Statement of the U.S. Chamber of Commerce

ON: Legislative Proposals to Help Fuel Capital and Growth on Main Street

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

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DATE: May 23, 2018

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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 three 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").

This hearing, "Legislative Proposals to Help Fuel Capital and Growth on Main Street" is a continuation of this Committee's good work over the last several years to help provide growing businesses with the capital they need to create jobs, expand, and innovate. I am pleased to provide testimony on behalf of Chamber members regarding several of the proposals that are being considered today.

As members of this Committee are aware, the post-recession recovery over the last decade was extremely weak by historical standards. From 2010-2017, for example, gross domestic product (GDP) in the United States failed to achieve 3% growth in any given year, well below the post-World War II historical norm. To put the importance of 3% growth into perspective, if our economy moved 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 simply statistics, but underlying them is the opportunity for millions of Americans to create a better life for themselves and their families.

Not only was the post-recession recovery historically weak, it was also remarkably uneven across the country. A striking 2016 report from the Economic Innovation Group found that 50% of post-crisis new business creation occurred across only *twenty* counties in the United States.[1] Coupled with the fact that new business creation itself has been a fraction of what it was in previous recoveries, these statistics show that large swaths of the United States have largely been left out of any economic upswing over the last decade. Congress and regulatory agencies must continue to be focused on pro-growth initiatives that help create and sustain wealth for households and communities all across the country.

Fortunately, action has already been taken this Congress that will help reverse these trends. The historic tax reform package signed by President Trump in December 2017 is already producing positive benefits for American households and businesses.[2] By lowering rates and making our tax system more globally competitive, business leaders are investing back in their businesses, rewarding their employees, and hiring more workers.

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[1] "The New Map of Economic Growth and Recovery" Economic Innovation Group, May 2016.

[2] See e.g. U.S. Chamber Tax Reform Map https://www.uschamber.com/tax-reform

Additionally, the House of Representatives is scheduled this week to vote on S. 2155, the "Economic Growth, Regulatory Relief, and Consumer Protection Act," following Senate passage of the legislation in March. This legislation is the culmination of bipartisan work in both the House and Senate to move bank regulation away from the "one-size-fits-all" approach that has regrettably taken hold in the post-financial crisis era. S. 2155 will help small and regional banks better serve their communities around the country, and will ultimately contribute to stronger economic growth.

But we believe Congress should not merely rest on its laurels, and should continue to pursue pro-growth and pro-opportunity policies that help growing businesses access capital. The Financial Services Committee – as well as the full House of Representatives - has already passed dozens of bipartisan bills this Congress that we believe merit further action and should ultimately make it to the President's desk before the end of this year. The Chamber strongly supports many of these bills and is optimistic that the House and Senate can work together to craft a bipartisan capital formation package.

The legislative proposals being discussed at today's hearing also present opportunities to advance bipartisan legislation this Congress that will modernize the rules and regulations that apply to public companies in the United States.

The Need to Modernize the Public Company Model

The public company has been a key source of strength and growth which has helped make the United States economy the strongest and most prosperous in world history. When businesses go public, jobs are created and new centers of wealth are formed. A 2012 study done by the Kauffman Foundation found that for the 2,766 companies that went through the IPO process between 1996 and 2010, employment cumulatively across these business increased by 2.2 million jobs, while total revenue increased by over $1 trillion.[3]

The public capital markets are also not static and help to support innovation. Only about 12% of the Fortune 500 companies in 1955 were still on the list in 2014, while the other 88% have either gone out of existence, merged with another company, or fallen out of the Fortune 500.[4] This system of creative destruction has forced businesses to change with the times, or be replaced by new entrants with innovative

[3] Post-IPO Employment and Revenue Growth for U.S. IPOs June 1996-2010 https://www.kauffman.org/what-we-do/research/2012/05/postipo-employment-and-revenue-growth-for-us-ipos-june-19962010

[4] Mark Perry, AEIdeas, August 18, 2014

ideas and products that meet the needs of consumers and an ever-changing marketplace.

