



Statement of the U.S. Chamber of Commerce

ON: Legislative Proposals to Improve the U.S. Capital Markets

TO: House Subcommittee on Capital Markets and Government Sponsored Enterprise

BY: Tom Quadman, Senior Vice President, Center for Capital Markets Competitiveness

DATE: November 30, 2015

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 Garrett, Ranking Member Maloney, and members of the Capital Markets and Government Sponsored Enterprises subcommittee—my name is Tom Quaadman, senior 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 of all sizes, sectors, and regions. I appreciate the opportunity to testify before the subcommittee today on behalf of the businesses the Chamber represents.

The Chamber views a strong and fair Securities and Exchange Commission (“SEC”) as a critical and essential element needed for efficient capital markets. Having a strong securities regulator is necessary for investors and businesses to have the certainty needed to transfer capital for its best use with an expectation of return. This allows market participants to engage in reasonable risk taking on a fair playing field.

While the SEC has traditionally been considered the premier securities regulator, in recent years its effectiveness has been questioned and its credibility has diminished—many factors have contributed. First, markets have fundamentally changed since the SEC was created during the Great Depression of the 1930’s. Second, managerial challenges have created obstacles that have prevented the SEC from acquiring the appropriate expertise and deploying its resources for the best use, undercutting its ability to evolve with changing markets and overseeing them. Third, changes in enforcement practices, some of which have been helpful, have created fundamental issues of due process and fairness that are at the heart of any legal proceeding under our constitutional form of government. Finally, it has been difficult for the SEC to focus on all of the elements of its tripartite mission—promoting investor protection, facilitating capital formation and maintaining fair, orderly, and efficient markets.

Many, including the Chamber, have identified shortcomings in our financial regulatory structure that are making it harder for businesses to acquire the capital needed to grow and prosper. The Chamber released a report in 2007, the [*Report and Recommendations of the Commission on the Regulation of U.S. Capital Markets in the 21st Century*](#), and a report in 2011, the [*U.S. Capital Markets Competitiveness, the Unfinished Agenda*](#), to identify problems and the shortfalls of our current financial regulatory system and the drag this creates on the United States to compete in a global economy.

But the Chamber has also offered solutions. In 2009, we issued a report, [*Examining the Efficiency and Effectiveness of the U.S. Securities and Exchange Commission*](#), and in 2011, [*the U.S. Securities and Exchange Commission: a Roadmap for Transformational Reform*](#), that contained 51 recommendations for managerial reforms and regulatory enhancements to help the SEC acquire the knowledge and expertise needed to better understand and oversee the markets and products it regulates. This past summer, the Chamber issued a new report, [*Examining U.S. Securities and Exchange Commission Enforcement: Recommendations on Current Processes and Practices*](#) (“Chamber SEC enforcement report”), that made 28 recommendations to improve SEC enforcement and due process.

The Chamber’s SEC enforcement report reviewed the current practices of the SEC Enforcement Division, changes in strategy and practice by the SEC, the evolving use of administrative proceedings, and the adequacy of rules of practice. This was the culmination of almost two years of effort that included a survey of public company CEOs and general counsels, dozens of in-depth interviews with businesses, academics, former SEC enforcement officials, and meetings with many securities lawyers. The report recommended a review and changes in the rules of practice to make due process enhancements, creating a right of removal to district court under appropriate circumstances, improving the investigative process and strengthening the Wells process.

To their credit, the SEC has been moving forward on some of these recommendations. The SEC is integrating trial lawyers into the investigative process at an early stage. Similarly, the SEC has also put out for comment a review and changes of its Rules of Practice for administrative proceedings. This responds to a specific recommendation in our 2015 report. We will file a comment letter on this proposal later this week and will be happy to provide a copy to the Subcommittee. I will defer a more in-depth discussion of several of the issues regarding SEC enforcement in the discussion of H.R. 3798, the Due Process Restoration Act of 2015.

The Chamber has also been concerned about the SEC’s focus on its mission of promoting capital formation and competition. Too often, the SEC had failed to keep its rules current, forcing Congress to step in. Accordingly, the Chamber has been supportive of the Subcommittee’s efforts in these areas, including the Jumpstart Our Business Startups Act (“JOBS Act”) and other legislative efforts including disclosure modernization, improving the process for private placements and use of business

development corporations. We support several of the bills that are the subject of this hearing and will discuss them in more depth.

1. H.R. 3798, the Due Process Restoration Act of 2015

As mentioned earlier, the Chamber has taken a long, hard look at SEC enforcement practices. A major concern raised during our work in this area was the increased and wide-spread use of administrative proceedings for enforcement cases.

Over the past few years, we have seen administrative proceedings being used as the primary means of the SEC prosecuting enforcement cases under its non-criminal powers. This has created an imbalance in the system that endangers the rights of defendants and undermines the use of appropriate enforcement tools, while raising important questions regarding the separation of powers between the executive and judicial branches of government.

