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Selected Securities Legislation in the 114th Congress

Updated September 7, 2016

Congressional Research Service
https://crsreports.congress.gov
R44255

CRS REPORT
Prepared for Members and
Committees of Congress

Summary

In the aftermath of the 2008-2009 financial crisis, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act; P.L. 111-203), a wide-ranging package of regulatory reform legislation. Some provisions mandated new securities regulations that expanded required corporate disclosures to the Securities and Exchange Commission (SEC) and the investing public. Some Members of Congress have characterized provisions of the act, including several requiring additional corporate disclosures, as excessive regulation.

Enacted in the 112th Congress, the Jumpstart Our Businesses Startup Act of 2012 (JOBS Act; P.L. 112-106) generally reflected a different regulatory strategy than did the Dodd-Frank Act. The legislation was broadly aimed at stimulating corporate capital formation, particularly for newer and smaller firms. It largely attempts to do so by giving such firms regulatory relief from various SEC disclosures generally required by federal securities laws.

Congress is currently considering securities legislation that in many instances would extend the JOBS Act's focus on corporate regulatory relief. The securities bills examined in this report have been reported by committee or have been approved in floor action in the 114th Congress. Most attempt to foster capital formation, potentially trading off some disclosure-based investor protections. Such bills include the following:

- H.R. 22/P.L. 114-94 (Titles LXXIIV, LXXIV, LXXXI, and LXXXV)
- H.R. 37 (Titles III, VI, VII, IX, X, XI; passed the House)
- H.R. 414 (H.Rept. 114-504)
- H.R. 1334 (passed the House)
- H.R. 2064 (passed the House)
- H.R. 432 (passed the House)
- H.R. 1525 (passed the House)
- H.R. 1675 (H.Rept. 114-398)
- H.R. 1723 (passed the House)
- H.R. 1839 (passed the House)
- H.R. 1965 (H.Rept. 114-399)
- S. 1484 (Sections 601, 602, 604; reported from the Senate Banking, Housing and Urban Affairs Committee without written report)
- S. 1910 (Sections 971, 972, 974; S.Rept. 114-97)

In addition to bills that reduce disclosure requirements, a number of other bills addressing securities regulation have been reported from committee or taken up on the floor. H.R. 1975 would require the agency to award certain SEC-regulated trading-related entities (such as NASDAQ) future credit for earlier excessive fees that they paid the agency. H.R. 2354 would require the SEC to evaluate and vote on all "significant regulations" within the first 5 years after enactment and then every 10 years thereafter. H.R. 2356 would require the SEC to provide a legal safe harbor for research reports issued by brokers or dealers on Exchange Traded Funds. H.R. 2357 would amend the SEC's Form S-3 (shelf) registration statement to give companies with public floats (i.e., regular shares that a company has issued to the public and are available for investor trades) below $75 million greater access to that registration protocol. H.R. 3032 would repeal a requirement that the SEC annually report to Congress on how often it sought financial institutions' customer records.

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Introduction

To help restore confidence in the securities markets after the stock market crash of 1929, Congress passed the Securities Act of 1933 (P.L. 73-22). The act sought to ensure that investors receive salient information on securities offered for public sale and to ban fraud in the sale of securities. The act requires companies issuing securities to disclose information deemed germane to investors. Potential investors must also receive an offering prospectus containing disclosed securities data. Certain offerings are exempt from such registration requirements, including private offerings and offerings made to a limited number of sophisticated persons or institutions.

Shortly afterwards, Congress passed the Securities Exchange Act of 1934 (P.L. 73-291), which authorized creation of the Securities and Exchange Commission (SEC), an independent and nonpartisan regulatory agency responsible for administering federal securities laws. As such, the agency exercises broad regulatory authority over significant parts of the securities industry, including stock exchanges, mutual funds, investment advisers, and brokerage firms.

In subsequent years, Congress enacted a number of other federal securities laws, including the Investment Advisers Act of 1940 (Advisers Act; P.L. 76-768), which defined the role and responsibilities of investment advisers and imposed SEC registration and disclosure requirements on them.