Regrettably, the public company model has become increasingly unattractive to businesses. In the 20 years from 1996-2016, the number of public companies in the United States dropped in 19 of those years. The one year where there was an increase is attributable to the passage of the Jumpstart our Business Startups Act ("JOBS Act") that was spearheaded by this Subcommittee. To put it in even starker measures, an article last year by the Wall Street Journal pointed out that we have roughly the same number of public companies today as we did in 1982.[5] Since 1982, the United States population has grown by 40% and the real GDP has increased by 160%, yet the number of public companies has remained stagnant.

No one single event or regulation lies at the heart of the public company crisis. Like straw upon a camel's back, the burdens and reporting requirements associated with being a public company today have steadily accumulated over the years, to the point where many businesses are rejecting a model that was once the ultimate dream of American entrepreneurs. The JOBS Act was a great first step towards arresting this worrisome trend, and we have already seen tangible results from the law's implementation. For example, in 2013 – the first full calendar year after the JOBS Act was passed – 226 initial public offerings (IPOs) were listed in the United States (the

[5] "America's Roster of Public Companies is Shrinking Before our Eyes" Wall Street Journal January 6, 2017

highest number since 2004), followed by 291 in 2014.[6] While the IPO market has since cooled, the vast majority of companies that are going public are doing so using provisions of the JOBS Act.

To help promote policy solutions that would build off the success of the JOBS Act, eight organizations – the American Securities Association, Biotechnology Innovation Organization, Equity Dealers of America, Nasdaq, National Venture Capital Association, Securities Industry and Financial Markets Association, TechNet, and the U.S. Chamber – recently released a report entitled *Expanding the On-Ramp: Recommendations to Help More Companies Go and Stay Public*. This report includes 22 recommendations that encompass five general categories:

1) Enhancements to the JOBS Act;
2) Recommendations to encourage more research of emerging growth companies (EGCs) and other small public companies;
3) Improvements to certain corporate governance, disclosure, and other regulatory requirements;
4) Recommendations related to financial reporting and;
5) Recommendations related to equity market structure

The full report is included as an addendum to this testimony. While these eight organizations all represent different facets of the American economy, we all share a common concern that the decline in public companies presents serious long term growth and job creation challenges for the United States economy if it is left unaddressed. We appreciate that the Subcommittee has put forward a number of pieces of draft legislation that incorporate many of the recommendations in our report. Our comments on several of these measures are included below.

H.R. 5756, to require the Securities and Exchange Commission to adjust certain resubmission thresholds for shareholder proposals

H.R. 5756 would adjust the levels of support that a proposal from a public company shareholder must receive before it is resubmitted in a subsequent year. The current "resubmission rule" under Rule 14a-8 of the 1934 Securities Exchange Act allows a company to exclude a proposal from its proxy statement if it failed to receive the support of:

- 3% of shareholders the last time it was voted on (if voted on once in the past five years)

[6] https://www.sec.gov/info/smallbus/acsec/giovannetti-presentation-acsec-021517.pdf

- 6% of shareholders the last time it was voted on (if voted on twice in the past five years)
- 10% of shareholders the last time it was voted on (if voted on three or more times in the past five years)

In other words, a shareholder proponent is able to continuously resubmit a proposal even if – in some instances – over 90% of shareholders have voted against it on more than one occasion. The shareholder proposals system under Rule 14a-8 was originally established as a means to facilitate communication between shareholders and management, and to ensure that shareholders maintained a voice in how a particular company was run. Over the years, however, the shareholder proposal system has devolved into a mechanism that special interests use to advance idiosyncratic agendas at the expense of other investors. To put this into perspective, according to the Manhattan Institute, during the 2016 proxy season fully *half* of all proposals submitted to Fortune 250 companies dealt with some type of social or public policy related matter – not issues fundamental to enhancing the long term value of public companies.[7] Not only does this misuse of the system cost shareholders in terms of legal and other fees, but it serves to distract management and company boards from focusing on long term strategy – both issues that can be particularly impactful to small or midsize public companies.

