; when rules are applied in a manner that does not promote stability, there is nothing but unnecessary drag on economic growth.

#### RECOMMENDATIONS:

- **REGULATIONS MUST “FIT” THE INDUSTRY:** Regulators must identify where they need discretion to tailor rules to fit nonbank financial institutions, and Congress should enact those reforms.
- **TAILOR REGULATIONS TO RISK:** The next administration should propose amending Dodd-Frank to mandate that regulators review all rules applicable to depository institutions and bank holding companies and tailor them to ease regulatory burden associated with compliance and to accurately reflect the risks that different types of institutions pose. The regulators should be required to seek public input regarding this effort and report to Congress on how they addressed the comments received.
- **ASSESS THE COSTS:** The Government Accountability Office (GAO) should examine the true costs of Dodd-Frank implementation, including the cost of establishing and maintaining compliance regimes and the impact of the law on the ability of financial institutions to support economic growth and job creation.





### Small Bank Relief

The Dodd-Frank Act creates rigid thresholds that, once crossed, place a bank under enhanced regulations. Many of those banks are regional or even large community banks, and enhanced regulations harm their ability to execute their unique role in the American economy—providing liquidity and financing to Main Street businesses. Because of their smaller geographic footprint, lack of interconnectedness, and business models, these banks are not systemically risky. Accordingly, many smaller banks are swept up in a costly, burdensome systemic risk regulatory regime, while the smaller businesses that create jobs and growth are starved for capital.

#### RECOMMENDATION:

- **REFORM THE ENHANCED REGULATORY RISK MODEL:** Develop a new means of determining risk and tests to exempt smaller banks from enhanced regulations.

### Cumulative Impact Study

Many of the major policy initiatives, undertaken under the auspices of Dodd-Frank, Basel III, or money market fund reforms, have had a dramatic impact for nonfinancial business treasurers. This has impacted businesses' ability to attract liquidity, manage cash, and raise capital. However, many of those regulations were done without any economic analysis. Yet, we have seen the cost of capital increase and strains and inefficiencies rising in the capital markets. We believe that the regulatory agencies must understand the individual and cumulative impacts of these regulations and include public commentary in the process. Based upon those studies, regulators must address unforeseen and adverse consequences and fix any damage to the capital markets.

#### RECOMMENDATION:

- **UNDERTAKE A CUMULATIVE IMPACT STUDY:** The Federal Reserve, FDIC, OCC, SEC, and CFTC should undertake a cumulative impact of regulations impacting the capital markets including but not limited to: liquidity coverage ratio, net stable funding ratio, the Volcker rule, and money market fund reforms.

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### Living Wills

The living will requirement in section 165 of Dodd-Frank is intended to provide a guide for the resolution of a financial institution pursuant to Title II of the act. While the efficacy of the living will exercise will hopefully never be tested, it has clearly been among the most expensive of the Dodd-Frank mandates. According to an April 2016 GAO report on resolution plans (GAO-16-341), the cost of preparing resolution plans from 2012 through 2015 has in some cases exceeded \$100 million. Given the expense, it is reasonable to ask whether the process is as effective and efficient as possible. According to the GAO, there is broad agreement that the Federal Reserve and the FDIC need to be more transparent about their assessment framework. The GAO found that:

Disclosing the assessment framework, at least in an abbreviated form, would provide companies with a more comprehensive understanding of the principal factors that the regulators use to identify plan deficiencies. (p. 28)

Because of the secrecy surrounding the assessment frameworks, the public cannot properly judge the regulators' assessments, which can only damage the faith that the public has that these institutions can be resolved fairly seamlessly. Transparency would help filing companies to revise their plans in order to have them deemed credible and improve performance in the future. It would also permit academics and professionals with expertise in financial institution resolution to more accurately assess whether this exercise, and the resolutions it envisions, could, in fact, result in a successful resolution.

### RECOMMENDATIONS:

- **PROVIDE GREATER TRANSPARENCY:** The Federal Reserve and the FDIC should provide greater transparency regarding their assessment frameworks. Given regulatory recalcitrance on this topic, legislation may be necessary.
- **ADJUST THE ASSESSMENT SCHEDULE:** Given the time that regulators require to fully assess these plans, it would make sense to move from an annual assessment schedule to a biannual schedule. This additional time would permit filers more time to come to grips with an assessment that their plan was not credible, and address any shortcomings.
- **TAILOR FOR WAVE 3 FILERS:** Recognizing the burden and cost that plan preparation imposes on smaller institutions, the Federal Reserve and the FDIC have already permitted a majority of Wave 3 filers to submit tailored plans. We recommend that all Wave 3 filers be accorded this treatment.

RETIREMENT SAVINGS

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### RETIREMENT SAVINGS

A voluntary, private retirement system provides individuals with a secure financial future and strengthens U.S. capital markets by markedly increasing investment funds flowing into these markets. Accordingly, Congress and the new administration should encourage employment-based retirement savings plans and investment in individual retirement accounts. The current regulatory focus—shoe-horning all retirement plans into the constraints of the Employee Retirement Income Security Act (ERISA)—will likely decrease retirement savings and result in conflicting regulatory mandates.

Private-sector retirement plays a larger role in ensuring the economic well-being of Americans during retirement. Over the past four decades, more retirees have received income from private retirement plans, and the amount of income generated from those plans has also increased—as evidenced by the more than \$24 trillion in retirement plan assets. Nonetheless, a number of current issues must be addressed to strengthen and expand the success of the private retirement system for generations to come. Moreover, people are living longer, retirements last longer, and, as a result, many Americans outlive their retirement savings. As America has grown older as a nation, the ratio of Social Security beneficiaries to Social Security contributors is moving in the wrong direction. According to the Social Security Administration 2015 *Trustees Report*, beginning in 2019, Treasury will begin to deplete trust fund reserves to meet Social Security obligations until total trust fund reserves are depleted in 2034. After 2034, tax income is projected to be sufficient to pay about three-quarters of scheduled benefits.

Clearly something needs to be done, and in a defined contribution world, a market-based component has to be part of the picture. How do we make sure that as many workers and individuals as possible are saving toward retirement? How do we optimize the growth of those retirement savings?

The Chamber believes that retirement savers with a long view are best served by investing with the guidance of investment professionals. The key is to incentivize future retirees to begin saving earlier and saving more. With this in mind, the Chamber proposes the following steps.

#### Small Business Retirement Plans

Small businesses represent over 97% of all employers in America. Many small businesses do not offer retirement plans for employees because of the complexity of the current system, onerous reporting requirements, increased liability, and attendant costs. In 2007, the Chamber organized a bipartisan Commission on the Regulation of U.S. Capital Markets in the 21st Century. One of the primary thrusts of the Commission's report is a series of recommendations designed to encourage small businesses to



provide retirement benefits. These included creating a simplified structure for small business retirement accounts and encouraging multiple employer plans (MEPs). All of these ideas are worth revisiting and deserve serious consideration by policymakers.

#### RECOMMENDATIONS:

- **REPEAL THE DEPARTMENT OF LABOR (DOL) FIDUCIARY DUTY RULE AND REPLACE IT WITH THE SEC UNIFORM FIDUCIARY STANDARD RULE:** The DOL's effort to impose the ERISA structure on market-based plans designed for small businesses is misguided and counterproductive. All available evidence indicates that it will lead to fewer small businesses offering retirement benefits to their employees, with the net result being fewer retirement savers. A similar initiative in the United Kingdom compelled many financial professionals to stop serving savers with limited resources because doing so became cost-prohibitive. Everyone agrees that financial professionals owe a duty of care to their clientele. However, this regulatory initiative should be led by the SEC, the agency with market expertise and whose statutory framework appropriately balances flexibility and choice with robust investor safeguards.
- **FACILITATE THE EXPANSION AND USE OF MEP DESIGNS:** A multiple employer plan is a single plan that is maintained by an MEP sponsor and one or more unrelated employers ("adopting employers"). MEPs allow for the pooling of resources to give small businesses the opportunity to tailor plan provisions. They offer an attractive and cost-efficient alternative for small businesses where a stand-alone 401(k) plan is not feasible. However, the disadvantage to participating in an MEP is that every employer is jointly liable for the qualification failures of every other employer in the MEP. This liability can be a daunting hurdle for many employers. In addition, some employers may be discouraged by the inability to find an MEP sponsor or by the notice and disclosure requirements that are not assumed by the plan administrator. Amending several of the rules regarding MEPs could significantly expand their use. Accordingly, the Chamber recommends the following changes:
  - Implement safe harbors for MEP sponsors and adopting employers to immunize them from noncompliant adopting employers.
  - Simplify MEP reporting and disclosure obligations under ERISA. Particularly, reconsider the annual audit requirements and consolidate Form 5500 filings and Summary Plan Description notices.

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

- Issue Internal Revenue Service (IRS) and the DOL guidance that states "employer commonality" is not required to establish an MEP. While the Chamber believes that there is no basis to apply this requirement to MEPs, there is sufficient ambiguity to create reluctance on the part of employers who may otherwise consider participation in an MEP.

### State-Sponsored Retirement Accounts

A growing number of states have enacted or are considering enacting laws to require employers, including small businesses, to automatically enroll employees in a state-sponsored retirement savings plan if the employer doesn't offer a plan. President Obama directed the Labor Department to clear federal obstacles to such plans. The DOL has provided interpretive relief and finalized an ERISA safe harbor regulation clearing the path for state plans for non-governmental employees. The Chamber believes that this is a step in the wrong direction. States have a less-than-enviable track record as stewards of public employee pension funds. Even the states themselves acknowledge that state retirement plans are underfunded by as much as \$1 trillion (based on the states' extremely optimistic projections regarding investment returns). Pension obligations are currently close to 130% of state and local government annual budgets. While it is true that the state plans under current consideration would operate somewhat differently, they would result in millions and ultimately billions of dollars withheld from employees' paychecks being put into investment programs controlled by state bureaucrats who will decide what investments are available at what price. Further, unlike the single set of rules under federal law, employers would have to comply with potentially 50 different state rules about when the state plan has to be used and how it works. An expansion of the states' role into retirement savings without the protections of ERISA is anti-competitive and could jeopardize the retirement security of countless private-sector employees.

#### RECOMMENDATION:

- **MAINTAIN ERISA PREEMPTION OR IMPOSE ERISA REQUIREMENTS ON STATE-MANAGED FUNDS:** For over 40 years, employers have depended on ERISA to ensure that they can offer plans on a nationwide basis, providing fairness to all employees regardless of where they live or work. State actions establishing



and regulating private employer-provided plans will create complexity in the system. Layering a state-imposed retirement regime on top of ERISA will cause unnecessary burdens, particularly for small businesses, a result counter to the very purpose of ERISA. It could also create unfair competition between the government and the private sector. Therefore, maintaining ERISA's preemption of all state laws that "relate to" employee benefit plans covered by ERISA is appropriate. Furthermore, creating different retirement plans in different states will create significant compliance challenges for employers. Even a small business can have operations, employees, or facilities in more than one state and therefore could have difficulty complying with differing state requirements. A key purpose of ERISA's preemption provision was to avoid this situation. If state-sponsored plans are not preempted by ERISA, they should—at the very least—be compelled to operate under the same ERISA obligations and subject to the same personal liability as their private-sector counterparts. Private-sector employees participating in state-sponsored plans should be afforded the same ERISA protections they enjoy under federal law.

### Economically Targeted Investment Bulletins for ERISA

A contributing factor to public pension performance is the penchant of certain systems for environmental, social, and governance investing and related shareholder activism. While many of the goals espoused by these investors may be worthy, the use of retirement funds of thousands of Americans to try to push forward a policy wish list is irresponsible arrogance. People cannot retire on good karma. The basic premise underlying ERISA is that a fiduciary should act solely in the interest of the plan participant, so while social causes may be a good alternative, investments without regard to social causes may yield a higher return that would better secure the retirement of a participant. Therefore, economic return should be the primary consideration for an ERISA fiduciary.

#### RECOMMENDATION:

- **REINSTITUTE THE ECONOMICALLY TARGETED INVESTMENT BULLETIN:** The next administration should reinstitute the 2008 Bulletins on Economically Targeted Investment regarding the obligations of benefit plan fiduciaries in this regard.

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### Financial Transaction Tax

In the past, some policymakers have called for the imposition of a financial transaction tax ("FTT") on stock trades and similar transactions in order to pay for various unrelated initiatives, such as infrastructure spending. These proposals miss the fact that a FTT will hurt average investors, reduce savings, and make it harder for America's job creators to contribute to economic growth. In fact, FTTs have been tried in the past, both in the U.S. and abroad, and have failed to either raise revenue or curb undesired financial behavior. In fact, such taxes have created havoc in the markets where they have been imposed. In short, an FTT will hurt the liquidity of the U.S. capital markets and dramatically increase the cost of trading, further restricting retail investors from accessing markets, reducing retirement saving balances, and damaging the American economy.

#### RECOMMENDATION:

- **OPPOSE A FINANCIAL TRANSACTION TAX:** The next administration should not endorse any proposal to impose a FTT on financial transactions, including stocks and other financial instruments purchased on behalf of investors or future retirees and taxes on institutions that support market liquidity.

### Post Offices as Banks

Recently, there have been calls to transform the U.S. Post Office into a financial institution, expanding its services into new offerings well beyond delivering and receiving mail. However, the U.S. Postal Service (USPS) has no experience in the banking business and would be taking on a substantial new role while struggling to meet its current mission. Consequently, these proposals would steer consumers into a potentially unsafe and unsound banking alternative at their own risk.

#### RECOMMENDATION:

- **OPPOSE EFFORTS TO TRANSFORM THE USPS INTO A BANK:** The next administration should oppose proposals to expand the role of the USPS to include banking. Such proposals would dramatically increase the role of the USPS when it has no experience in the business of banking, increasing its costs, risks, and regulatory burdens. This would ultimately hurt depositors, borrowers, and savers that used banking services at a post office.



FINANCIAL REPORTING,  
CORPORATE GOVERNANCE, AND  
DISCLOSURE EFFECTIVENESS

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### FINANCIAL REPORTING, CORPORATE GOVERNANCE, AND DISCLOSURE EFFECTIVENESS

Different forms of business ownership have provided the American economy with a unique diversity that is a source of strength and resilience for entrepreneurial initiatives. For generations, the public company model has been the predominant business structure used to access capital for expansion, job growth, and the creation of shareholder value.

The systems of public company financial reporting and corporate governance provide investors with the information, transparency, and confidence necessary to deploy capital and for businesses to access the resources needed to grow. Over the past 10 years, the state of financial reporting and corporate governance has improved. Yet, at the same time, fewer businesses are going public and fewer businesses are staying public. It is clear that a 1930s-based disclosure system cannot keep up with the needs of 21st century investors, businesses, or markets. A challenge for the next administration and Congress will be to modernize these policies to keep pace with the changes in the marketplace and to help ensure that regulators can promote investor protection, capital formation, and competition.

... a 1930s-based disclosure system cannot keep up with the needs of 21st century investors, businesses, or markets.

#### Financial Reporting

In the wake of the Enron and WorldCom scandals and the subsequent passage of the Sarbanes-Oxley Act ("SOX") in 2002, the preparation and audit of financial reports has undergone significant changes. Policymakers realized that financial reporting must keep pace with those changes. Consequently, then SEC Chairman Chris Cox formed the Advisory Committee on Improvements to Financial Reporting (CIFIR), which in August 2008 released its report and recommendations to improve financial reporting. Unfortunately, the demands of the financial crisis diverted the time and attention of the SEC from its ongoing agenda of modernizing financial reporting. We believe that the implementation of these recommendations remains an urgent item on the SEC's agenda.

Adding to the urgency of these recommendations is the pace of change in financial reporting that has taken place since the financial crisis. Among the many new legislative, regulatory, and standard-setting requirements that have influenced financial reporting in the past few years is the Jumpstart Our Business Startups Act ("JOBS Act"). Similarly, Dodd-Frank has profoundly impacted and exacerbated many of the issues identified in the CIFIR report.



For these reasons, it is important for the SEC to adopt a comprehensive approach to modernizing financial reporting policies that includes, in addition to stepped-up enforcement, increased communication and cooperation among regulators, standard-setters, and stakeholders. This will reinforce the SEC's efforts to drive bad actors out of the marketplace, by eliminating the complexity and ambiguity on which they thrive. In fact, the CIFI report found that financial reporting complexity is a key driver in the disconnection between current financial reporting and the information necessary to make sound investment decisions. Because keeping a clear focus on the SEC's mission to ensure that investors receive relevant decision-useful information and to promote capital formation will maximize the agency's chances of success in stamping out accounting fraud and financial disclosure irregularities, we view this as a win-win for the SEC and its stakeholders.