I want to bring to your attention two Wall Street Journal op-eds that address these issues.¹ The first one, by Russell Ryan, a former assistant director of enforcement at the SEC, raises questions regarding the increased use of administrative proceedings in a quasi-criminal manner. The second, by Nelson Obus, founding partner of Wynnefield Capital, describes a case that stretched over 12 years because of its consideration at both the administrative level and in District Court. However, because the case was ultimately decided in a District Court where greater due process was afforded, the defendant was acquitted. Today, that case would not have a path to go straight to District Court. If Mr. Obus had been required to litigate in an administrative proceeding, he would have been denied the opportunity to use pre-trial discovery to uncover the evidence that led to his acquittal.

While administrative proceedings allow for a speed of resolution, some have raised issues that it provides the SEC with an advantage because the rules of discovery, right of deposition and motion practice are severely restricted or non-existent in an administrative proceeding as compared to a case litigated in district court.

It should be remembered that certain cases should only go through an administrative proceeding, such as stop order proceedings or license revocations.

¹ The Wall Street Journal Op-eds are from August 4, 2014 and June 24, 2014 and can be found at: <http://www.wsj.com/articles/russell-g-ryan-the-sec-as-prosecutor-and-judge-1407195362> and <http://www.wsj.com/articles/nelson-obus-refusing-to-buckle-to-sec-intimidation-1403651178>.

However, more serious cases should, within certain parameters, allow a defendant the option to remove a proceeding to District Court.

The SEC has also started to redress some of the issues through its current review of the rules of practice. However, we believe that these proposed changes do not go far enough. In fact, we will make the following suggestions to the SEC later this week to expand the scope of procedural changes including:

1. The proposed amendments to rule 233 on the use of depositions are insufficient to provide respondents with meaningful discovery.
2. The proposed amendments to rule 230(a) on document production should require enforcement staff to promptly provide a list of all persons interviewed and/or deposed during the investigation.
3. The proposed amendments should permit an ALJ to extend the time available for pre-trial process for proceedings in which the staff has compiled a huge documentary record.
4. A clear standard governing the use of hearsay testimony should be adopted that is consistent with the standard proposed for deposition testimony.
5. The proposed amendment to rule 230(b) enabling staff to withhold or redact documents reflecting settlement negotiations should also prohibit staff from introducing Wells submissions or white paper as evidence in an administrative proceeding.
6. The proposed amendment of rule 900 that extends the time period for completion of the Commission's review exacerbates a long-standing problem.
7. The proposing release does not discuss the important issue of choice of venue.
8. The proposed rule changes affect substantive and material rights of all persons named in an administrative proceeding and do not qualify for exemption from the notice and comment requirements of the Administrative Procedure act.

The failure to discuss the right of removal question is a glaring and unfortunate omission in the SEC proposal. The American system of jurisprudence has always provided the defendant with the right to request a jury trial. The current SEC system provides the prosecutor, the SEC Division of Enforcement, with exclusive control over the request for a jury trial. For more serious offenses, we believe that a defendant, not the government should have the ability to decide if they should preserve their right to a jury trial.

We believe that the Due Process Restoration Act of 2015 is an important step forward in restoring the balance between the appropriate uses of administrative proceedings and preserving the due process rights of defendants. This bill, if passed, would allow defendants, within parameters, to have the option to take a case to district court. We believe this bill would allow for the SEC to use administrative proceedings as they have been used historically, while allowing defendants all available options. If the SEC rules of practice are amended to allow for a fair process of discovery, administrative proceedings would be a fair and level playing field. The right of removal would not, in our opinion, burden court dockets.

Nevertheless, we believe that certain amendments are needed for the Due Process Restoration Act of 2015 to achieve its intent.

First, the legislation should amend the 1933 Exchange Act, the Investment Company Act, and the Investment Advisors Act of 1940. As currently drafted, the bill only amends the 1934 Exchange Act and therefore only be applicable to a narrow band of cases. By expanding the scope of this bill to include the 1933 Exchange Act, the Investment Company Act, and the Investment Advisors Act of 1940, it would ensure that the same right to a district court proceeding would be applicable for all major enforcement matters.

Second, the Chamber has concerns about the use of a clear and convincing standard through a right of removal process. This would create different levels of a burden of proof that would create an uneven-playing field. The burden of proof should be the same in an administrative proceeding or a district court case. While we understand the thought behind the use of a clear and convincing standard, this can have unforeseen consequences that may not help defendants or appropriate enforcement activities.

The Chamber believes that the passage of the Due Process Restoration Act of 2015, with our suggested amendments, as well as expanded changes to the SEC's rules of practice, would allow for both fair due process and strong enforcement policies. This will be a two pronged approach necessary for efficient capital markets.