In 1997, the Securities and Exchange Commission (SEC) proposed a rule that would have changed the current 3%/6%/10% system to a more reasonable 6%/15%/30% system. Such modified thresholds would still allow eligible shareholders to submit proposals on various issues, however it would limit the number of times that the vast majority of shareholders would be forced to pay the costs in order to register their opposition. H.R. 5756 simply adopts what the SEC proposed in 1997, which we believe would properly balance the interest of issuers with ensuring that shareholders maintain their voice in corporate matters.

H.R. 5054, the Small Company Disclosure Simplification Act of 2018

This legislation would provide a temporary and optional exemption for small issuers from the eXtensible Business Reporting Language (XBRL) requirements administered by the SEC. While XBRL was created in order to move way from a paper-based system of financial disclosures, it remains a work in progress and has experienced a number of growing pains. As a result, it has proven to be yet another

[7] An Annual Report on Corporate Governance and Shareholder Activism September 27, 2016 (J. Copland and M. O'Keefe)
https://www.manhattan-institute.org/sites/default/files/pmr_2016.pdf

hurdle placed in front of growing business that are looking to gain access to America's robust capital markets.

H.R. 5054 would afford the SEC time to fix some of the deficiencies associated with XBRL. The optional exemption for EGCs and small issuers appropriately grants company boards and their shareholders the ultimate authority to decide whether or not using XBRL is in the best long term interest of the company. This is preferable to a top-down mandate from the SEC for issuers of all sizes to comply with a system that is clearly facing a number of short-term issues.

Furthermore, Congress made it clear when the JOBS Act was passed that the bifurcation of securities regulation can help promote capital formation for small companies. This is why Congress created an "on-ramp" in Title I of the JOBS Act and excluded EGCs from a number of onerous mandates that were inhibiting their ability to grow and create jobs. H.R. 5054 is consistent with this approach, and the Chamber supports its adoption.

H.R.__, to provide a five year extension of certain exemptions and reduced disclosure requirements for companies that were emerging growth companies and would continue to be emerging growth companies but for the five year restriction on emerging growth companies, and for other purposes.

The Chamber strongly supports this draft legislation, which would simply extend many of the exemptions afforded to EGCs under the IPO "on-ramp" of Title I of the JOBS Act from five years to ten years. These exemptions include an allowance for confidential reviews of registration statements by SEC staff, simplified executive compensation disclosures, and exemptions from certain provisions under the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), including say on pay and say on frequency requirements, and the "pay ratio" disclosure mandate. The vast majority of EGCs have taken advantage of many of these exemptions, which have helped reduce reporting and compliance burdens without compromising important investor protections. As companies continue to mature five years after going public, extending these targeted exemptions to ten years would likely further incentivize businesses to go public in the first place. This is especially timely and critical as many companies that went public soon after the JOBS Act was passed are now reaching their five-year time limitation, and yet are still sensitive to becoming subject to full reporting requirements that are more appropriate for large, established issuers. Importantly, these exemptions would remain completely optional – companies would be free to begin reporting some of this information if they felt it was in the best interest of their shareholders and the long-term performance of the company.

H.R.__, to direct the Securities and Exchange Commission to revise Rule 163 under the 1933 Securities Act to apply the exemption offered in such section to communications made by underwriters and dealers acting by or on behalf of well-known seasoned issuers

Well-known seasoned issuers, or "WKSIs," are issuers that have a demonstrated reporting history with the SEC, meet certain market capitalization thresholds, and are generally widely followed in the marketplace. Because of this status, WKSIs are under certain conditions permitted to engage in oral or written communications with potential investors without violating the "gum jumping" provisions of the 1933 Securities Act. In 2009, the SEC proposed allowing underwriters or dealers to engage in such communications on behalf of WKSIs.[8] While current rules allow issuers to engage in pre-filing communications, underwriters are often best positioned to "test the waters" prior to an offering. Allowing WKSIs to authorize an underwriter or dealer to communicate about offerings of the issuer's securities prior to the filing of a registration statement would help these companies better gauge investor interest before having to expand the time and resources to file a formal registration statement. While the SEC's response to the financial crisis overtook Rule 163 reform as a priority and the 2009 proposal was never finalized, we believe this remains an important initiative that will help issuers raise capital. The Chamber strongly supports the draft legislation, which would simply codify into statute the SEC's 2009 proposal.