#### RECOMMENDATIONS:

- **MAKE DEFINITIONS OF MATERIALITY CONSISTENT:** The SEC should supplement existing guidance to ensure that the SEC, Financial Accounting Standards Board (FASB), and Public Company Accounting Oversight Board (PCAOB) use a common definition of materiality. The FASB has defined materiality for U.S. Generally Accepted Accounting Principles ("U.S. GAAP") differently than securities laws have, while the PCAOB is using the definition from the federal securities laws.
- **DEVELOP A DISCLOSURE FRAMEWORK:** Investors face information overload from multiple overlapping and sometimes contradictory reporting and disclosure standards. A disclosure framework would also address issues of placement of information within audited U.S. GAAP financial statements versus management discussion and analysis ("MD&A"), which is unaudited, has safe harbors, and provides forward-looking information.
- **ISSUE A POLICY STATEMENT ARTICULATING HOW THE SEC AND PCAOB EVALUATE THE REASONABLENESS OF ACCOUNTING AND AUDITING JUDGMENTS:** In developing new standards, the FASB and PCAOB continue including the recognition, measurement, and disclosure of more fair value and accounting estimates that require judgment. Investors must be made aware that there may not be a single "right answer" in accounting and auditing matters. Investors need clear, specific guidance on the framework that will be used to evaluate these judgments in order to evaluate them.

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

- **HAVE THE SEC WORK WITH THE FASB AND PCAOB TO CONSIDER THE AUDITABILITY OF U.S. GAAP WHEN DEVELOPING ACCOUNTING STANDARDS AND DISCLOSURE REQUIREMENTS:** A formal, ongoing, and transparent dialogue should be created to consider the auditability of accounting standards. This would allow for the auditing of accounting standards to work in conjunction with standards development. It would also provide for the identification and resolution of issues that arise in practice. A similar process should be created to ensure that regulators have an understanding of standards and that different entities are not working at cross purposes.
- **ESTABLISH A FINANCIAL REPORTING FORUM ("FRF"):** While there have been recent efforts to reverse the trend, historically there has been a lack of transparent communication and coordination among regulators, standard-setters, and market participants. An FRF should be created with the mission to identify and propose solutions to problems before they reach the crisis stage. It should be composed of the SEC, FASB, PCAOB, investors (broadly defined), and businesses. An FRF will also provide a mechanism to allow for appropriate coordination among regulators and input from investors and businesses.
- **THE PCAOB SHOULD CREATE NEW BUSINESS AND AUDITOR ADVISORY GROUPS:** Too often, there has been a disconnect between the PCAOB and other stakeholders to appropriately identify and address issues. This has led to unintended consequences that may have misapplied solutions or misidentified problems. The PCAOB and SEC have, over the past 18 months, taken great strides to address these issues. However, a more formalized dialogue can prevent problems from occurring while assisting the PCAOB in providing better oversight of audits.
- **EMPOWER THE PRIVATE COMPANY COUNCIL TO ADDRESS THE NEEDS OF PRIVATE COMPANY USERS:** Any modernization of financial reporting policies requires that the differing needs of users of financial statements be considered and addressed. In particular, private company users do not require the same information as public investors. Accordingly, we believe the SEC, FRF, and Financial Accounting Foundation should closely monitor the activities of the Private Company Council to ensure the needs of private company users are met and that the congressional intent of the JOBS Act is fulfilled.



- **ENCOURAGE THE FASB, PCAOB, AND THEIR ADVISORY GROUPS TO FOLLOW THE SAME RULES OF PROCEDURE AS THE SEC:** FASB and PCAOB standards carry the weight of regulations, and at times their processes can be opaque. Both the FASB and PCAOB and their attendant advisory groups should abide by the same rules of procedures required of regulatory agencies by the Administrative Procedures Act and Federal Advisory Committee Act, including the rule that any advisory groups should be balanced in presentation and open in process. During standard-setting or rule-writing, the FASB and PCAOB should also publish an economic analysis that is subject to public comment.

### Corporate Governance

Effective corporate governance is essential to the long-term vitality of public companies. Governance that is mindful of long-term growth is needed to provide investors with appropriate returns, in turn providing businesses with the capital needed to grow and operate. Traditionally, corporate governance is a triad among management, directors, and shareholders. Since its beginnings, corporate governance, like all corporate law in the United States, has been a matter of state law. While certain states like Delaware have been leaders in the development of corporate law, the competition among the states has resulted in a vibrant and nimble corporate law environment. Those relationships have evolved over decades, aided by enlightened state corporate laws and expert courts. This system, built upon the foundation of the Business Judgment Rule, has created an environment conducive to the growth of public companies. Unfortunately, this system has been increasingly infringed upon by federal actions in recent years.

The federal government has increased its role in establishing governance standards. This is a troubling trend because the imposition of unitary, one-size-fits-all rules only acts to supplant the judgment of shareholders and directors. Policymakers in the past have not adequately taken into account the unintended consequences of reform. One unfortunate consequence has been the marked decrease in the number of public companies over the past 20 years.

... the number of public companies in the United States has fallen in 19 of the past 20 years, leaving the country with less than half of the public companies it had in 1996.

As a result, the number of public companies in the United States has fallen in 19 of the past 20 years, leaving the country with less than half of the public companies it had in 1996. The recommendations provided here are designed to reverse these trends and make the public company model attractive again and regain its place in spurring economic growth and wealth creation.

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### RECOMMENDATIONS:

- **DEVELOP 14A-8 REFORMS:** The SEC should reinstitute its policies to act as a gatekeeper for shareholder proposals. Accordingly, the “Whole Foods” and “Trinity” decisions should be reversed. If the SEC refuses to do so, Congress should pass legislation devolving these powers back to the states. The SEC has abdicated its duty to determine if shareholder proposals will interfere with company ordinary business operations and if shareholder proposals on similar topics conflict with one another. This has led to inconsistent and unnecessary proposals on the ballot and unreliable rules that have confused all stakeholders.
- **REVISIT RESUBMISSION THRESHOLDS:** The SEC should revisit the thresholds on repetitive shareholder proposals that have low or declining support. Those proposals with low or declining support drive up costs for businesses and investors and prevent a meaningful dialogue between the two groups. Failure to address these issues harms the rights of majority shareholders and makes the public company model less attractive. The SEC should adopt the 2014 rulemaking petition.
- **PROVIDE ADDITIONAL PROXY ADVISORY FIRM OVERSIGHT:** The SEC should expand the 2014 guidance and require more oversight over proxy advisory firms by requiring transparent processes and communication around voting policies and recommendations. Vote recommendations must correlate to the fiduciary duty of the proxy advisory firm client. Disclosures around conflicts of interest should also be enhanced. If the SEC does not act, Congress should pass the “Corporate Governance Reform and Transparency Act” (H.R. 5311).
- **REPEAL RULES UNRELATED TO THE SEC'S MISSION:** Corporate disclosures have increasingly been used to promote social or political agendas unrelated to the growth of shareholder value. This has forced the growth of disclosures, made the proxy uncommunicative for investors, and often made the social or political problems worse. Congress should repeal the Conflict Minerals Rule, Resource Extraction Rule, and Pay Ratio Rule.
- **RE-PROPOSE PAY-FOR-PERFORMANCE AND CLAW-BACK PROPOSALS:** While these proposed tools can provide useful information for investors, the current proposals fall short of the mark. The SEC should re-propose these rules so that they meet their intended purpose. These proposals incentivize short-termism, and a better balance must be struck or the requirements repealed.



- **REPEAL INCENTIVE COMPENSATION RULE:** Government should not decide compensation, which is a matter between employer and employee. The proposed rules under section 956 of Dodd-Frank insert regulators into this process and go well beyond the intent of Congress by including information of all employees of some firms. Congress should repeal this requirement.
- **EXAMINE STATE AND MUNICIPAL PUBLIC PENSION PLANS:** Congress and the SEC should investigate the role of public pension plans in corporate governance, along with the return these plans make for their participants and the exposure created for taxpayers. Recent studies have shown the most active public pension plans to have inadequate rates of return while pushing political agendas.

### Disclosure Effectiveness

Disclosure is the foundation of the federal securities laws. The purpose of disclosure is to provide investors with the material information they need to make informed investment and voting decisions. It is crucial that investors have access to information that will permit them to make fully informed decisions regarding when to invest, hold, or divest a financial asset. Disclosure effectiveness, accordingly, should be measured by the degree to which the disclosure regime helps investors understand and evaluate a business when making these decisions. An effective disclosure regime provides investors the material information they need to make objective decisions regarding the value of an investment, but does not overwhelm them with extraneous information that can obscure what is material and distract investors from what really matters about a company.

... "information overload" has been identified as a leading concern with the current disclosure regime.

Over the decades since the securities laws were enacted, and especially in more recent years, the disclosure documents companies file with the SEC have continued to expand and today go on at great length. More information is disclosed than ever before, as reflected, for example, by the lengthy Forms 10-K and proxy statements provided to investors. It should come as no surprise then, that "information overload" has been identified as a leading concern with the current disclosure regime.

In rethinking the disclosure regime, the guiding principle of disclosure reform should be materiality. As investors become inundated with information, they struggle to identify what is material. In some instances, investors simply ignore long, dense documents as too challenging or time-consuming to struggle through.

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

Materiality has long been the touchstone for determining the line between what should be disclosed (material information) and what should not have to be disclosed (immaterial information) under the federal securities laws.

Considering materiality through the eyes of a reasonable shareholder is significant. Judging materiality from a reasonable shareholder's perspective reduces the risk that disclosure documents will balloon even more based on the idiosyncratic interests of a particular investor in issues that have no bearing on the financial soundness of an investment. Furthermore, a focus on the reasonable shareholder helps ensure that what is disclosed is tied to advancing the goals of the federal securities laws, as reflected in the SEC's mission to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. We should seek to put an end to using SEC disclosure documents to advance policy goals that are unrelated to the policy objectives of the federal securities laws.

A more focused disclosure regime, focused on delivering actionable information that any investors trying to maximize the value of their investment would want, will yield immediate benefits. Capital should be allocated more efficiently, market discipline and corporate governance should improve, and the costs and burdens companies incur when raising capital should ease. Emerging growth companies—those newer and smaller entrepreneurial businesses that are a vital source of innovation and job creation in the United States—stand to benefit along with the individuals and institutions investing in them.

### RECOMMENDATIONS:

- **REMOVE OBSOLETE DISCLOSURES:** It is worth noting that much of what needs to be done is simply a matter of eliminating disclosure requirements that are no longer needed. Some items are relics of the paper-based disclosure system of the past, when reliable information took hours, days, or weeks to deliver and there was no immediate access to free analytical tools. Other once-meaningful disclosures have been superseded by subsequent disclosure requirements, or are premised on a presumptive materiality that may not result in decision useful information.
- **PRIORITIZE MATERIALITY:** Our securities disclosure regime has been inundated with disclosure mandates that are unnecessary and frequently duplicative and result in disclosures that are almost undecipherable to ordinary investors. The end result is that vital disclosure documents go unread, or essential information is lost in the minutiae. Materiality (i.e., what would a reasonable, ordinary investor consider





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important information for a decision regarding a financial investment) needs to become the touchstone of our disclosure regime again. The next chair of the SEC should make a review of the existing disclosure regime premised on materiality as a top priority. The chair should report to Congress regarding legislative changes needed to accomplish this effort. In the short term, all redundant and antiquated disclosures should be modified or repealed.

CAPITAL FORMATION  
AND FINTECH

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### CAPITAL FORMATION AND FINTECH

Capital formation is critical for the American economy to grow, create jobs, and provide its citizens with a prosperous future. Policymakers, entrepreneurs, and executives must be cognizant of and receptive to market innovations and allow for new industries. This will enable both the nonfinancial and financial private sectors to remain diverse and vibrant. Federal regulators must allow market-based innovation to continue and allow new business lines, such as FinTech, to develop and exist with established industries. This will allow for the American financial system to keep its traditional diversity that allows businesses of differing models and maturity to access varied forms of capital.

#### Capital Formation

The foundation of economic growth is access to capital. In recent years, and especially since the enactment and implementation of the Dodd-Frank Act, regulatory burdens—such as those placed on financial institutions, private funds, and existing public companies—have made it harder for businesses to access the capital they need to innovate, grow, and create jobs. It is critically important that lawmakers and regulators understand the importance of maintaining an economy that features a diversity of capital sources offered on market-competitive terms.

The foundation of economic growth is access to capital.

#### RECOMMENDATIONS:

- INCREASE SMALL BUSINESS ACCESS TO CAPITAL:** Congress acknowledged the need to preserve and encourage the ability of Main Street businesses, which did not contribute to the financial crash of 2007-2008, to access capital from investors when it passed the JOBS Act. Today, we see the benefits the JOBS Act has wrought: the tailoring of regulatory burdens on small and emerging growth companies has permitted them to divert more capital to production, innovation, and job creation and away from compliance with regulations that do not meaningfully contribute to investor protection. The result of the JOBS Act is more efficient investment by smaller companies. Congress should build on the work begun in the JOBS Act by passing bills that promote capital formation like: the Helping Angels Lead Our Startups (HALOS) Act, the Expanding Proven Financing for American Employers Act, the Fair Access to Investor Research Act, the Encouraging Employee Ownership Act, the SEC Small Business Advocate Act, and the Small Business Capital Formation Enhancement Act.



## FinTech

With the growth of regulatory burdens on (and their associated costs to) traditional capital sources, financial companies and even new market participants have increasingly invested in, developed, and deployed technology to automate historically manual processes and meet market demand. Thus it is often said that technology-driven innovations have “disrupted” the financial services industry, just as they have in past decades. One thing is clear: new technologies are here to stay and that has the potential to fundamentally impact the delivery of financial services as diverse as payments and clearing, small business lending, consumer credit, and factoring. How FinTech is regulated in the coming years will have significant effects on an already struggling credit market. But first, policymakers and regulators should commit themselves to understanding the new roles technology is playing in financial services. Then, with a clear picture of the FinTech landscape, regulators can cooperate with the entire financial services industry—traditional players and new entrants—to develop a sensible regulatory scheme, developed in coordination with all appropriate regulators, that does not forsake growth in the name of financial stability.

... policymakers and regulators should commit themselves to understanding the new roles technology is playing in financial services.

### RECOMMENDATIONS:

#### • CREATE A CONGRESSIONAL BICAMERAL SPECIAL COMMITTEE TO UNDERTAKE AN IN-DEPTH STUDY OF THE FINTECH LANDSCAPE AND THE POLICY IMPLICATIONS OF DISRUPTIVE TECHNOLOGY.

This is an approach that Congress has used in the past to grapple with the policy implications of technological innovation (for instance, the relevant committees of the House and Senate undertook special studies of the implications that data processing and telecommunications were having on the securities markets in the early 1970s). This special committee, which could be comprised of members of the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs, should be charged with completing a report to both Houses of Congress with policy alternatives and legislative recommendations, as appropriate.

LITIGATION REFORM AND  
RESTORING DUE PROCESS

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### LITIGATION REFORM AND RESTORING DUE PROCESS

When an event of the enormity of the financial crisis takes place, it is easy to lose sight of urgent issues that faced our capital markets prior to that event. While Dodd-Frank focused on a set of problems facing our markets, it completely ignored other problems that predated the crisis. In some instances, Dodd-Frank has actually compounded these problems. One such area is the seemingly endless growth of spurious litigation, particularly class actions against financial intermediaries and public companies. Securities class action litigation, and the settlements that defendants feel compelled to enter into to avoid prolonged and expensive litigation, is too frequently without merit, providing a windfall to a cadre of trial attorneys, and only nominal payments to the putative victims who are members of the class. This is not to say that all litigation is without merit; but a decline in a stock's price in and of itself is no grounds for litigation. The United States' unpredictable litigation quagmire discourages foreign investment and listings of public companies in the country.

The competitive implications of our ongoing litigation explosion was one of the focal points of Mayor Michael Bloomberg and Sen. Chuck Schumer's report titled *Sustaining New York's and the US' Global Financial Services Leadership*. This detailed survey of the competitive challenges facing our financial services markets documented the dramatic and ongoing growth in litigation costs. The report noted that in 2004 the cost of the U.S. tort system was \$260 billion, a figure that represented a 100% increase over 1990 levels. At that time these costs were increasing by an annualized rate of 10%. This bipartisan report makes a compelling case for litigation reform, both to abate unnecessary costs and to help America's competitive position. A survey of senior executives that was incorporated in the report was particularly telling on this point. The survey found that after the quality of the professional workforce, a fair and predictable legal environment was the most important factor determining a financial center's competitiveness, followed by an attractive regulatory environment.