2. H.R. 3784, the SEC Small Business Advocate Act of 2015

The Chamber supports the passage of the Small Business Advocate Act of 2015, and thanks Mr. Carney, Mr. Duffy, Mr. Quigley, and Mr. Crenshaw for its introduction. Attached with this testimony is a copy of a letter by a coalition of business and investor trade associations supporting passage of this legislation.

Nevertheless, the Chamber believes that the Small Business Advocate Act of 2015 should be amended in two ways.

First, the bill allows for small business advocate to be on the same plane as the investor advocate. Accordingly, the small business advocate should be given the same powers to consult with the investor advocate, as the investor advocate is given to consult with the small business advocate. As such, this bill should be amended to have the Investor Advocate consult with the Small Business Advocate for any proposed changes it may make. The bill should also be amended to allow for the small business advocate to appoint a non-voting member to the investor advisory committee.

Second, the Chamber has consistently advocated that advisory committees of the SEC, or its subordinate organizations, be subject to appropriate levels of transparency and accountability and subject to the Sunshine Act and the Federal Advisory Committee Act ("FACA").² In its current form, the Small Business Capital Formation Advisory Committee is exempt from FACA, as the Investor Advisory Committee currently is. We recommend this bill be amended to place the Small Business Capital Formation Advisory Committee, the Investor Advisory Committee, as well as Investor Advisory Group of the Public Company Accounting Oversight Board ("PCAOB") be placed under the jurisdiction of FACA.

3. Discussion Draft of the Small Business Capital Formation Enhancement Act

² As an example, see the attached letter of October 7, 2009 to the PCAOB on transparency and the Investor Advisory Group.

The Chamber appreciates the work of Mr. Poliquin for putting forth this discussion draft. The SEC has been slow, at best, to modernize regulations to meet the current needs of investors and businesses to compete and acquire capital. Too often, regulatory structures remain stagnant over the course of decades while the marketplace is constantly evolving. In fact, the proactive efforts by this subcommittee and Congress in passing the JOBS Act and other bills to advance capital formation are directly related to the inertia of the SEC to modernize regulations.

The Small Business Capital Formation Enhancement Act would help to overcome the inertia of the SEC and take the initiative in modernizing regulations. Many of the initiatives encompassed in the JOBS Act were first identified and proposed by the forum on small business capital formation. This bill would require the Commission to pay closer attention to the forum and take affirmative action to move forward or not. Therefore, the needs of capital formation cannot simply be ignored.

The Small Business Capital Formation Enhancement Act may be a small step, but it is an important step forward to help the SEC stay connected to a changing market place and provide the structures needed to meet the needs of investors and businesses.

4. Discussion Draft of the Helping Angels Lead Our Startups Act (“HALOS Act”)

The Chamber appreciates the work of Mr. Chabot, Ms. Sinema, Mr. Hurt, and Mr. Takai in drafting the HALOS Act. We support the intent of this bill to expand the role of angel investing in assisting start-up businesses to acquire the financing needed to grow. We believe that the increase of information in the marketplace is an important step forward in expanding the use of angel investing, provided that such information is directed at accredited investors and is accompanied by appropriate investor protections.

The Chamber has consistently urged the SEC to review all of its rules with the broader goal of removing rules or disclosures that no longer fulfill their intended purpose or where the costs of the rule outweigh any intended benefit. Such a review should take several forms. For disclosures to investors, the SEC should consider whether the disclosure provides investors with information useful in making investment decisions, or whether the disclosure become obsolete with irrelevant

clutter that investors must sift through. Obsolete disclosures deter investors from reviewing disclosures, and may negatively impact the investors' decision making matrix, while also making the investor less productive. Additionally, a retrospective cost benefit analysis would help the SEC and market participants to understand if the new rules are benefiting the marketplace, or heaping unneeded costs upon businesses and ultimately their investors.

We raise this analysis in the context of this legislation since these circumstances present the perfect opportunity to put in place a retrospective review of this change in information distribution. Commitment to perform such a review would allow the SEC and market participants to know by a date certain if the advertising permitted by the final rule is assisting capital formation, if the benefits outweigh the costs and if the investor protections are sufficient.

We believe that such a retrospective review should be added to this bill to have the SEC provide the information needed for all stakeholders to understand if the HALOS Act is a positive for both capital formation and investor protection, or if more needs to be done.

5. Conclusion

The Chamber views these bills, along with our proposed improvements, as important steps to provide for appropriate regulatory structures and to meet the needs of a dynamic marketplace.

Passage of the Due Process Restoration Act of 2015 would allow for a fair and due process that allows for the SEC to prosecute wrong-doers and for defendants to protect themselves. We believe that capital formation and competition would be well served through the three prong approach of the SEC Small Business Advocate Act of 2015, Small Business Capital Formation Enhancement Act and the HALOS Act.

We ask that the subcommittee and House consider these bills expeditiously and include them in a JOBS Act 2.0 to provide American businesses with the capacity to access the resources needed to compete, thrive and create jobs.

I am happy to take any questions that you may have at this time.