H.R.__, to direct the Securities and Exchange Commission to conduct a study with respect to research coverage of small issuers before their initial public offerings, and for other purposes

One major issue that has developed in the public capital markets over the last two decades is a steady decrease in the level of analyst coverage of small public companies. According to Capital IQ, 61% of all companies listed on a major exchange with less than a $100 million market capitalization have no research coverage at all. Notwithstanding provisions of the JOBS Act intended to increase research, EGCs and other small issuers still have trouble obtaining analyst coverage today. The draft legislation would simply direct the SEC to conduct a long-overdue study on this issue and to develop recommendations on how to increase the amount of research that is conducted on small public companies. The bill would require the SEC to examine its own rulebook, as well as that of the Financial Industry Regulatory Authority (FINRA), state and federal liability concerns, the 2003 Global Research

[8] Release No. 33-9098 Revisions to Rule 163, 74 Fed. Reg. 68545 (December 28, 2009).

Analyst Settlement, and the Markets in Financial Instruments Directive (MiFID II). The Chamber supports this legislation, which will help the public better understand how current regulations may be restricting the flow of information to investors regarding small issuers. The bill should also produce helpful recommendations that Congress or the SEC can act upon in the future.

H.R.__, to remove the limitation on large accelerated filers qualifying as an emerging growth company, and for other purposes

The Chamber supports this draft legislation which would remove the counterproductive "phase out" rules which cause a great deal of uncertainty regarding EGC status for public companies. Under the JOBS Act, an issuer will cease to be an EGC if they happen to cross the public float threshold that constitutes a "large accelerated filer" under Securities Exchange Act Rule 12b-2. Thus a company that happens to be highly valued in the market – but which may have revenues that fall well below the EGC threshold of $1 billion per year – could lose their EGC status and many of the regulatory exemptions that come with it. In 2014, for example, some 30% of EGCs that went public in 2012 complied with the internal controls requirements of Sarbanes Oxley Section 404(b) because they became large accelerated filers.[9] Importantly, the draft bill also grants the SEC the authority to establish a public float threshold (above the current $700 million, which constitutes a large accelerated filer) that a company would have to trigger before losing status as an EGC. This would help ensure that EGC status is reserved only for smaller public companies.

H.R.__, to require the Securities and Exchange Commission to revise the definition of a qualifying portfolio company to include an emerging growth company, for purposes of the exemption from registration for venture capital fund advisers under the Investment Advisers Act of 1940

The Dodd-Frank Act included an exemption for certain venture capital funds from a requirement to register as a registered investment adviser (RIA). However, the SEC's implementing regulation for this exemption provided for a definition of a venture capital fund that was unnecessarily narrow and failed to take into account many aspects of the venture capital industry. For example, many growth equity funds – which often times are large investors in EGCs and other small companies – are left out of the definition of a venture capital fund. The Chamber supports the draft legislation, which would allow shares of EGCs to be considered "qualifying investments" for purposes of RIA exemption determinations. This would allow

[9] The JOBS Act, Two Years Later: An Updated Look at the IPO Landscape. Latham & Watkins April 5, 2014

growth equity and other venture capital funds to continue to play a critical role in providing capital to EGCs around the time they are considering an IPO.