Since the time of the Bloomberg/Schumer study, the litigation environment in this country has only become worse. Dodd-Frank and other administration priorities have created a maze of confusing and highly technical regulations that are fertile ground for minor violations. For instance, the CFPB's mandatory arbitration rulemaking threatens a system of speedy alternative dispute resolution that has benefited aggrieved consumers. Outside of Dodd-Frank, the DOL fiduciary rule creates a new cause of action under state law against financial advisers trying to assist people saving for retirement. The plaintiff's bar is aggressive and creative; therefore, litigation reform will be an ongoing battle. But it is a battle that must be fought. The cost to our economy far exceeds the dollar amount of settlements. There is a tremendous incidental cost to our economy



when directors, management, advisers, and intermediaries have to make decisions through the prism of harassment litigation avoidance. This is a cost ultimately borne by shareholders, consumers, and retirement savers.

Regulators and law enforcement must also be mindful of the incidental costs of their actions. Legal, regulatory, and enforcement processes in the United States must be fair, balanced, and predictable. Regulators and law enforcement agencies should vigorously enforce the laws to drive out bad actors and provide stakeholders with an even playing field. At the same time, it is incumbent on the government to protect the constitutional and due process rights of individuals and businesses.

Legal, regulatory, and enforcement processes in the United States must be fair, balanced, and predictable.

Shortcuts that deny the right to a jury trial in serious cases, or subject a defendant to multiple enforcement actions based on the same events, can run counter to the principles of fairness and due process enshrined in the Constitution. We must have strong cops on the beat to put away bad actors, but enforcement must be fair and predicated on clear rules of the road.

In certain instances, the intersection of regulation and law enforcement can be made fairer simply if all stakeholders work together toward smarter solutions. Even the most laudable policy goals can result in a quagmire of expensive, burdensome regulatory paperwork that provides little or no meaningful benefit. Bank Secrecy Act compliance is one such area. This law was intended to make financial intermediaries the first line of defense in detecting money laundering. What it ultimately spawned was a time-consuming, incredibly expensive paperwork exercise that requires the collection and reporting of data, most of which has no law enforcement value. In fact, the sheer volume of data that must be manipulated may be counterproductive to law enforcement.

Money laundering detection is clearly a law enforcement priority, but the system must be improved.

The Chamber recommends that the next administration support a few targeted revisions (some specific recommendations regarding the SEC enforcement program are separately enumerated in the section that follows).

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### RECOMMENDATIONS:

- **ELIMINATE DUPLICATIVE ENFORCEMENT:** The government should eliminate duplicative and overlapping enforcement responses by multiple enforcement authorities against the same party for the same conduct. The expense associated with defending multiple actions can compel defendants to settle solely to avoid the expense associated with prolonged litigation. The federal government should take a leadership role among regulatory bodies at the federal and state levels, to reduce or eliminate duplicative and overlapping investigations and duplicative enforcement actions for the same conduct.
- **REMOVE INCENTIVES FOR CRIMINAL BEHAVIOR:** Section 922 of the Dodd-Frank Act provides for the payment of awards to whistleblowers in an SEC enforcement action. While individuals who have been convicted of crimes related to the subject of the SEC action cannot collect award money, it does not preclude the payment of awards to culpable parties who have not been convicted. There is a difference between a whistleblower and a co-conspirator. While cooperation should be a mitigating factor in SEC action, the co-conspirator should not be rewarded for misconduct.



SEC ENFORCEMENT REFORM

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### SEC ENFORCEMENT REFORM

SEC enforcement proceedings should be conducted in a manner that ensures fairness and in a forum in which the rights of defendants are preserved. The purpose of these recommendations is to ensure that the process is fair and that all stakeholders can benefit from the SEC enforcement activities that will engender efficient capital markets.

#### RECOMMENDATIONS:

- **DEVELOP POLICY ON ADMINISTRATIVE PROCEEDINGS:** The SEC should formally adopt, and uniformly apply, a policy that it will use administrative proceedings to adjudicate contested matters if
  - The proceeding is based upon well-established legal principles that have been established in Article III courts;
  - The factual predicate for the alleged violations are substantially equivalent to those asserted and upheld in past enforcement actions; and
  - The matter does not entail an extensive investigative record such that considerations of fairness warrant providing the respondent/defendant with adequate opportunity for pretrial discovery and time within which to fully review the investigative record; or
  - The staff is alleging a cause of action that may be brought only in an administrative proceeding, such as a stop order proceeding, a section 12(j) revocation proceeding, a license revocation or bar proceeding, or a rule 102(e) proceeding, or proceedings based upon a failure to reasonably supervise or causing a violation.
- **ENABLE CHALLENGES OF FORUM:** The SEC should create a procedure to enable respondents to challenge the choice of forum by filing a motion for change of forum with the SEC prior to institution of the proceeding.
- **REVIEW RULES OF PRACTICE:** The SEC should review its Rules of Practice to give effect to its changed authority and increased experience with the broader utilization of administrative proceedings, to recognize the substantial increase in the volume of investigation materials, and to ensure that the SEC's administrative forum is a fundamentally fair and impartial venue, especially for persons and entities not directly regulated by the SEC. Among other things, its rules should be revised to provide adequate opportunities for



pretrial discovery and depositions. SEC rules on completion of the initial decision should be amended to provide sufficient time for the expansion of pre-hearing process.

- **REFORM THE WELLS PROCESS:** The SEC Enforcement Division ("Division") should adopt a uniform policy that all Wells submissions will be provided to the Commission at the same time and in the same format (electronic or paper) used to submit the Action Memorandum containing the recommendation for enforcement action. The Division should consistently provide access to its investigative files with adequate time to permit a meaningful response to a staff Wells Notice or request for a white paper, by establishing a presumption in favor of granting access and requiring that a senior-level official review preliminary decisions to deny such access. The Division should formally adopt and uniformly apply a "reverse proffer" policy and provide potential defendants/respondents with a full presentation of the nature of its proposed case and the supporting evidence before commencing the Wells submission or white paper process. The Division should formally adopt a policy that any party that has made a Wells submission or requested advance notice should be provided reasonable advance notice, such as three business days that the staff will file an enforcement action.
- **CLARIFY THE ADMISSIONS POLICY:** The SEC should reexamine its policy on requiring admissions in some enforcement actions, to reflect its experience to date. As part of this undertaking, the SEC should consider of the policies of other government agencies. Following a careful examination, if the SEC determines that the admissions policy should be continued, a clear statement of the policy should be added to the SEC's Informal and Other Procedures. The codified guidance should articulate meaningful standards that provide guidance on when admissions will be required, promoting consistency in the exercise of its broad discretion. The policy should describe the level of detail used for admissions, including the description of the misconduct and the articulation of the statutory provisions or regulations that were violated, to promote consistency within the Division. The purpose of these admissions statements should be to provide normative guidance to other persons or entities similarly situated. The SEC should publish guidance on how the issue of requiring admissions will be incorporated into settlement negotiations.
- **INCORPORATE ALTERNATIVE CASE RESOLUTIONS:** The SEC should incorporate the use of alternative case resolution methods to rapidly resolve minor, technical infractions, and to encourage and reward effective internal compliance and systems of internal controls. Creative use of informal remedial actions, such as

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deficiency letters, desk injunctions, reports of investigations, and voluntary disclosure of internal investigations and remediation actions, will enable the SEC to devote its limited resources to major instances of misconduct.

- **IMPROVE COMMISSION OVERSIGHT OF ENFORCEMENT:** The Division of Enforcement should submit a quarterly management report to the Commission containing productivity and efficiency metrics developed by the Department of Economic and Risk Analysis. The Commission should receive quarterly oversight briefings on the enforcement program. The briefings should focus on investigations in the following areas:
  - Significant “National Priority” investigations,
  - Investigations raising novel or complex legal questions,
  - Oldest active investigations,
  - Post-mortem analysis of litigated decisions not in favor of the SEC, and
  - New or emerging areas warranting investigation.
- **INCREASE TRANSPARENCY AND DIALOGUE:** The SEC should periodically alert those subject to its regulations of emerging trends. New standards, or new interpretations of existing standards, should be addressed through agency rulemaking or formal interpretive guidance, not through negotiated settlements of enforcement proceedings. The Commission should publish annually a report on its enforcement program, provide a public comment period on relevant issues, and conduct an annual public roundtable to discuss the report and the operations of its enforcement program. There should also be transparency around credit given for cooperation.
- **IMPROVE ACCURACY AND PROMOTE FAIRNESS:** In the interest of maintaining the highest levels of integrity and fairness, SEC staff should adhere to the American Bar Association Code of Professional Conduct Rules on Trial Publicity (rules 3.6 and 3.8) when drafting litigation and press releases. To ensure conformity with these standards and consistency within the Division, all litigation-related press releases should be reviewed pre-release by personnel outside the Division of Enforcement. Releases concerning litigated actions should state explicitly that the description of events represents allegations that must be proven. In settled cases, the Division



should provide counsel for giving settling parties an advance opportunity to review the proposed Litigation Release or press release solely for accuracy and fairness.

- **ENSURE DOCUMENT PRESERVATION AND DISCOVERY:** At the earliest stage of an investigation—whether formal or informal—the Division should notify companies, individuals, and their counsel, to the extent appropriate, that it has an investigative interest in a matter (or matters), and request that companies and individuals immediately institute “information preservation measures” to prevent the destruction (automatic or otherwise) or alteration of any documents, data, or other information that may be relevant to the investigation. The Division should require and receive satisfactory assurances regarding the continuing preservation of all documents, data, and information relevant to the investigation and the understanding that no change in this status will occur without advance communications with the Division.
- **IDENTIFY THE SCOPE OF SUBPOENAS:** To expedite and focus an investigation, the Division should, at an early stage of its investigative efforts, engage in dialogue with counsel for persons and entities receiving subpoenas to identify the scope of the inquiry, and promote an efficient production of materials. In this dialogue, recipients of subpoenas should be encouraged to provide the following information:
  - A description of the categories of documents deemed by the company or individual involved to be most relevant to the matter(s) under review; and
  - An identification of individuals and entities deemed by the company or individual to have relevant information or knowledge about the circumstances relating to the matter(s) under review.
- **BALANCE APPROACH TO DOCUMENT PRODUCTION:** Following the exchange of initial documents and information described above, Division staff and defense counsel should discuss document production, balancing the Division’s need for relevant information with the need of those involved to control costs of document production. Among other things, the Division should
  - Implement concepts of access to information, as an alternative to actual production of information, wherever that approach can be implemented feasibly, and without adding unnecessary time to the investigative process;

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- ° Utilize rolling productions of documents, rather than requiring all potentially relevant documents to be produced at the same time;
  - ° Negotiate document demands or subpoenas that take into account the actual costs associated with production of certain data, especially where information preservation measures have been implemented;
  - ° Jointly identify aspects of the request that may impose disproportionate costs and time burdens; and
  - ° Memorialize written agreements with defense counsel regarding document requests and subpoenas, to avoid any future misunderstandings, and to provide new or future investigators with an understanding of production obligations.
- **PROVIDE NOTICE OF A CLOSED INVESTIGATION:** Written notification that a formal or informal investigation has been closed should be sent promptly to persons and entities whose conduct was under investigation, within two weeks of closure.
  - **PUBLISH AN ENFORCEMENT PLAN:** The SEC should publish annually a report on its Enforcement Program, provide a public comment period on relevant issues, and conduct an annual public roundtable to discuss the report and the operations of its Enforcement Program.
  - **INTEGRATE TRIAL AND INVESTIGATIVE TRIAL UNITS:** The SEC should have the Division integrate its trial attorneys into the investigative process to ensure that investigative records collect all evidence necessary for successful litigation and are based upon appropriate legal theories. Trial attorneys should actively participate in Division training programs.

CONSUMER PROTECTION



## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### CONSUMER PROTECTION

It is important for individuals to have the reliable access to credit needed for purchasing goods and services, while having means of redress in the event of problems. Consumer protection and good business practices are not mutually exclusive. Our markets cannot operate without consumers, and consumers would not have the choice of products, services, and innovation if not for businesses. Consumer protection should not be an overtly adversarial exercise from the outset. Our recommendations seek to strike this balance between consumer protection, on the one hand, and vibrant markets that are responsive to customers' needs, and to ensure that the CFPB meets the same minimum levels of accountability and transparency required of any other government agency.

Strong, clear, and predictable consumer protection policy is an important and necessary component of efficient capital markets.

Strong, clear, and predictable consumer protection policy is an important and necessary component of efficient capital markets. The Chamber believes that clear rules of the road given prospectively are important for both businesses and their customers. While these precepts seem incontrovertible, perhaps no title of the Dodd-Frank Act was (and remains) as controversial as the title that created the CFPB. Those who opposed the manner in which Congress insulated the bureau from meaningful oversight—such as its single-director structure and “ask and you shall receive” funding mechanism from the Federal Reserve—have been justified by the bureau's continuous overreaching during its short five-year existence. The CFPB is sorely in need of substantial structural reforms to make it more accountable to the American people whose congressional representatives created it.

#### RECOMMENDATIONS:

- **INSTITUTE STRUCTURAL REFORM:** The Chamber recommends that the next administration support legislation to replace the single-director governance of the CFPB with a bipartisan board. By doing so, the bureau will benefit from a diversity of viewpoints that go into its decision-making, as other regulators, such as the SEC, CFTC, and Federal Reserve, already do. Legislation should also be enacted to subject the bureau to the appropriations process.
- **REVIEW THE IMPACT OF RULES:** The next administration should also encourage CFPB leadership to reevaluate the bureau's most significant final rules, to examine whether they are benefiting or hurting the consumers the bureau is charged





with protecting, and to apply the same cost/benefit test to rules that have been proposed but not finalized. These rules include the bureau's arbitration rule (discussed below), which would replace consumer-friendly dispute resolution with a broken class action litigation system; its debt collection rule, which would increase transaction and other costs associated with selling and collecting debt that will get passed on to the customer; a rule that could threaten the viability of overdraft products used by millions of consumers; the CFPB's one-size-fits-all approach to small-dollar lending; and its upcoming rules on data collection under Dodd-Frank Act section 1071.

- **PRESERVE ARBITRATION:** In May 2016, the CFPB proposed a rule to prohibit consumer financial services providers from requiring consumers to pursue their disputes in arbitration rather than in class action. This rule would have the practical impact of eliminating consumer arbitration, which the bureau's own 2015 Arbitration Study and Report to Congress expressly found to be generally more consumer-friendly than class action. If the rule is finalized, the next administration should nullify the rule so that consumers—particularly those with individualized claims that are not classable—may once again have access to an economically rational forum to vindicate their claims.
- **STOP REGULATION BY ENFORCEMENT:** One of the CFPB's most destructive practices has been the use of its enforcement authority to impose the functional equivalent of regulation without any of the transparency hallmarks required under the Administrative Procedure Act. The bureau, quite intentionally and programmatically, uses its seemingly boundless authority to prohibit "unfair, deceptive, or abusive acts or practices" to compel administrative consent orders with one private party, and then demands faithful adherence to the terms of that order by everyone else in the marketplace. Failure to do so, in the words of the current director, is tantamount to "regulatory malpractice." Regulation by enforcement also introduces government-sponsored, anti-competitive forces in the market. The bureau's next leadership should continue a robust enforcement program to deter fraud and predation but immediately cease using enforcement as a regulatory substitute for the formal rulemaking process, which permits notice and comment.
- **TAILOR SMALL BUSINESS LENDING DATA COLLECTION:** This autumn, the CFPB will begin to develop criteria, rules, and policies governing its collection of small business lending data pursuant to section 1071 of the Dodd-Frank Act. These new requirements have the potential to add to the regulatory and compliance burdens already crushing small financial services providers. If not collected carefully, the data may also present a skewed picture of small business lending in America.

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The next administration should work collaboratively with the business community to ensure that this data collection is tailored for small institutions and undertaken in a manner that yields accurate data. The next administration should, however, reject the use of the disparate impact theory of discrimination under the Equal Credit Opportunity Act, which underpins the entire section 1071 data collection project.

- **SAFEGUARD APA PROTECTIONS:** Regulation by enforcement presents tremendous practical impediments for compliance systems because it assumes that fact pattern and remedial undertakings of a particular enforcement action are easily imposed on an entire industry. It assumes that companies are simply fungible "boxes" in a flowchart. The financial services industry in American is incredibly diverse. Participants in the same industry can have radically different business models offering distinct products marketed in different ways to different customer bases. This is exactly why notice and comment are so important to our regulatory process. They provide a forum for instructive input by all stakeholders so that regulators can tailor broad legislative directives to industry practices. This is not possible through an ad hoc, bilateral negotiation between two parties.
- **RECOGNIZE COMPETITIVE CONCERNS:** While the CFPB clearly retains the upper hand in enforcement actions, it is still vesting a lot of power in the defendant to negotiate on behalf of an entire industry, many of whom may compete with the defendant. While this may not be unconstitutional delegation to a private party, it is arbitrary, is unfair, and could be anti-competitive.
- **FACILITATE COMPLIANCE:** The CFPB is not the first agency to engage in regulation by enforcement; however, the CFPB uses this technique as its primary form of rulemaking. The CFPB's reliance on this technique is even more disturbing given its extreme reluctance to issue interpretation, guidance, or no-action letters to assist companies in their compliance efforts.
- **PROVIDE MEANINGFUL UDAAP GUIDANCE:** The CFPB director's complete lack of accountability has permitted the bureau to test the limits of its jurisdiction without providing any clarity around its preferred means of imposing its will—enforcement actions for "Unfair, Deceptive or Abusive Acts and Practices," or UDAAP. The CFPB has failed to provide any meaningful guidance through rulemaking. In this regard, the CFPB would be well-advised to consider the admonition of the Second Circuit to the Federal Trade Commission in its handling of similar regulatory authority.



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- **DEVELOP A FINANCIAL LITERACY PROGRAM:** To date, the CFPB has focused its substantial resources on ex post facto enforcement efforts. As discussed above, the CFPB has used its enforcement program to establish standards for expected behavior for entire industries. This confrontational approach to regulation may be unnecessary. Many of the goals that the CFPB hopes to accomplish could be achieved by arming consumers with knowledge necessary to make deliberate informed decisions. The key to this is financial literacy. The CFPB is the logical site to house a financial literacy program. The CFPB could draw on resources throughout the United States to develop financial literacy tools and act as a clearinghouse for information on this topic. We recommend that the next administration work to enact legislation to apportion 10% of the CFPB's current budget to the establishment of a best-in-class financial literacy program.

## RESTARTING THE GROWTH ENGINE: A PLAN TO REFORM AMERICA'S CAPITAL MARKETS

### CONCLUSION

Since the financial crisis of 2007-2008, policymakers and regulators have been solely focused on financial stability; however, as is evident through the economic stagnation of the past decade, stability is impossible without growth. Current policies that stifle growth and job creation have left us with a system that is not able to support sustained growth and innovative business models. The next administration must strike a critical balance and pursue a pro-growth agenda to stimulate much-needed job creation. A vibrant, diverse, and innovative financial system is critical to ensuring continued economic growth.

What is proposed in this agenda are reforms designed not to stand in the way of vigorous, ongoing efforts to stop genuine fraud or criminal conduct in the financial system; rather, these policies are designed to root out bad actions and strengthen our regulatory system, creating clear and fair rules of the road that promote the efficient capital markets necessary for investors to rationally deploy capital and for business to access the resources needed to expand.

The U.S. Chamber of Commerce is ready to work in partnership with all agencies, policymakers, and market participants to move forward with proper fixes, working toward reforming the financial system to support a goal of increased growth and stability. A modern and efficient regulatory system is unquestionably the foundation of the efficient capital markets necessary for a continuously thriving, growing economy. We must break through the political and regulatory standstill to make progress on all the issues outlined above to elevate job and economic growth past the stagnant 2% barrier.



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## FAQ: Majority Voting for Directors

### What is majority voting for directors?

CII considers companies to have majority voting when they require nominees to receive more “for” votes than “against” votes to be elected (or re-elected) to the board. Majority voting helps make board members responsive to the people they represent.

There is no standard definition of majority voting across the market. A company’s definition of majority voting does not necessarily include permitting shareholders to vote against nominees, and it almost never includes relinquishing the board’s authority to indefinitely retain majority-opposed directors.

There are just two ways to elect directors: by a plurality of votes cast and by a majority of votes cast. Policies and provisions determining what happens after the vote significantly affect how those vote requirements impact board composition. CII therefore discusses in this FAQ four discrete iterations of director election regimes:

- strict plurality
- “plurality plus” board-rejectable resignation
- majority voting with board-rejectable resignation
- consequential majority voting

### Which approach do most companies take?

Although nearly 90 percent of S&P 500 companies use majority voting in some form, just 29 percent of Russell 2000 companies use a majority vote standard in uncontested elections, according to FactSet. Most mid-cap and small-cap companies elect directors (when there is no contest for seats) by plurality vote. Most overseas markets use a majority vote standard in some form. Only a handful of U.S. companies, such as Microsoft, provide for consequential majority voting.

### What is plurality voting?

With plurality voting, the nominees who receive the most “for” votes are elected to the board until all board seats are filled. In an uncontested election, where the number of nominees and available board seats are equal, every nominee is elected upon receiving just one “for” vote.

A plurality standard is the best approach to contested elections and is appropriate for the small number of U.S. companies that permit cumulative voting. But a plurality standard is not appropriate for uncontested elections with no cumulative voting.

Almost all companies with plurality voting give shareholders an option on the ballot to “withhold” their vote. Withholding a vote allows shareholders to communicate their dissatisfaction with a given nominee, but it has no legal effect on the outcome of the election. Withholding a vote is fundamentally equivalent to an abstention, although as a practical matter, many interpret it as a non-binding “against.” CII is concerned that some investors may believe incorrectly that a “withhold” option has legal significance different from an abstention.

Plurality voting in uncontested elections makes directors more accountable to each other than to the shareholders they represent. It's a "rubber stamp" process that entrenches boards and, in rare instances, elects directors who lack the confidence of shareholders representing a majority.

**What is "plurality plus?"**

In response to growing investor concerns about the lack of accountability inherent in plurality voting, since 2004 some companies have modified their plurality standard, either through non-binding policies or bylaw amendments, to require that a majority-opposed director (for whom "withhold" votes withheld exceed "for" votes) must tender her resignation to the board. However, at "plurality plus" companies, a nominee who fails to receive majority support is legally elected for another term, subject to board acceptance of the individual's resignation. Boards in the large majority of cases have rejected resignations in this situation.

CII views plurality plus as a step in the right direction, but not the best way to elect uncontested directors. Plurality plus preserves board control regardless of the voting results. CII encourages plurality companies to skip "plurality plus" and adopt consequential majority voting.

**What is majority voting with board-rejectable resignation?**

With majority voting, uncontested nominees must receive more "for" votes than "against" votes to be elected. Importantly, this standard properly denies majority-opposed nominees the honor of being legally elected to the board. However, almost all companies with majority voting couple that standard with a resignation requirement for defeated directors. Under the terms of the requirement, the board retains ultimate control over whether the individual departs from the board or stays.

This is the form of majority voting found at most S&P 500 companies. Given its widespread prevalence, CII currently accepts this form of majority voting if the company already has it in place, and the board has a good-faith commitment to replace unelected directors within a reasonable period of time. Yet the core problem persists; uncontested director elections remain functionally symbolic. CII therefore recognizes consequential majority voting as best practice.

Shareholders have other non-binding mechanisms to express their collective views, including shareholder proposals and non-binding "say-on-pay" votes. Director voting, the basis for board legitimacy, should be binding. Plurality-plus and majority vote standards that permit the board to reject a resignation or immediately reappoint the rejected director leave the actual decision on a board member's continued service in the hands of the board. In the rare cases in which directors are rejected in uncontested votes, it is not clear that the board, which tends to be put on the defensive by votes against any of its members, should be trusted to make this decision, except for a reasonable holdover period to arrange for board change.

**What is consequential majority voting?**

Consequential majority voting requires an uncontested nominee to receive more "for" votes than "against" votes in order to be elected and establishes a reasonable point at which an unelected director may no longer serve on the board. It is the only approach that places ultimate authority in the hands of the company's owners. In this regard, it is the only approach with "teeth."

Some investors oppose this approach because in certain situations, shareholders oppose directors based on a policy matter, and in the view of these investors it is acceptable for the individual to continue on the board if the policy matter is resolved or meaningfully addressed. In some cases, this even extends to the director's behavior. For example, some incumbent directors are rejected due to poor attendance at board meetings, and shareholders can be amenable to their continued service with a pledge by the individual to improve attendance.

For sample bylaw language providing for consequential majority voting, please refer to Appendix 1, which provides both a Delaware-compliant example and a Model Business Corporation Act (MBCA) version.

**Does a majority standard (whether traditional or "consequential") create the potential for an abrupt board vacancy upon a director's defeat?**

In order to be workable, any majority vote requirement must be coupled with some form of "holdover" provision ensuring reasonable accommodation for a smooth transition in the event of a director's defeat. The purpose of a holdover provision is twofold: to safeguard against a hasty recruitment process for a suitable replacement, and to maintain compliance with the company's governing documents, contractual agreements, exchange listing standards and regulatory requirements throughout the transition period. Holdover provisions typically allow 90 days for the transition, and CII believes a window of up to 180 days is reasonable in certain circumstances.

**Is consequential majority voting permissible under state law?**

Yes. Section 141 of Delaware General Corporation Law provides that each director shall hold office until such director's successor is elected and qualified or until such director's earlier resignation. A 2006 amendment to Section 141 clarified that "a resignation is effective when the resignation is delivered unless the resignation specifies a later effective date or an effective date determined upon the happening of an event or events [including failure to obtain a majority of votes cast]. A resignation which is conditioned upon the director failing to receive a specified vote for reelection as a director may provide that it is irrevocable."

Although many Delaware companies since 2006 have amended their bylaws to adopt a majority vote standard and a resignation requirement for directors who fail to obtain a majority of votes cast, these bylaws generally preserve the board's discretion to reject the resignation letter and keep the director on the board indefinitely.

Consequential majority voting is also permitted under the MBCA. In states where corporate law is based on the MBCA, mandatory departure of an unelected director can be tied to a fixed number of days following the election, unlike in Delaware where departure must be tied to a resignation.

**Is there evidence that shareholders care about this issue?**

Yes. According to FactSet, the 89 management proposals from 2013- 2016 for a majority vote standard received average support of 98 percent of shares voted (and 79 percent of shares outstanding). In each year since 2007, average support for shareholder proposals requesting majority voting exceeded 50 percent. Since that year, average annual support has grown from 50.4 percent of votes cast "for" and "against" to 73 percent in 2016. Most of these shareholder proposals were opposed by management.



**Would there be significant director turnover if every company had to replace majority-opposed directors?**

No. A tiny fraction of uncontested director elections result in failure to obtain majority support. In 2016, just 47 uncontested directors in the entire Russell 3000 did not receive majority support. These failures affected only 28 companies, or less than 1 percent of the index.

**Is there any evidence that having majority voting in place makes a difference in actual director turnover when directors fail to obtain majority support?**

Yes. Based on uncontested elections from 2013-2016 in which at least one director did not receive majority support, the vote requirement matters. Overall, a rejected uncontested director left the board 25 percent of the time. At “plurality plus” companies, the departure rate was nearly the same—24 percent, as of the close of 2016.

By contrast, at companies with majority voting, seven of nine directors who lost elections in the same period permanently left the board. The numbers involved are small but encouraging. Of course, any majority-opposed director at a company with consequential majority voting would have a 100 percent departure rate for unelected directors.

More details can be found on CII’s [website](#). These findings are generally consistent with a 2012 [study](#) by the IRRRC Institute and GMI Ratings, which found that “companies with majority standards are more likely than others to remove directors who receive minority support.”

**Why do so few companies have consequential majority voting?**

Many boards view themselves as best qualified to make final decisions about the fate of majority-opposed directors, discounting shareholder views. Skeptics of consequential majority voting may argue that requiring an unelected director to leave the board could cause the company to be out of compliance with contracts, listing standards or corporate governing documents. (In fact, consequential majority voting provides a grace period to maintain compliance.) Skeptics may also claim that consequential majority voting empowers “special interests.” (This argument strikes CII as weak on its face, as holders of a majority of shares voting – the threshold for failure of a nominee under consequential majority vote standard – should not be considered a “special interest” in the context of a widely held public company with one-share, one-vote.)

Additionally, statutory and regulatory history bends toward plurality voting. Most states have corporate codes establishing plurality voting as the default standard, and companies are inclined to follow the default. Although some states have made majority voting the default, no state requires majority voting in uncontested director elections. CII petitioned the Delaware State Bar Association and the American Bar Association (ABA) to embrace majority voting, first as a default, then as a universal standard for publicly-traded companies. The Delaware bar and the ABA declined to support the proposals. The major U.S. stock exchanges do not require listed companies to elect directors by majority vote, despite CII requests to amend listing standards subject to SEC approval. (Correspondence with the Delaware bar, the ABA and the exchanges can be found [here](#).)

**Isn’t the threat of a proxy fight from activist shareholders sufficient to hold boards accountable to shareholders, without any need for shareholders to have an option to vote against directors in routine, uncontested elections?**

No. Even in uncontested situations, the election of directors should be more than an empty formality. Director elections are the basis for legitimacy of boards of directors in their exercise of power over property they do not own.

It is true that proxy fights for board seats are a critical accountability mechanism, but such fights entail substantial cost, are often disruptive and in some cases can focus on financial engineering for the benefit of short-term shareholders. Directors should be accountable to all shareholders on a more routine basis. In addition to the traditional proxy fight, many companies now permit large long-term holders to use “proxy access” to nominate a small minority of directors. However, we believe that voting rights should be meaningful without a requirement for a dissident nomination process and escalation to a proxy fight, even including a tool like proxy access that empowers only long-term shareholders. Moreover, proxy access has not been mandated market-wide.

**Does the SEC regulate how companies describe their voting standards in SEC filings?**

Yes. While state law and companies’ governing documents define the voting standard, the SEC regulates the contents of proxy statements and proxy cards.

But investors should be aware that some plurality-vote companies provide confusing descriptions of their vote standard in their SEC filings. In particular, some:

- Use terminology such as “majority voting” and “majority vote standard” in proxy statements, when in fact they are referring to the support threshold at which a director is required to submit a resignation letter for board consideration
- Provide an “against” choice on the proxy card, potentially leading shareholders to believe such votes have an impact on the outcome of the election, when in fact they do not
- Avoid using the word “plurality” in the description of the vote requirement, for example by stating that majority voting applies unless certain external documents provide otherwise

CH raised concerns in 2015 with the SEC about companies’ use of confusing vote terminology. The SEC on Oct. 26, 2016, proposed certain reforms (see p. 83). The most beneficial of these, in CH’s view, is the proposed requirement that plurality-vote companies disclose the effect of a “withhold” vote. This would make it crystal clear to investors that uncontested plurality elections guarantee victory for all nominees. However, the SEC proposal would not require the handful of plurality companies that provide an “against” choice to similarly disclose that voting “against” has no impact on the election’s outcome. The SEC proposal would require companies with majority voting to provide “against” and “abstain” options, and bar them from providing a “withhold” choice.

\* \* \* \* \*

The **Council of Institutional Investors (CII)** is a nonpartisan, nonprofit association of employee benefit plans, foundations and endowments with combined assets under management exceeding \$3 trillion. Member funds include major long-term shareholders with a duty to protect the retirement savings of millions of workers and their families. CII’s associate members include a range of asset managers with more than \$20 trillion in assets under management. CII has advocated for majority voting since 2005.

-January 2017

**Appendix 1: Sample bylaw language for consequential majority voting**Sample bylaw language compliant in Delaware<sup>1</sup>

If, as of the record date for a meeting of stockholders for which directors are to be elected, the number of nominees for election of directors equals the number of directors to be elected (an “Uncontested Election”), each director shall be elected by the vote of the majority of the votes cast with respect to that director’s election at such meeting of stockholders, provided a quorum is present. For the purpose of an Uncontested Election, a majority of votes cast means that the number of votes “for” a director’s election must exceed fifty percent (50%) of the votes cast with respect to that director’s election. Votes “against” a director’s election will count as votes cast, but “abstentions” and “broker non-votes” will not count as votes cast with respect to that director’s election.

If, as of the record date for a meeting of stockholders for which directors are to be elected, the number of nominees for election of directors exceeds the number of directors to be elected, the nominees receiving a plurality of the votes cast by holders of shares entitled to vote in the election at a meeting at which a quorum is present shall be elected.

In order for any person to become a member of the Board of Directors, such person must agree to submit upon appointment or first election to the Board of Directors an irrevocable resignation, which resignation shall provide that it shall become effective, in the event of a stockholder vote in an Uncontested Election in which that person does not receive a majority of the votes cast with respect to that person’s election as a director, at the earlier of (i) the selection of a replacement director by the Board of Directors, or (ii) 90 [or 180] days after certification of such stockholder vote. Acceptance by the Board of Directors is not a condition to the effectiveness of the irrevocable resignation.

Any director may resign at any time upon notice given in writing or by electronic transmission to the Chairman of the Board or to the Secretary. A resignation is effective when delivered unless the resignation specifies (i) a later effective date or (ii) an effective date determined upon the happening of an event or events (including but not limited to a failure to receive more than fifty percent (50%) of the votes cast in an election).