H.R.__, to increase the threshold for mutual funds before triggering diversified fund limits from ten percent of voting shares to fifteen percent

The Chamber supports this draft legislation which would modestly increase the amount that a mutual fund could hold in a single security and still maintain status as a "diversified" fund. Currently, mutual funds qualify as diversified under the Investment Company Act of 1940 if they hold no more than 5% of their assets in any single company, or 10% of the voting shares in a company. Mutual funds provide an important source of capital and liquidity for the shares of EGCs and small companies, however the 10% limit on an investment in a single company constrains the ability of funds to provide this capital. As explained in a 2017 paper on small IPOs, "As a diversified fund's [assets under management] grows, efforts to deploy new fund flows into a small issuer will increasingly be constrained by this 10% position limit, meaning a large fund's investment in the company will represent a diminishing fraction of the fund's AUM."[10] We believe that modestly increasing this threshold from 10% to 15% will allow diversified mutual funds to continue to invest in EGCs or small issuers even as their assets under management continue to grow.

H.R.__, the Streamlining Disclosure Options to Reduce Redundant Disclosures to Investors Act

Over the decades since the securities laws were enacted, and especially in more recent years, the disclosure documents that companies file with the SEC have continued to expand, as reflected by the lengthy annual and quarterly reports, as well as proxy statements provided to investors. As many have pointed out, disclosure documents are laden with much information that is obsolete, unnecessarily repetitive, or otherwise not useful to investors. This problem can be especially acute for EGCs and small public companies, which often times don't have the same level of compliance resources as large established companies, and can be especially burdened by our outdated disclosure regime. According to the 2011 report of the IPO Task Force, 92% of public company CEOs stated that the "administrative burden of public reporting" was a significant challenge to completing an IPO and becoming a public company.[11]

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[10] The Small IPO and Investment Preferences of Mutual Funds (Robert Bartlett III, Paul Rose, Steven Davidoff Solomon) July 28, 2017 at 9.
Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2718862

[11] Rebuilding the IPO On-Ramp: Putting Emerging Companies and the Job Market Back on the Road to Growth
Available at: https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf

This draft legislation, which the Chamber strongly supports, would simply give issuers the option of reporting quarterly information in a different format than is currently required by Form 10-Q. For example, issuers could distribute a press release that contains quarterly financial results – which would provide investors with important information – instead of the lengthier 10-Q that often times contains repetitive information that has already been disclosed. Importantly, issuers would still be required to notify investors of any significant events through Form 8-K, so the legislation would not deprive shareholders or the public of material information that is critical for investment and voting decisions.

H.R.__, the Main Street Growth Act

The Chamber also supports this draft legislation circulated by Rep. Emmer, which would establish the legal framework for the creation of "venture exchanges." There is little doubt that investors have benefited from many of the technological and other changes in our equity markets over the last two decades, which have helped reduce trading costs, increased liquidity, and made markets more efficient. However, many of these benefits have not been distributed evenly across the equity markets. The trading environment for many small and midsize public companies – including EGCs – remains less liquid and fragmented as compared to the overall equity market. We believe that policymakers should move away from a "one size fits all" regulatory model and tailor market structure to help boost the trading of EGCs and other small issuers.

While the JOBS Act did a great deal to help EGCs raise capital in primary offerings, it did comparatively little to address the secondary market trading in these companies. The Main Street Growth Act seeks to remedy this issue by providing a tailored trading platform for EGCs and stocks with distressed liquidity. Companies that choose to list on a venture exchange would have their shares traded on a single venue, thereby concentrating liquidity and exempting these shares from rules that are more appropriate for deeply liquid and highly valued stocks. Venture exchanges would also be afforded the flexibility to develop intelligent "tick sizes" that could help incentivize market makers to trade in the shares of companies listed on the exchange. Importantly, both the creation of the venture exchange and the decision to list on such an exchange are completely optional – the bill would not mandate that companies that meet certain criteria trade on a venture exchange. We believe this legislation is an important step towards properly tailoring market structure rules for small issuers.

Conclusion

We appreciate the work of the Capital Markets, Securities, and Investment Subcommittee on these important bills and issues. The Chamber is prepared to work with the Subcommittee on a bipartisan basis to achieve many of these reforms that would modernize the public company regulatory regime in the United States. We must be successful in these efforts to spur economic growth that stimulates investment and creates good paying jobs.