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<sup>1</sup> Following consultation with multiple Delaware securities law experts, CII believes this sample language complies with Delaware General Corporation Law as currently interpreted. There can be no accounting for future litigation in this area, however. Any company exploring revisions to its vote requirement should seek counsel on bylaw language, including counsel on how to address extraordinary circumstances such as multiple failed elections potentially triggering change-in-control provisions under material contracts and debt covenants.

Sample bylaw language compliant with the Model Business Corporation Act

Companies incorporated in states that generally follow the Model Business Corporation Act may consider the consequential majority voting bylaw at Microsoft<sup>2</sup>, which is incorporated in Washington, an MBCA state:

2.2 Election – Term of Office. At each annual shareholders' meeting the shareholders shall elect the directors to hold office until the next annual meeting of the shareholders and until their respective successors are elected and qualified. If the directors shall not have been elected at any annual meeting, they may be elected at a special meeting of shareholders called for that purpose in the manner provided by these Bylaws.

Except as provided in Section 2.10 and in this paragraph, each director shall be elected by the vote of the majority of the votes cast. A majority of votes cast means that the number of shares cast "for" a director's election exceeds the number of votes cast "against" that director. The following shall not be votes cast: (a) a share whose ballot is marked as withheld; (b) a share otherwise present at the meeting but for which there is an abstention; and (c) a share otherwise present at the meeting for which a shareholder gives no authority or direction. In a contested election, the directors shall be elected by the vote of a plurality of the votes cast.

A contested election is one in which (a) on the last day for delivery of a notice under Section 1.13(a), a shareholder has complied with the requirements of Section 1.13 regarding one or more nominees, or on the last day for delivery of a notice under Section 1.14(g), an Eligible Shareholder has complied with the requirements of Section 1.14 regarding one or more nominees; and (b) prior to the date that notice of the meeting is given, the Board has not made a determination that none of the candidacies of the shareholder or Eligible Shareholder's nominees creates a bona fide election contest. For purposes of these Bylaws, it is assumed that on the last day for delivery of a notice under Section 1.13(a) or Section 1.14(g), there is a candidate nominated by the Board for each of the director positions to be voted on at the meeting. The following procedures apply in a non-contested election. A nominee who does not receive a majority vote shall not be elected. Except as otherwise provided in this paragraph, an incumbent director not elected because he or she does not receive a majority vote shall continue to serve as a holdover director until the earliest of (a) 90 days after the date on which an inspector determines the voting results as to that director pursuant to RCW 23B.07.290; (b) the date on which the Board appoints an individual to fill the office held by such director, which appointment shall constitute the filling of a vacancy by the Board pursuant to Section 2.10; or (c) the date of the director's resignation. Any vacancy resulting from the non-election of a director under this Section 2.2 may be filled by the Board as provided in Section 2.10. The Governance and Nominating Committee will consider promptly whether to fill the office of a nominee failing to receive a majority vote and make a recommendation to the Board about filling the office. The Board will act on the Governance and Nominating Committee's recommendation and within ninety (90) days after the certification of the shareholder vote will disclose publicly its decision. Except as provided in the next sentence, no director who failed to receive a majority vote for election will participate in the Governance and Nominating Committee recommendation or Board

<sup>2</sup> Microsoft's complete bylaws, filed with the SEC in an 8-K on July 5, 2016, are available at <https://www.sec.gov/Archives/edgar/data/789019/000119312516641678/000119312516-641678-index.htm>.

decision about filling his or her office. If no director receives a majority vote in an uncontested election, then the incumbent directors (a) will nominate a slate of directors and hold a special meeting for the purpose of electing those nominees as soon as practicable, and (b) may in the interim fill one or more offices with the same director(s) who will continue in office until their successors are elected.

Appendix 2: The continuum of regimes for uncontested director elections

	PLURALITY VOTING		MAJORITY VOTING	
	Strict Plurality (no resignation) Withhold their vote	Plurality Plus (rejectable resignation) Withhold their vote	Majority Voting (rejectable resignation) Vote against	Consequential Majority Voting Vote against
How do shareholders oppose <sup>1</sup> a nominee? Who gets elected?	Nominees receiving the most for votes (i.e., all nominees)	Nominees receiving the most for votes (i.e., all nominees)	Nominees receiving more "for" votes than "against" votes	Nominees receiving more "for" votes than "against" votes
Must majority-opposed directors <i>immediately</i> depart from the board?	No. Majority-opposed directors are duly elected.	No. Majority-opposed directors are duly elected.	No. Unelected directors remain temporarily via holdover provision, though sometimes indefinitely.	No. Unelected directors remain only temporarily via holdover provision.
Must majority-opposed directors <i>eventually</i> depart from the board?	No	No. The "hard deadline" is the board's decision to accept or reject the resignation.	No. The "hard deadline" is the board's decision to accept or reject the resignation.	Yes. Unelected directors cannot serve beyond a grace period such as 90 or 180 days. (For DE companies, cutoff ties to irrevocable resignation; for MBCA companies, cutoff ties directly to calendar.)

<sup>1</sup> Shareholders who withhold their vote "oppose" a nominee only in unofficial capacity. Technically, every uncontested nominee in a plurality election receives 100% support and zero opposition because withholding a vote is the legal equivalent of an abstention.

	PLURALITY VOTING		MAJORITY VOTING	
	Strict Plurality (no resignation)	Plurality Plus (rejectable resignation)	Majority Voting (rejectable resignation)	Consequential Majority Voting
<b>Argument in favor</b>	Assures board continuity	Enables board continuity while instituting a process for board to consider removal of majority-opposed directors	Same as Plurality Plus, but also denies majority-distinction of legally being re-elected	The only approach with "teeth." Places ultimate authority in the hands of the company's owners by removing the possibility of unelected directors indefinitely remaining on board
<b>Argument against</b>	No accountability to shareholders and no formal process for board to consider removing a majority-opposed director	Legal election of all nominees remains certain. Resignation requirement provides discretion to reject the letter, which routinely happens.	Board retains discretion to keep unelected directors, and sometimes does so (albeit less often than at "plurality plus" companies.)	Does not accommodate scenario of unelected directors "curing" or pledging to resolve issue(s) perceived as having caused the defeat
<b>Currently most prevalent among</b>	Smaller-cap companies	Smaller-cap companies	Larger-cap companies	Not prevalent at present; early examples include WA-incorporated Microsoft's MBCA-compliant version; first DE company TBD
<b>CII position</b>	Opposes	Opposes	Accepts at companies with MV already in place and good-faith commitment to replace unelected directors within reasonable period	Supports as best practice

**Council of Institutional Investors®**  
The voice of corporate governance

Via Hand Delivery

March 13, 2017

The Honorable Jeb Hensarling  
Chairman  
Committee on Financial Services  
United States House of Representatives  
Washington, DC 20515

The Honorable Maxine Waters  
Ranking Member  
Committee on Financial Services  
United States House of Representatives  
Washington, DC 20515

The Honorable Bill Huizenga  
Chairman  
Capital Markets, Securities, and Investment  
Subcommittee  
Committee on Financial Services  
United States House of Representatives  
Washington, DC 20515

The Honorable Carolyn B. Maloney  
Ranking Member  
Capital Markets, Securities, and Investment  
Subcommittee  
Committee on Financial Services  
United States House of Representatives  
Washington, DC 20515

**Re: Hearing entitled, "The JOBS Act at Five: Examining Its Impact and Ensuring the Competitiveness of the U.S. Capital Markets"**

Dear Chairman Hensarling, Chairman Huizenga, Ranking Member Waters, and Ranking Member Maloney:

I am writing on behalf of the Council of Institutional Investors (CII). CII is a nonprofit, nonpartisan association of public, corporate and union employee benefit funds, and other employee benefit plans, foundations, and endowments with combined assets under management exceeding \$3 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. Our associate members include a range of asset managers with more than \$20 trillion in assets under management.<sup>1</sup>

The purpose of this letter is to express our appreciation for holding the above referenced hearing and to offer our views on an issue that is critically important to ensuring the competitiveness of the U.S. capital markets—shareholder rights. As the Committee on Capital Markets Regulation has previously stated:

The strength of shareholder rights in publicly traded firms directly affects the health and efficient functioning of U.S. capital markets. Overall, shareholders of U.S. companies have fewer rights in a number of important areas than do their foreign competitors. This difference creates an important potential competitive problem for U.S. companies. If such rights enhance corporate value, capital will be invested, at the margin, in foreign companies, and in the foreign capital

<sup>1</sup> For more information about the Council of Institutional Investors ("CII"), including its members, please visit the CII's website at <http://www.cii.org/members>.



March 13, 2013  
Page 2 of 2

markets in which such foreign companies principally trade. The importance of shareholder rights also affects whether directors and management are fully accountable to shareholders for their actions.<sup>2</sup>

CII believes there are at least two areas where it is important to enhance shareholder rights: (1) majority vote standard in election of directors, rather than a plurality standard, and (2) one share/one vote, rather than unequal voting rights in common stock.

Attached are two recent CII documents explaining the importance of each of these issues to investors and the capital markets: "FAQ: Majority Voting for Directors," and "Remarks to the SEC Investor Advisory Committee, Ken Bertsch, Executive Director, Council of Institutional Investors, 'Equal Voting Rights in Common Stock,' March 9, 2017." We respectfully request that this letter and the related attachments be included in the public record for the above referenced hearing.

Please contact me with any questions at 202.822.0800 or [jeff@cii.org](mailto:jeff@cii.org).

Sincerely,



Jeff Mahoney  
General Counsel

Attachments

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<sup>2</sup> Interim Report of the Committee on Capital Markets Regulation 93 (Nov. 30, 2006), available at <http://www.capmktsreg.org/wp-content/uploads/2014/08/Committees-November-2006-Interim-Report.pdf>.



**REMARKS TO THE SEC INVESTOR ADVISORY COMMITTEE**  
**KEN BERTSCH**  
**EXECUTIVE DIRECTOR, COUNCIL OF INSTITUTIONAL INVESTORS**  
**“UNEQUAL VOTING RIGHTS IN COMMON STOCK”**  
**MARCH 9, 2017**

Thank you Kurt and members of the IAC for your invitation to join the discussion today.

Snap Inc.'s IPO last week, featuring public shares with no voting rights, appears to be the first no-vote listing at IPO on a U.S. exchange since the New York Stock Exchange (NYSE) in 1940 generally barred multi-class common stock structures with differential voting rights.

Members of the Council of Institutional Investors have watched with rising alarm for the last 30 years as global stock exchanges have engaged in a listing standards race to the bottom. With NYSE-listed Snap's arrival with “zero” rights for public shareholders, perhaps the bottom has been reached.

The Snap IPO took place as the Singapore Exchange proposed to permit multi-vote common stock, and Hong Kong Exchange leaders suggested their exchange may revive consideration of the same. The Hong Kong Securities and Futures Commission, which has provided strong leadership on the matter, blocked such a move just two years ago.

It is clear that Singapore and Hong Kong are responding to competitive pressure from low standards at the NASDAQ and the NYSE, just as NYSE was pressured to relax its rules in 1986 by the lack of restrictions on dual-class listings at NASDAQ. The Council of Institutional Investors was founded in 1985, and this was the first issue we confronted. The Council at that time adopted a strong policy setting one-share, one-vote as a bedrock principle. That remains our policy today, with strong support from all of our constituent groups, including asset owners and asset managers with varying investment methodologies.

We believe multi-class common structures and their power to separate ownership from control pose substantial risks with respect to all three aspects of the commission's tripartite mission: protecting investors; maintaining fair, orderly, and efficient markets; and facilitating capital formation. It is time for the SEC to revisit with U.S.-based stock exchanges the rules on new offerings of multi-class common structures with differential voting rights.

If the exchanges are not willing to bar future common share structures with differential voting rights, the SEC should work with U.S.-based stock exchanges to:

- Bar future no-vote share classes;
- Require true and reasonable sunset provisions for differential common stock voting rights (that cannot be overridden by the controlling shareholder, as often happens); and
- Consider enhanced board requirements for dual-class companies to build greater confidence that boards do not simply rubber-stamp founder managers or the controlling family.

Some background: Soon after the NYSE matched NASDAQ on this in the 1980s, the SEC took action itself to sharply limit multi-class share structures with differential voting rights. But the SEC rule was struck down by a court in 1990. Subsequently, the SEC approved new rules from the U.S. stock exchanges themselves. While the rules created consistency between U.S. exchanges, they have proven weak and decreasingly successful in promoting equal voting rights.

The core concern here is corporate governance 101: Separation of ownership and control over time can lead to a lack of accountability, and accountability to owners is necessary for course corrections that are critical in our capitalist system. Private equity owned firms typically have owners who are engaged and able to force change where management is failing. Public company shareholders rely on the board members they elect to do the same. At Snap, public shareholders, who likely will come to be the dominant providers of capital, have no role in electing directors. And disclosures may be limited compared with true public companies, including no requirement to file a proxy statement or hold an annual meeting open to public shareholders.

Corporations are led by human beings, who are fallible and who do not always see clearly their own mistakes and limitations. Eventually, every company runs into problems, and there needs to be an effective mechanism of accountability to owners. The vitality of American capitalism stems in large measure from U.S. companies' responsiveness to pressures for change from the providers of capital, even when egos are bruised, strategies are upended and executive careers derailed.

Proponents of shielding founders and managers from a company's owners through multi-class structures say that the public markets too often are impatient, and visionary leaders must be protected from company owners to create value for the long-term. For example, Snap CEO Evan Spiegel says it will be five years before markets will see what he can do.<sup>1</sup> That seems to be the basis for Snap's extreme disenfranchisement of public shareholders.

I believe the assertion is dubious. But even if true, why not sunset the share structure in five years, or at least provide an opportunity at the five-year mark for shareholders to vote on a one-share, one-vote basis on whether to extend this protection for another five years?

<sup>1</sup> "We built our business on creativity," Spiegel said. "And we're going to have to go through an education process for the next five years to explain to people how our users and that creativity creates value." See *Los Angeles Times*, at <http://www.latimes.com/business/technology/la-fi-to-evan-spiegel-bobby-murphy-20170302-story.html>.

Snap has a type of sunset provision, but it is triggered only when both founders die (unless they sell off their shares). One founder is age 26, and the other is age 28. Sumner Redstone turns 94 in May, and problems in recent years at Viacom, which he controls by virtue of dual-class shares, are a good example of long-term pitfalls of multi-class stock companies. Assuming that Mr. Spiegel matches Mr. Redstone in longevity, Snap shareholders may be stuck with current control for the next 66 years.

The Council's membership of asset owners, mostly pension funds, have 25- or 30-year investment horizons. They view the increasing prevalence of ever-worse multi-class share structures as seeding problems that will manifest decades from now, harming pension beneficiaries and others. And all on the basis of a theory for which there is little evidence – that founders and controlling holders can grow companies more successfully if they are insulated from accountability to shareholders.

Evidence is lacking that, on net, the management teams, founders and families protected by dual class shares outperform. An upcoming Council study comparing multi-class companies with other firms finds that a multi-class structure neither increases nor decreases return on invested capital (ROIC). The study, of 1,763 U.S. companies in the Russell 3000 index, looks at ROIC from 2007 through 2015. Similarly, two IRRC Institute studies in recent years, including a 2016 paper, have found no clear advantage at controlled companies with differential voting rights, and some evidence of underperformance.

We hear an argument that as long as disclosure rules are good, multi-class structures are acceptable, as purchasers of shares with inferior voting rights can factor that into pricing. To the extent there is validity to that argument at IPO, it breaks down over the longer term given the present operation of our security markets, with long-term investors acting as universal owners, and portfolios to one extent or another indexed to the entire market.

Indeed, the growing importance of indexed investment in the market has increased the need for strong definitions around categories of securities. The idea of an endless variety of securities offerings, with fuzzy, poorly defined boundaries between categories, is attractive to investment bankers and law firms that can make a lot of money off their creative ideas. Such creative ideas include innovative structures that provide comfort to founder/managers that they will not be challenged by company owners, even as they pull in significant capital from public markets. But at some point there is substantial risk of market confusion, and disenabling of simple passive approaches to investment. We learned in the financial crisis that greater complexity in financial structures can have real downsides.

The Snap offering lacks some components for the definition of “equity security” that our members regard as inherent in the definition of an equity, most importantly voting rights. We have heard suggestions that Snap’s public share class is less like common equity and more like a preferred share, or a derivative, or a master limited partnership unit. There is merit in these comparisons, although the Snap public share class is a poor cousin to all of them as well. Just to take the preferred shares comparison, the Snap security lacks a higher claim on company assets,

and there is no mechanism for providing voting rights if the company fails to perform or falls into distress.

CII and a group of our members are approaching index providers to explore exclusion from core indexes, on a prospective basis, of share classes with no voting rights.

But this does not absolve stock exchanges of responsibility. When the SEC worked with U.S. stock exchanges in the 1990s to put the present rules in place, I do not believe many envisioned significant classes of shares with zero voting rights. With the Snap IPO, it is clearer than ever that current rules are ineffective and need to be revisited. With each further step in enabling multi-class stock structures, critical investor protections are eroded and the potential for strong rules recedes. To the extent that Singapore, Hong Kong and other exchanges that have maintained strong standards on multi-class common share listings decide they cannot compete, we will see further decline that will be very difficult to reverse.

We also hear an argument that investors should tolerate multi-class structures as they entice private companies to go public when they might not otherwise. We believe the primary driver of reduced IPO activity relative to other times in history is easy access to private capital, not a fear among founders that their performance as managers will become subject to oversight from the company's owners. In our view, asking public company investors to accept multi-class structures for the sake of IPO growth is as unreasonable as asking private company investors to cease investing in private companies for the sake of IPO growth.

I recognize that the chair-designee of the SEC, Jay Clayton, was intimately involved as a securities lawyer in Alibaba, a Chinese company that succeeded in sharply limiting voting rights of public shareholders only by listing at the NYSE rather than in Hong Kong. Nonetheless, I hope that the Investor Advisory Committee will work with the Commission, including its new chair, assuming that he is confirmed, on reviewing the adequacy of U.S. stock exchange rules.



## FAQ: Majority Voting for Directors

### What is majority voting for directors?

CII considers companies to have majority voting when they require nominees to receive more “for” votes than “against” votes to be elected (or re-elected) to the board. Majority voting helps make board members responsive to the people they represent.

There is no standard definition of majority voting across the market. A company’s definition of majority voting does not necessarily include permitting shareholders to vote against nominees, and it almost never includes relinquishing the board’s authority to indefinitely retain majority-opposed directors.

There are just two ways to elect directors: by a plurality of votes cast and by a majority of votes cast. Policies and provisions determining what happens after the vote significantly affect how those vote requirements impact board composition. CII therefore discusses in this FAQ four discrete iterations of director election regimes:

- strict plurality
- “plurality plus” board-rejectable resignation
- majority voting with board-rejectable resignation
- consequential majority voting

### Which approach do most companies take?

Although nearly 90 percent of S&P 500 companies use majority voting in some form, just 29 percent of Russell 2000 companies use a majority vote standard in uncontested elections, according to FactSet. Most mid-cap and small-cap companies elect directors (when there is no contest for seats) by plurality vote. Most overseas markets use a majority vote standard in some form. Only a handful of U.S. companies, such as Microsoft, provide for consequential majority voting.

### What is plurality voting?

With plurality voting, the nominees who receive the most “for” votes are elected to the board until all board seats are filled. In an uncontested election, where the number of nominees and available board seats are equal, every nominee is elected upon receiving just one “for” vote.

A plurality standard is the best approach to contested elections and is appropriate for the small number of U.S. companies that permit cumulative voting. But a plurality standard is not appropriate for uncontested elections with no cumulative voting.

Almost all companies with plurality voting give shareholders an option on the ballot to “withhold” their vote. Withholding a vote allows shareholders to communicate their dissatisfaction with a given nominee, but it has no legal effect on the outcome of the election. Withholding a vote is fundamentally equivalent to an abstention, although as a practical matter, many interpret it as a non-binding “against.” CII is concerned that some investors may believe incorrectly that a “withhold” option has legal significance different from an abstention.

Plurality voting in uncontested elections makes directors more accountable to each other than to the shareholders they represent. It's a "rubber stamp" process that entrenches boards and, in rare instances, elects directors who lack the confidence of shareholders representing a majority.

**What is "plurality plus?"**

In response to growing investor concerns about the lack of accountability inherent in plurality voting, since 2004 some companies have modified their plurality standard, either through non-binding policies or bylaw amendments, to require that a majority-opposed director (for whom "withhold" votes withheld exceed "for" votes) must tender her resignation to the board. However, at "plurality plus" companies, a nominee who fails to receive majority support is legally elected for another term, subject to board acceptance of the individual's resignation. Boards in the large majority of cases have rejected resignations in this situation.

CII views plurality plus as a step in the right direction, but not the best way to elect uncontested directors. Plurality plus preserves board control regardless of the voting results. CII encourages plurality companies to skip "plurality plus" and adopt consequential majority voting.

**What is majority voting with board-rejectable resignation?**

With majority voting, uncontested nominees must receive more "for" votes than "against" votes to be elected. Importantly, this standard properly denies majority-opposed nominees the honor of being legally elected to the board. However, almost all companies with majority voting couple that standard with a resignation requirement for defeated directors. Under the terms of the requirement, the board retains ultimate control over whether the individual departs from the board or stays.

This is the form of majority voting found at most S&P 500 companies. Given its widespread prevalence, CII currently accepts this form of majority voting if the company already has it in place, and the board has a good-faith commitment to replace unelected directors within a reasonable period of time. Yet the core problem persists; uncontested director elections remain functionally symbolic. CII therefore recognizes consequential majority voting as best practice.

Shareholders have other non-binding mechanisms to express their collective views, including shareholder proposals and non-binding "say-on-pay" votes. Director voting, the basis for board legitimacy, should be binding. Plurality-plus and majority vote standards that permit the board to reject a resignation or immediately reappoint the rejected director leave the actual decision on a board member's continued service in the hands of the board. In the rare cases in which directors are rejected in uncontested votes, it is not clear that the board, which tends to be put on the defensive by votes against any of its members, should be trusted to make this decision, except for a reasonable holdover period to arrange for board change.

**What is consequential majority voting?**

Consequential majority voting requires an uncontested nominee to receive more "for" votes than "against" votes in order to be elected and establishes a reasonable point at which an unelected director may no longer serve on the board. It is the only approach that places ultimate authority in the hands of the company's owners. In this regard, it is the only approach with "teeth."

Some investors oppose this approach because in certain situations, shareholders oppose directors based on a policy matter, and in the view of these investors it is acceptable for the individual to continue on the board if the policy matter is resolved or meaningfully addressed. In some cases, this even extends to the director's behavior. For example, some incumbent directors are rejected due to poor attendance at board meetings, and shareholders can be amenable to their continued service with a pledge by the individual to improve attendance.

For sample bylaw language providing for consequential majority voting, please refer to Appendix 1, which provides both a Delaware-compliant example and a Model Business Corporation Act (MBCA) version.

**Does a majority standard (whether traditional or "consequential") create the potential for an abrupt board vacancy upon a director's defeat?**

In order to be workable, any majority vote requirement must be coupled with some form of "holdover" provision ensuring reasonable accommodation for a smooth transition in the event of a director's defeat. The purpose of a holdover provision is twofold: to safeguard against a hasty recruitment process for a suitable replacement, and to maintain compliance with the company's governing documents, contractual agreements, exchange listing standards and regulatory requirements throughout the transition period. Holdover provisions typically allow 90 days for the transition, and CII believes a window of up to 180 days is reasonable in certain circumstances.

**Is consequential majority voting permissible under state law?**

Yes. Section 141 of Delaware General Corporation Law provides that each director shall hold office until such director's successor is elected and qualified or until such director's earlier resignation. A 2006 amendment to Section 141 clarified that "a resignation is effective when the resignation is delivered unless the resignation specifies a later effective date or an effective date determined upon the happening of an event or events [including failure to obtain a majority of votes cast]. A resignation which is conditioned upon the director failing to receive a specified vote for reelection as a director may provide that it is irrevocable."

Although many Delaware companies since 2006 have amended their bylaws to adopt a majority vote standard and a resignation requirement for directors who fail to obtain a majority of votes cast, these bylaws generally preserve the board's discretion to reject the resignation letter and keep the director on the board indefinitely.

Consequential majority voting is also permitted under the MBCA. In states where corporate law is based on the MBCA, mandatory departure of an unelected director can be tied to a fixed number of days following the election, unlike in Delaware where departure must be tied to a resignation.

**Is there evidence that shareholders care about this issue?**

Yes. According to FactSet, the 89 management proposals from 2013- 2016 for a majority vote standard received average support of 98 percent of shares voted (and 79 percent of shares outstanding). In each year since 2007, average support for shareholder proposals requesting majority voting exceeded 50 percent. Since that year, average annual support has grown from 50.4 percent of votes cast "for" and "against" to 73 percent in 2016. Most of these shareholder proposals were opposed by management.



**Would there be significant director turnover if every company had to replace majority-opposed directors?**

No. A tiny fraction of uncontested director elections result in failure to obtain majority support. In 2016, just 47 uncontested directors in the entire Russell 3000 did not receive majority support. These failures affected only 28 companies, or less than 1 percent of the index.

**Is there any evidence that having majority voting in place makes a difference in actual director turnover when directors fail to obtain majority support?**

Yes. Based on uncontested elections from 2013-2016 in which at least one director did not receive majority support, the vote requirement matters. Overall, a rejected uncontested director left the board 25 percent of the time. At “plurality plus” companies, the departure rate was nearly the same—24 percent, as of the close of 2016.

By contrast, at companies with majority voting, seven of nine directors who lost elections in the same period permanently left the board. The numbers involved are small but encouraging. Of course, any majority-opposed director at a company with consequential majority voting would have a 100 percent departure rate for unelected directors.

More details can be found on CII’s [website](#). These findings are generally consistent with a 2012 [study](#) by the IRRRC Institute and GMI Ratings, which found that “companies with majority standards are more likely than others to remove directors who receive minority support.”

**Why do so few companies have consequential majority voting?**

Many boards view themselves as best qualified to make final decisions about the fate of majority-opposed directors, discounting shareholder views. Skeptics of consequential majority voting may argue that requiring an unelected director to leave the board could cause the company to be out of compliance with contracts, listing standards or corporate governing documents. (In fact, consequential majority voting provides a grace period to maintain compliance.) Skeptics may also claim that consequential majority voting empowers “special interests.” (This argument strikes CII as weak on its face, as holders of a majority of shares voting – the threshold for failure of a nominee under consequential majority vote standard – should not be considered a “special interest” in the context of a widely held public company with one-share, one-vote.)

Additionally, statutory and regulatory history bends toward plurality voting. Most states have corporate codes establishing plurality voting as the default standard, and companies are inclined to follow the default. Although some states have made majority voting the default, no state requires majority voting in uncontested director elections. CII petitioned the Delaware State Bar Association and the American Bar Association (ABA) to embrace majority voting, first as a default, then as a universal standard for publicly-traded companies. The Delaware bar and the ABA declined to support the proposals. The major U.S. stock exchanges do not require listed companies to elect directors by majority vote, despite CII requests to amend listing standards subject to SEC approval. (Correspondence with the Delaware bar, the ABA and the exchanges can be found [here](#).)

**Isn’t the threat of a proxy fight from activist shareholders sufficient to hold boards accountable to shareholders, without any need for shareholders to have an option to vote against directors in routine, uncontested elections?**

No. Even in uncontested situations, the election of directors should be more than an empty formality. Director elections are the basis for legitimacy of boards of directors in their exercise of power over property they do not own.

It is true that proxy fights for board seats are a critical accountability mechanism, but such fights entail substantial cost, are often disruptive and in some cases can focus on financial engineering for the benefit of short-term shareholders. Directors should be accountable to all shareholders on a more routine basis. In addition to the traditional proxy fight, many companies now permit large long-term holders to use “proxy access” to nominate a small minority of directors. However, we believe that voting rights should be meaningful without a requirement for a dissident nomination process and escalation to a proxy fight, even including a tool like proxy access that empowers only long-term shareholders. Moreover, proxy access has not been mandated market-wide.

**Does the SEC regulate how companies describe their voting standards in SEC filings?**

Yes. While state law and companies’ governing documents define the voting standard, the SEC regulates the contents of proxy statements and proxy cards.

But investors should be aware that some plurality-vote companies provide confusing descriptions of their vote standard in their SEC filings. In particular, some:

- Use terminology such as “majority voting” and “majority vote standard” in proxy statements, when in fact they are referring to the support threshold at which a director is required to submit a resignation letter for board consideration
- Provide an “against” choice on the proxy card, potentially leading shareholders to believe such votes have an impact on the outcome of the election, when in fact they do not
- Avoid using the word “plurality” in the description of the vote requirement, for example by stating that majority voting applies unless certain external documents provide otherwise

CII raised concerns in 2015 with the SEC about companies’ use of confusing vote terminology. The SEC on Oct. 26, 2016, proposed certain reforms (see p. 83). The most beneficial of these, in CII’s view, is the proposed requirement that plurality-vote companies disclose the effect of a “withhold” vote. This would make it crystal clear to investors that uncontested plurality elections guarantee victory for all nominees. However, the SEC proposal would not require the handful of plurality companies that provide an “against” choice to similarly disclose that voting “against” has no impact on the election’s outcome. The SEC proposal would require companies with majority voting to provide “against” and “abstain” options, and bar them from providing a “withhold” choice.

\* \* \* \* \*

The **Council of Institutional Investors (CII)** is a nonpartisan, nonprofit association of employee benefit plans, foundations and endowments with combined assets under management exceeding \$3 trillion. Member funds include major long-term shareholders with a duty to protect the retirement savings of millions of workers and their families. CII’s associate members include a range of asset managers with more than \$20 trillion in assets under management. CII has advocated for majority voting since 2005.

-January 2017

**Appendix 1: Sample bylaw language for consequential majority voting**Sample bylaw language compliant in Delaware<sup>1</sup>

If, as of the record date for a meeting of stockholders for which directors are to be elected, the number of nominees for election of directors equals the number of directors to be elected (an "Uncontested Election"), each director shall be elected by the vote of the majority of the votes cast with respect to that director's election at such meeting of stockholders, provided a quorum is present. For the purpose of an Uncontested Election, a majority of votes cast means that the number of votes "for" a director's election must exceed fifty percent (50%) of the votes cast with respect to that director's election. Votes "against" a director's election will count as votes cast, but "abstentions" and "broker non-votes" will not count as votes cast with respect to that director's election.

If, as of the record date for a meeting of stockholders for which directors are to be elected, the number of nominees for election of directors exceeds the number of directors to be elected, the nominees receiving a plurality of the votes cast by holders of shares entitled to vote in the election at a meeting at which a quorum is present shall be elected.

In order for any person to become a member of the Board of Directors, such person must agree to submit upon appointment or first election to the Board of Directors an irrevocable resignation, which resignation shall provide that it shall become effective, in the event of a stockholder vote in an Uncontested Election in which that person does not receive a majority of the votes cast with respect to that person's election as a director, at the earlier of (i) the selection of a replacement director by the Board of Directors, or (ii) 90 [or 180] days after certification of such stockholder vote. Acceptance by the Board of Directors is not a condition to the effectiveness of the irrevocable resignation.

Any director may resign at any time upon notice given in writing or by electronic transmission to the Chairman of the Board or to the Secretary. A resignation is effective when delivered unless the resignation specifies (i) a later effective date or (ii) an effective date determined upon the happening of an event or events (including but not limited to a failure to receive more than fifty percent (50%) of the votes cast in an election).

<sup>1</sup> Following consultation with multiple Delaware securities law experts, CIT believes this sample language complies with Delaware General Corporation Law as currently interpreted. There can be no accounting for future litigation in this area, however. Any company exploring revisions to its vote requirement should seek counsel on bylaw language, including counsel on how to address extraordinary circumstances such as multiple failed elections potentially triggering change-in-control provisions under material contracts and debt covenants.

Sample bylaw language compliant with the Model Business Corporation Act

Companies incorporated in states that generally follow the Model Business Corporation Act may consider the consequential majority voting bylaw at Microsoft<sup>2</sup>, which is incorporated in Washington, an MBCA state:

2.2 Election – Term of Office. At each annual shareholders' meeting the shareholders shall elect the directors to hold office until the next annual meeting of the shareholders and until their respective successors are elected and qualified. If the directors shall not have been elected at any annual meeting, they may be elected at a special meeting of shareholders called for that purpose in the manner provided by these Bylaws.

Except as provided in Section 2.10 and in this paragraph, each director shall be elected by the vote of the majority of the votes cast. A majority of votes cast means that the number of shares cast "for" a director's election exceeds the number of votes cast "against" that director. The following shall not be votes cast: (a) a share whose ballot is marked as withheld; (b) a share otherwise present at the meeting but for which there is an abstention; and (c) a share otherwise present at the meeting for which a shareholder gives no authority or direction. In a contested election, the directors shall be elected by the vote of a plurality of the votes cast.

A contested election is one in which (a) on the last day for delivery of a notice under Section 1.13(a), a shareholder has complied with the requirements of Section 1.13 regarding one or more nominees, or on the last day for delivery of a notice under Section 1.14(g), an Eligible Shareholder has complied with the requirements of Section 1.14 regarding one or more nominees; and (b) prior to the date that notice of the meeting is given, the Board has not made a determination that none of the candidacies of the shareholder or Eligible Shareholder's nominees creates a bona fide election contest. For purposes of these Bylaws, it is assumed that on the last day for delivery of a notice under Section 1.13(a) or Section 1.14(g), there is a candidate nominated by the Board for each of the director positions to be voted on at the meeting. The following procedures apply in a non-contested election. A nominee who does not receive a majority vote shall not be elected. Except as otherwise provided in this paragraph, an incumbent director not elected because he or she does not receive a majority vote shall continue to serve as a holdover director until the earliest of (a) 90 days after the date on which an inspector determines the voting results as to that director pursuant to RCW 23B.07.290; (b) the date on which the Board appoints an individual to fill the office held by such director, which appointment shall constitute the filling of a vacancy by the Board pursuant to Section 2.10; or (c) the date of the director's resignation. Any vacancy resulting from the non-election of a director under this Section 2.2 may be filled by the Board as provided in Section 2.10. The Governance and Nominating Committee will consider promptly whether to fill the office of a nominee failing to receive a majority vote and make a recommendation to the Board about filling the office. The Board will act on the Governance and Nominating Committee's recommendation and within ninety (90) days after the certification of the shareholder vote will disclose publicly its decision. Except as provided in the next sentence, no director who failed to receive a majority vote for election will participate in the Governance and Nominating Committee recommendation or Board

<sup>2</sup> Microsoft's complete bylaws, filed with the SEC in an 8-K on July 5, 2016, are available at <https://www.sec.gov/Archives/edgar/data/789019/000119312516641678/000119312516641678-index.htm>.

decision about filling his or her office. If no director receives a majority vote in an uncontested election, then the incumbent directors (a) will nominate a slate of directors and hold a special meeting for the purpose of electing those nominees as soon as practicable, and (b) may in the interim fill one or more offices with the same director(s) who will continue in office until their successors are elected.

Appendix 2: The continuum of regimes for uncontested director elections

	PLURALITY VOTING		MAJORITY VOTING	
	Strict Plurality (no resignation) Withhold their vote	Plurality Plus (rejectable resignation) Withhold their vote	Majority Voting (rejectable resignation) Vote against	Consequential Majority Voting Vote against
How do shareholders oppose <sup>1</sup> a nominee? Who gets elected?	Nominees receiving the most for votes (i.e., all nominees)	Nominees receiving the most for votes (i.e., all nominees)	Nominees receiving more "for" votes than "against" votes	Nominees receiving more "for" votes than "against" votes
Must majority-opposed directors <i>immediately</i> depart from the board?	No. Majority-opposed directors are duly elected.	No. Majority-opposed directors are duly elected.	No. Unelected directors remain temporarily via holdover provision, though sometimes indefinitely.	No. Unelected directors remain only temporarily via holdover provision.
Must majority-opposed directors <i>eventually</i> depart from the board?	No	No. The "hard deadline" is the board's decision to accept or reject the resignation.	No. The "hard deadline" is the board's decision to accept or reject the resignation.	Yes. Unelected directors cannot serve beyond a grace period such as 90 or 180 days. (For DE companies, cutoff ties to irrevocable resignation; for MBCA companies, cutoff ties directly to calendar.)

<sup>1</sup> Shareholders who withhold their vote "oppose" a nominee only in unofficial capacity. Technically, every uncontested nominee in a plurality election receives 100% support and zero opposition because withholding a vote is the legal equivalent of an abstention.

	PLURALITY VOTING		MAJORITY VOTING	
	Strict Plurality (no resignation)	Plurality Plus (rejectable resignation)	Majority Voting (rejectable resignation)	Consequential Majority Voting
Argument in favor	Assures board continuity	Enables board continuity while instituting a process for board to consider removal of majority-opposed directors	Same as Plurality Plus, but also denies majority-opposed directors the distinction of legally being re-elected	The only approach with "teeth." Places ultimate authority in the hands of the company's owners by removing the possibility of unelected directors indefinitely remaining on board
Argument against	No accountability to shareholders and no formal process for board to consider removing a majority-opposed director.	Legal election of all nominees remains certain. Resignation requirement provides discretion to reject the letter, which routinely happens.	Board retains discretion to keep unelected directors, and sometimes does so (albeit less often than at "plurality plus" companies.)	Does not accommodate scenario of unelected directors "curing" or pledging to resolve issue(s) perceived as having caused the defeat
Currently most prevalent among	Smaller-cap companies	Smaller-cap companies	Larger-cap companies	Not prevalent at present; early examples include WA-incorporated Microsoft's MBCA-compliant version; first DE company TBD
CII position	Opposes	Opposes	Accepts at companies with MV already in place and good-faith commitment to replace unelected directors within reasonable period	Supports as best practice

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WRITTEN STATEMENT OF MIKE ROTHMAN

PRESIDENT, NORTH AMERICAN SECURITIES ADMINISTRATORS  
ASSOCIATION, INC.

AND

MINNESOTA COMMISSIONER OF COMMERCE

BEFORE THE

U.S. HOUSE COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON CAPITAL MARKETS, CAPITAL MARKETS AND  
INVESTMENT

“The JOBS Act at Five: Examining Its Impact and Ensuring the Competitiveness of the  
U.S. Capital Markets”

MARCH 22, 2017

WASHINGTON, DC



Good Afternoon, Chairman Huizenga, Ranking Member Maloney, and Members of the Subcommittee. On behalf of the North American Securities Administrators Association, Inc. (NASAA), I am pleased to submit this statement for inclusion in the record of the hearing entitled “The JOBS Act at Five: Examining Its Impact and Ensuring the Competitiveness of the U.S. Capital Markets,” held on March 22, 2017 by the Subcommittee on Capital Markets, Securities and Investment.

NASAA was organized in 1919, and its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico and the U.S. Virgin Islands. State securities regulators have protected Main Street investors for the past 100 years, longer than any other securities regulator. State securities regulators are responsible for administering state securities laws that both serve to protect investors and provide a regulatory framework through which businesses can raise capital.

As Congress and this Subcommittee evaluate the JOBS Act on its five-year anniversary, NASAA members continue to provide a level of accessibility to local, small business issuers and investors that is unavailable from federal regulators. State securities regulators provide important information that businesses need to know if they are contemplating raising capital. By providing this information and conducting outreach programs, state regulators help to raise awareness among businesses of the laws and rules that govern how companies raise money from investors.

State securities regulators enforce state securities laws by investigating suspected investment fraud, and, where warranted, pursuing enforcement actions that may result in fines, restitution to investors and in some instances jail time. Keeping the bad actors out of the markets serves not only the interests of investors, but the businesses that rely on markets to raise money. State securities regulators also ensure honest financial markets by licensing registrants – both firms and investment professionals – and conducting ongoing compliance inspections and examinations.

#### **I. Goals of the JOBS Act of 2012**

On April 5, 2012, the Jumpstart Our Business Startups Act JOBS Act was signed into law by President Obama. The JOBS Act was designated as “A bill to increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies.” President Obama made the following remarks at the JOBS Act signing:

*Here's what's going to happen because of this bill. For business owners who want to take their companies to the next level, this bill will make it easier for you to go public. And that's a big deal because going public is a major step towards expanding and hiring more workers. It's a big deal for investors as well, because public companies operate with greater oversight and greater transparency. . . .*

*Because of this bill, start-ups and small business will now have access to a big, new pool of potential investors -- namely, the American people. For the first time, ordinary Americans will be able to go online and invest in entrepreneurs that they believe in.*

*Of course, to make sure Americans don't get taken advantage of, the websites where folks will go to fund all these start-ups and small businesses will be subject to rigorous oversight. The SEC is going to play an important role in implementing this bill. And I've directed my administration to keep a close eye as this law goes into effect and to provide me with regular updates.<sup>1</sup>*

The goal of JOBS Act was thus to lessen regulation governing capital formation, including the process by which companies go public, to ultimately create jobs for American workers. A secondary goal was to “democratize” access to capital markets by enabling ordinary investors to participate more directly in the private securities markets.

While the JOBS Act was broadly designed to facilitate access to capital, it ultimately had competing priorities – allowing more companies to stay private, while at the same time encouraging a greater number of companies to become public. Despite the JOBS Act’s well-intentioned goals, recent studies have shown that the number of U.S. listed public companies has continued to decline significantly since its peak in 1997.<sup>2</sup> Some have argued that a fundamental and permanent shift in the types of businesses that are created today, rather than over-regulation, explains the declining IPO market.<sup>3</sup>

## II. NASAA Perspectives on the JOBS Act and Related Legislation

NASAA was an early and active contributor to the debate regarding many of the changes to federal securities laws that would eventually be enacted under the JOBS Act. Prior to the law’s passage, NASAA leaders testified about many of the law’s provisions before subcommittees of the House Financial Services Committee and the Senate Banking Committee. As the primary regulator of many small-sized offerings, especially offerings to retail investors, states had an obligation to share with Congress their perspective on how the changes contemplated by the 2012 law would affect investors and capital markets.

During the timeframe Congress was considering the JOBS Act, and subsequently following, NASAA urged Congress to take a balanced approach to policies aimed at spurring capital formation. Then, as now, the best policies are those that promote fairness and efficiency, meet the legitimate and evolving needs of the marketplace, and maintain or expand investor protection. As explained by then-NASAA President and Nebraska Securities Director Jack Herstein during Congress’s consideration of legislation that ultimately became the JOBS Act, “Main Street investors should not be treated as the easiest source of funds for the most speculative business ventures.” While my former colleague Mr. Herstein acknowledged the utility of new and “creative ways to spur economic development and job creation,” he reiterated the premise that “the

<sup>1</sup> Barack H. Obama, “REMARKS BY THE PRESIDENT AT JOBS ACT BILL SIGNING” (2012).

<sup>2</sup> See, e.g., Maureen Farrell, “America’s Roster of Public Companies Is Shrinking Before Our Eyes”, *The Wall Street Journal*, Jan. 6, 2017, available at [wsj.com/articles/americas-roster-of-public-companies-is-shrinking-before-our-eyes-1483545879](http://wsj.com/articles/americas-roster-of-public-companies-is-shrinking-before-our-eyes-1483545879).

<sup>3</sup> See, e.g., Gerald Davis, *Capital markets and job creation in the 21st century*, December 2015, The Brookings Institution, December 2015, available at [brookings.edu/wp-content/uploads/2016/07/capital\\_markets.pdf](http://brookings.edu/wp-content/uploads/2016/07/capital_markets.pdf), and *Post-Corporate: the Disappearing Corporation in the New Economy*, Third Way NEXT, Feb 1, 2017, available at [s3.amazonaws.com/content.thirdway.org/publishing/attachments/files/000/001/047/NEXT-post-corporate.pdf?1485968086](http://s3.amazonaws.com/content.thirdway.org/publishing/attachments/files/000/001/047/NEXT-post-corporate.pdf?1485968086).

law should not provide lesser protections to the investors who can least afford to lose their money.”<sup>4</sup> This remains NASAA’s position.

In the five years since the JOBS Act became law, NASAA has remained closely engaged with Congress, testifying before this and other Congressional committees. In our testimony, we have shared our perspectives on the law’s implementation, proposals intended to build upon the provisions that make up the JOBS Act, and proposals aimed at addressing potential shortcomings. In a number of cases, Congress has acted to improve legislation as a result of information provided by state securities regulators acting through NASAA. We also remain engaged in the work of our counterparts at the SEC and with several federal advisory forums that serve to organize and consider proposals for improving capital formation.

State securities regulators look forward to continuing this constructive dialogue with the 115<sup>th</sup> Congress, as well as with businesses, issuers and others directly affected by these policies.

### **III. State Securities Regulation under the JOBS Act**

The provisions of the JOBS Act, while primarily focused on changes to federal securities laws, resulted in changes to state regulatory authority over certain securities offerings. Specifically, Title IV of the JOBS Act added a new Section 3(b)(2) to the Securities Act of 1933 and directed the U.S. Securities and Exchange Commission (“SEC”) to adopt a new exemption from registration by rule for public offerings of up to \$50 million (which became known as Regulation A+). Final SEC rules were adopted on March 25, 2015, over NASAA’s objections to certain aspects of the rules, including the agency’s regulatory preemption of state review authority in Tier 2 offerings contrary to Congressional intent.<sup>5</sup>

NASAA, however, instituted a new coordinated, multistate review system designed specifically for Regulation A+, Tier 1 offerings. NASAA’s “Multi-State Coordinated Review Program” was implemented in April 2014 prior to the SEC’s final rule adoption. The Coordinated Review Program has been used by issuers to raise capital under Tier 1, and NASAA continues to explore ways that the program can be further improved and utilized.

As industry participants awaited final rule adoption of Title III of the JOBS Act (i.e., federal crowdfunding), many states adopted laws in the form of intra-state crowdfunding exemptions. These exemptions allow small businesses to access capital from investors in their communities. As of today, 31 states and the District of Columbia have enacted state-based “equity” crowdfunding laws, or other limited offering exemptions, and additional states are finalizing rulemaking and/or legislation.<sup>6</sup> Although equity crowdfunding on a federal level was not yet legal

<sup>4</sup> Written Testimony of Jack E. Herstein, NASAA President and Nebraska Bureau of Securities Assistant Director to Senate Banking Committee, 12/2011. [www.nasaa.org/wp-content/uploads/2011/12/NASAA-Testimony-Senate-Banking-Crowdfunding-12-1-2011.pdf](http://www.nasaa.org/wp-content/uploads/2011/12/NASAA-Testimony-Senate-Banking-Crowdfunding-12-1-2011.pdf)

<sup>5</sup> Letter from Andrea Seidt, NASAA President and Ohio Securities Commissioner, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated Mar. 24, 2014, available at [www.nasaa.org/wp-content/uploads/2011/07/NASAA-Comment-File-S7-11-13-03242014.pdf](http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Comment-File-S7-11-13-03242014.pdf).

<sup>6</sup> Alabama, Alaska, Arizona, Colorado, Delaware, District of Columbia, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Montana, Nebraska, New Jersey, Oregon, South Carolina, Tennessee, Texas, Virginia, Washington, West Virginia, Wisconsin, Vermont.

until final rules were adopted in May 2016, states found creative ways as early as 2011 to work within existing federal exemptions to enable their local businesses to reach potential investors while maintaining important investor protections. Local businesses such as breweries, grocery stores, gyms, restaurants, senior care facilities, real estate platforms, and others have turned to intrastate crowdfunding laws to raise seed capital for their businesses.

NASAA and state securities regulators also worked with members of Congress to seek changes to the federal securities framework on which intra-state crowdfunding relies. On October 7, 2016, Rep. Tom Emmer (R-MN), along with 14 other members of the House Financial Services Committee sent a letter to the SEC requesting that it update and modernize federal Rule 147 and 504. In the letter, Congress suggested specific revisions while also preserving important investor protections, including existing state authority.<sup>7</sup> On October 26, 2016, the SEC issued final rules implementing those changes.

NASAA has been working on other initiatives over the last several years to help streamline state filing requirements. For instance, in 2014, NASAA implemented an electronic filing system, the Electronic Filing Depository (EFD), to allow private company issuers to electronically file a Form D for Regulation D, Rule 506 securities offerings in one or more states. This system interfaces with the SEC's EDGAR system and enhances the efficiency of the regulatory filing process for certain exempt securities offerings. It also allows the public to search and view, free of charge, state Form D filings.

NASAA also hosts a yearly Capital Formation Roundtable in Washington, D.C. that brings together state securities regulators and stakeholders from private industry and the public sector. The annual Roundtable is attended by small business owners, entrepreneurs, corporate finance practitioners, representatives of venture capital and several major exchanges, academia, investor advocates and others. One goal of the Roundtable is to learn more about the priorities of these various stakeholders, and discuss how state and provincial securities regulators may work effectively with investors, the regulated community, and advocates for both in shaping the future of state and provincial capital formation regulation.

#### **IV. New & Future Legislative Proposals**

One of the purposes of today's hearing is to examine whether there are steps Congress and regulators can take to identify "issues that are hampering the competitiveness of the U.S. capital markets and what actions should be taken to address those issues."

To the extent that our national securities and capital markets may be enhanced by making these markets more efficient and open and fair for investors, then NASAA supports the goal, and

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The following states are working on legislation and/or rulemaking: Arkansas, California, North Carolina, Ohio and Wyoming,

<sup>7</sup> Letter to SEC Chair Mary Jo White, Oct. 7, 2016, from Reps. Tom Emmer, Gwen Moore, Patrick McHenry, John Carney, Scott Garrett, Denny Heck, Randy Neugebauer, Terri Sewell, Luke Messer, Keith Ellison, Peter King, Robert Hurt, Robert Pittenger, Roger Williams and Stephen Fincher, *available at* <https://www.sec.gov/comments/s7-22-15/s72215-34.pdf>.

hopes to work with the 115<sup>th</sup> Congress in furtherance of the effort. We are optimistic that a number of areas exist that are conducive to such collaboration.

For example, NASAA supports Chairman Huizenga's legislation to establish a new and limited exemption for M&A brokers, and we look forward to working with him to get the bill passed this year. NASAA has long shared Congress's interest in establishing a more streamlined regulatory framework for persons serving as brokers in M&A deals that involve the transfer of securities. NASAA recently adopted a Model Rule which exempts M&A brokers from state securities registration pursuant to certain conditions.<sup>8</sup>

We also strongly support the SeniorSafe Act legislation, sponsored in the House by Reps. Sinema (D-AZ) and Poliquin (R-ME), and hope to work with the Committee to see the legislation enacted promptly. The SeniorSafe Act's objectives and benefits are far-reaching. Older Americans stand to benefit directly from such reporting, because early detection and reporting will minimize their financial losses from exploitation, and because improved protection of their finances ultimately helps preserve their financial independence and their personal autonomy.

NASAA looks forward to collaborating with Congress on the enactment of laws that put the interests of investors first and provide for the strong enforcement of securities laws. These are the hallmarks of healthy and vibrant markets. However, legislation that could weaken investor protection or regulators' efforts to maintain the integrity of the marketplace remain a concern for NASAA. For example, proposals that would make it more difficult for states to police "private" securities offerings, both in the context of Rule 506 offerings to accredited investors, and other offerings made directly to retail purchasers pose significant potential investor protection concerns. Congress has an obligation when creating these markets to provide regulators with all the tools they require to keep the markets clean and to deter and punish fraud. NASAA also questions the basis for proposals to establish certain new or overly broad securities registration exemptions, and to expand demand and liquidity for these types of offerings through the regulatory engineering of certain small-sized exchanges, especially if such exchanges are to be exempted from state securities laws.

In conclusion, state securities regulators look forward to working with the 115<sup>th</sup> Congress, and appreciate the opportunity to share their perspective with the Subcommittee today. While the state and federal perspectives are often complimentary, they sometimes may differ. Nevertheless, as the Subcommittee investigates how to further the competitiveness of America's capital market through policy innovation, state securities regulators will be very pleased to offer advice and perspective on any important questions that Congress may confront.

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<sup>8</sup> On September 29, 2016, NASAA adopted a Model Rule Exempting Certain Merger & Acquisition Brokers from Registration. The NASAA Model Rule is available at [nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2011/07/MA-Broker-Model-Rule-adopted-Sept-29-2015-corrected.pdf](https://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2011/07/MA-Broker-Model-Rule-adopted-Sept-29-2015-corrected.pdf).

Brian Hahn

Chief Financial Officer, GlycoMimetics, Inc.

On behalf of the Biotechnology Innovation Organization (BIO)

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**Written Responses to Questions from Rep. Sean Duffy**

**Proxy Advisory Firms**

**Mr. Knight and Mr. Hahn, I appreciate the support that you and other witnesses on this panel have given in testimony to the Corporate Governance Reform and Transparency Act. This legislation, which I sponsored last Congress with my friend and now Governor of Delaware, Mr. Carney, passed our committee with solid bipartisan support. I intend to reintroduce the bill this Congress.**

- **QUESTION: Do you have any suggestions for improvements to the bill?**

As I noted in my testimony, BIO strongly supports this legislation, which we believe would bring important transparency and accountability to the proxy firm industry. In terms of improvements to the bill, BIO would support a requirement that the firms include a dissenting opinion of sorts in their final report in instances where an issuer and a firm reach different conclusions on a given recommendation. These statements could include an issuer's reason for disagreeing with the firm's recommendation, or simple clarifications to misconceptions, including data errors, in the report. With such an addendum, proxy firms' clients would still have access to the recommendation and the firms' reasoning behind it, but they would gain insights into the company's decision-making process and be able to make a voting decision based on a full set of information.

**Short Selling**

**Mr. Hahn, in your testimony you note that "BIO supports short selling transparency in order to shine a light on manipulative trading behaviors that disincentivize long-term investment in innovation."**

**Last year, I sent a letter to Chair White about this issue following a story in the *Wall Street Journal* that revealed a potentially deceptive and manipulative practice by some hedge funds to challenge the legitimacy of a drug patent while simultaneously shorting the drug manufacturer's stock.**

- **QUESTION: Can you discuss the impact of this kind of tactic on the life sciences innovation industry?**

As you noted in your letter to Chair White, manipulative hedge fund managers have developed a short selling strategy to abuse the U.S. patent system in order to inflate their own profits.

Briefly, these individuals take short positions in a company's stock and then file a series of challenges through the Patent Office's *inter partes* review (IPR) process. They do not have a competing patent, or indeed any specific stake in the company's science, yet the IPR process allows them to file a challenge – which naturally impacts the company's stock price as news spreads that its patents may be in jeopardy. The short investors' goal is not to actually impact the long-term standing of the patent (nor the long-term health of patients), but rather to initiate a short-term drop in the stock. The lack of transparency around short selling enables this behavior, which is extraordinarily damaging to companies of all sizes in our industry.

In addition to the manipulation that biotechs experience through the patent system, they are also subject to more "run-of-the-mill" manipulation wherein short investors spread rumors through blog posts and social media about small biotech companies (often following positive clinical trial data), driving down their stock price and generating a profit for short sellers at the expense of the long investors who support life-saving innovation.

These abusive strategies have significant damaging effects on life-saving innovation. Targeted rumors and insinuations can drive down a company's stock price, divert long investors away from potentially life-saving therapies, and harm the ability of biotech companies to advance innovative treatments. This type of shorting behavior can also prevent growing companies from raising valuable innovation capital, often placing an additional discount on the equity pricing of a financing round.

Ultimately, this consistent risk of manipulation, and the lack of information available that would allow companies to combat it, disincentivizes the long investment necessary to fund the decade-long, billion-dollar biotech development pathway

- **QUESTION: What should Congress or the SEC do to address this?**

BIO believes that increased short transparency, designed to complement the existing long disclosure regime, would shine a light on manipulative behaviors, allow market participants to make informed trading decisions, and ensure equitable rules for all types of investments. Specifically, we would support required disclosures of investors taking significant short positions, modeled after the beneficial ownership disclosure obligations in SEC Regulations 13D and 13G.

The current disclosure regime for long positions exists to provide information regarding persons that may have potential influence over, or control of, an issuer. Investors taking short positions, on the other hand, face no public disclosure requirement, despite the significant influence they exert on issuers. Their power stems not from voting rights, but rather from the ability to spread rumors and engage in manipulative trading behaviors that harm growing companies and disincentivize long-term investment in 21<sup>st</sup> century innovation and job creation – yet there is not a parallel disclosure regime for the reporting of short positions.

Notably, BIO supports a short disclosure regime that is *complementary*, rather than identical, to the existing long disclosure requirements. The long disclosure trigger in Regulation 13D (5% of a class of an equity security) is unlikely to capture short manipulation for the simple reason that

few short sellers take a large enough short position to cross the 5% threshold – yet still find it easy to manipulate a company's stock even if they are short far less than 5%. BIO would support either a lower disclosure trigger or a standard based on a different metric than outstanding shares (for example, trading volume could be a more appropriate measure given that the depressive effect of short sales on a stock price is largely a function of the volume and frequency of short transactions relative to the overall securities transaction volume).

Issuers, investors, and patients are all impacted by the current lack of short transparency. A commonsense disclosure regime for short positions would shine a light on manipulative practices while giving investors and companies the information they need to make informed market decisions.



Brian Hahn

Chief Financial Officer, GlycoMimetics, Inc.

On behalf of the Biotechnology Innovation Organization (BIO)

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**Written Responses to Questions from Rep. Randy Hultgren**

**Our markets are predicated on accurate and equal access to information to drive price discovery, investment, and economic growth. For these reasons, the short-selling strategy used to drive down the price of biotechnology start-ups, described on Page 8 of your testimony, is troubling. I do not believe spreading online rumors, as raised in your testimony, is constructive for our markets. Furthermore, I recognize that the business model of start-up biotechnology companies makes them especially vulnerable to the news of the day including unverified rumors or falsehoods.**

- 1. Can you provide any examples of the spreading of “online rumors” or the publication of “false or misleading data” about small biotech companies as referenced in your written testimony?**

Emerging biotechs face a consistent and significant risk of manipulation by short sellers, who are protected by the lack of disclosure required of short positions. My colleagues across the industry have shared stories with me ranging from “analyst” reports predicting clinical trial difficulties to selectively edited data to social media rumors. Sometimes these strategies are undertaken with the utmost secrecy – as when short sellers need to convince long investors to sell in order to drive down the stock price to cover their short; other times, the process is much more public – as with the manipulative hedge fund managers who publicize their challenges to a company’s patents via the Patent Office’s *inter partes* review (IPR) process.

These experiences, combined with dramatically increased trading volume and a high percentage of short interest, strongly suggest short manipulation – but the lack of transparency makes it impossible to determine for certain. Despite companies’ best efforts to manage their stock in such a way that protects long-term investments in innovation and allows for capital raises to fund life-saving clinical trials, the information simply does not exist to connect the dots from suspicious trading activity to specific bad actors.

Company management has a fiduciary duty to protect shareholders, but the lack of transparency around short positions makes it exceedingly difficult to police short manipulation effectively. This consistent risk of manipulation, and the lack of information available that would allow companies to combat it, disincentivizes the long investment necessary to fund the decade-long, billion-dollar biotech development pathway.

- 2. Are there any policy recommendations you would propose to address manipulative trading strategies? What specific changes could be made to increase transparency for short positions?**

BIO believes that transparency is the easiest and most direct way to combat these trading behaviors – a short disclosure regime complementary to the existing long disclosure requirements would shine light on the motivations of short sellers and provide valuable information to issuers and the public.

Specifically, BIO support a short disclosure regime modeled after the beneficial ownership disclosure obligations in SEC Regulations 13D and 13G. Such a regime would require short sellers to file with the SEC if they take a significant short position in a company's stock.

Notably, BIO supports a short disclosure regime that is *complementary*, rather than identical, to the existing long disclosure requirements. The long disclosure trigger in Regulation 13D (5% of a class of an equity security) is unlikely to capture short manipulation for the simple reason that few short sellers take a large enough short position to cross the 5% threshold – yet still find it easy to manipulate a company's stock even if they are short far less than 5%. BIO would support either a lower disclosure trigger or a standard based on a different metric than outstanding shares (for example, trading volume could be a more appropriate measure given that the depressive effect of short sales on a stock price is largely a function of the volume and frequency of short transactions relative to the overall securities transaction volume).

Issuers, investors, and patients are all impacted by the current lack of short transparency. A commonsense disclosure regime for short positions would shine a light on manipulative practices while giving investors and companies the information they need to make informed market decisions.



Edward S. Knight  
Executive Vice President &  
General Counsel  
1100 New York Avenue, NW  
Washington, DC 20005

April 15, 2016

The Honorable Sean Duffy  
Chairman, Housing and Insurance Subcommittee  
United State House of Representatives  
Washington, DC 20515

RE: March 22, 2017 Capital Markets Subcommittee hearing question for the record response on ideas to improve your legislation, the Corporate Reform and Transparency Act.

Dear Chairman Duffy:

Over the past five years, Nasdaq has expressed deep concerns about the business models and practices of Proxy Advisory Firms, and we are grateful for this opportunity to offer our thoughts on possible improvements to the Corporate Governance Reform and Transparency Act.

It is because Proxy Advisory Firms serve an important function for market participants that Nasdaq has judiciously approached the public policy process to recommend changes to their oversight and transparency. As a regulator ourselves, we understand the critical need for transparency in standard setting and the importance of making every effort to mitigate both functional and perceived conflicts of interests. It is in this light that we previously endorsed, along with more than 100 publicly-traded companies, your bipartisan legislation in the last session of Congress, H.R. 5311, which passed the House of Representatives.

In the intervening time period, several ideas have been proposed and appeared in the public debate about this issue aimed at improving your legislation. We believe that some of these ideas could enhance the legislation and empower public companies to address and dispel mistaken assumptions and facts in Proxy Advisory Firm recommendations.

One suggestion that we believe warrants serious consideration is to allow companies to include a statement in the Proxy Advisory Firm's report addressing any disagreement between the issuer and the firm in terms of the firm's analysis or the facts underlying its recommendations. This would provide shareholders with a more complete picture and useful information to help inform their voting decisions. It would also be similar to the process that permits shareholders to place a proposal on a company's proxy and for both the shareholder and company management to include their views on the proposal in the proxy.

Thank you again for the opportunity to comment on your legislation. We are happy to work with you and your staff on other ideas that will strengthen your bipartisan legislation and help it move along in the legislative process.

Sincerely,

Edward S. Knight  
Executive Vice President and Chief Regulatory Officer

### Shareholder Proposal Rule

Mr. Quaadman, the SEC's Shareholder Proposal Rule has been a constant source of frustration for many issuers who have called for its modernization.

Rule 14a-8 allows any shareholder with \$2,000 or 1% of stock in a company – whichever is less – to put a proposal on the company's annual proxy ballot. The asset threshold has not been updated for inflation since 1998.

- **QUESTION: Would you support updating this number for inflation?**

Yes. A significant issue that presents itself across a number of SEC regulations is that specific dollar thresholds have not been updated for inflation throughout the years, inhibiting the ability of market participants to utilize important exemptions as our economy has grown larger. With the JOBS Act, Congress recognized that this was a problem and therefore indexed for inflation the revenue thresholds for Emerging Growth Companies under Title I of that law, as well as the amount that companies can raise through crowdfunding under Title III. Adjusting regulations for inflation ensures that they remain relevant and accurately reflect the size and scope of the American economy. We therefore fully support adjusting the initial thresholds for eligibility under Rule 14a-8.

Some have advocated for eliminating the dollar-holding threshold and moving toward a percentage ownership-only approach.

- **QUESTION: Would you support that approach?**

We believe it is important to recognize that there are many flaws both with the substance of Rule 14a-8 itself as well as the SEC's actions through the no-action process, which have created a level of uncertainty for issuers and investors. While the low initial thresholds allow a shareholder who holds miniscule amounts of stock (relative to a company's overall market cap) to submit a proposal, the SEC has in many cases allowed subject matter unrelated to enhancing long-term value to make its way onto a company's proxy. The latter is a significant problem that cannot be fixed simply by making more investors ineligible to submit a proposal.

We also believe that it is important for all shareholders to have a voice and to use it in legitimate ways. In fact, the Chamber has strongly advocated that the SEC reverse the benign neglect that have effectively disenfranchised retail shareholders from the shareholder voting process. However, in a balanced system the SEC should also verify

the ownership of stock to ensure that a shareholder proponent is an actual owner of stock and not a gadfly pursuing causes unrelated to the company or interest of a majority of actual owners of stock.

It is also important to keep in mind that much of the special interest activism under 14a-8 comes not from small-dollar investors, but from public pension plans that hold large amounts of stock. For example, the New York City Comptroller has embarked on a campaign in recent years to target the oil and gas industry using proposals related to proxy access. If Congress or the SEC moved towards a percentage ownership-only approach, public pension funds in New York City and elsewhere would likely still remain eligible to submit proposals, and in fact could become even more active under 14a-8.

We would support Congress or the SEC focusing primarily on 1) Increasing thresholds under the Resubmission Rule which would make proposals excludable based on past support instead of ownership levels and 2) the SEC reasserting the intent of many of the provisions under 14a-8, which were originally drafted to ensure that a company's proxy did not simply become a repository for special interest priorities.

The resubmission threshold under Rule 14a-8 has also been criticized for being too low. To avoid exclusion, a proposal needs to only receive 3 percent of the vote on its first submission, 6 percent on the second, and 10 percent on the third. Currently, a proposal with 90 percent opposition can be resubmitted indefinitely.

In 1997, the SEC proposed to increase these thresholds to 6 percent on the first submission, 15 percent on the second submission, and 30 percent on the third.

- **QUESTION: Would you recommend updating the resubmission threshold and if so, what threshold would you recommend?**

We believe that the SEC's 1997 proposal – put forth under a Democratic Chairman – should be the “floor” for reform of the Resubmission Rule. The 6/15/30 thresholds make much more sense compared to the status quo and could be implemented swiftly either by the SEC or Congress. However, Congress should also consider whether the final threshold should be set at 50% - in other words, if you've submitted a proposal three times and have not received majority support, then shareholders have stated in pretty plain terms that they don't believe the company should adopt the proposals.