As noted above, the federal securities laws are responsible for regulations that are overseen and enforced by the SEC, which apply to various entities involved in the securities markets entities as well as companies that issue securities. Statutorily, the regulations that the SEC oversees—whether specifically directed by Congress or adopted independently by the SEC per its authority under the securities laws—are supposed to facilitate the agency's broad mission to (1) ensure investor protection through a regime of information transparency aimed at facilitating informed investment decisionmaking; (2) maintain fair, orderly, and efficient markets; and (3) facilitate capital formation.

Historically, there have been a number of instances when certain policy and legislative proposals involved potential tradeoffs between the investor protection mission and the capital formation mission.

After the recent financial crisis, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank; P.L. 111-203), a wide-ranging package of regulatory reform legislation. Some provisions mandated new securities regulations expanding required corporate disclosures to the SEC and the investing public. In subsequent congressional sessions, some Members have depicted various provisions of the act, including several requiring new corporate disclosures, as excessive regulation.

Enacted in the 112th Congress, the Jumpstart Our Businesses Startup Act of 2012 (JOBS Act; P.L. 112-106) generally reflected a different regulatory strategy than did Dodd-Frank. Whereas various securities-related provisions in the earlier statute sought to expand disclosure-based investor protections, various provisions in the JOBS Act sought to help foster capital formation especially among smaller companies through various forms of regulatory relief.

Often in a securities context, providing regulatory relief to boost capital formation involves a diminution in required investor-based SEC disclosures, reflecting the potential tradeoffs between the two goals. However, this dynamic may be complicated, as some studies have found that markets may punish assets through lowered pricing after their corporate issuers were exempted

from certain required investor disclosures.[1] The policy tradeoff dynamic may become even more complicated when some of the many mandatory corporate disclosures may not necessarily facilitate informed investing because they may be superfluous or may contribute to investor information overload. For example, in a 2013 speech, SEC Chair Mary Jo White noted that the agency would be examining whether investors' needs are served by the "detailed and lengthy disclosures about all of the topics that companies currently provide in the reports they are required to prepare and file with us … [and] whether information overload is occurring."[2]

The 114th Congress is currently considering securities legislation that in many instances would extend the JOBS Act's focus on providing corporate regulatory relief to foster capital formation.

Some Perspectives on Regulatory Relief

In determining whether to provide regulatory relief, a central question is whether an appropriate tradeoff has been struck between the benefits and costs of regulation. In other words, can relief be provided while still maintaining the stability of the financial system and ensuring consumers are protected, or would relief undermine those goals? Regulatory relief is generally focused on the providers of financial services—such as banks, broker-dealers, and other institutions—but what effect would relief have on consumers, investors, particular markets, and market stability more broadly? Understanding the benefits and costs of regulation is a precondition for deciding whether the appropriate balance has been achieved.

Financial regulation has different objectives and potential benefits, including enhancing the safety and soundness of certain institutions; protecting consumers and investors from fraud, manipulation, and discrimination; and promoting financial stability while reducing systemic risk. Regulators employ different tools to achieve these goals. Regulators issue rules; supervise and examine institutions to verify that the rules are followed; and take certain enforcement actions, such as imposing fines, when the regulations are not followed. In other cases, regulators require companies or individuals to meet certain standards and receive a license before engaging in a particular business practice. The specific goals regulators attempt to achieve and the tools they used vary by market. For example, risk management is emphasized for banking regulation and disclosure is a priority in securities regulation.

The costs associated with government regulation—rulemaking, supervision, and enforcement—are referred to as regulatory burden. The presence of regulatory burden does not necessarily mean that a regulation is undesirable or should be repealed. A regulation can have benefits that could outweigh its costs, but the presence of costs means, tautologically, that there is regulatory burden. The concept of regulatory burden can be contrasted with the phrase unduly burdensome. Whereas regulatory burden is about the costs associated with a regulation, unduly burdensome refers to the balance between benefits and costs. For example, some would consider a regulation to be unduly burdensome if costs are in excess of benefits or the same benefits could be achieved at a lower cost. But the mere presence of regulatory burden does not mean that a regulation is unduly burdensome. Regulatory requirements are often imposed on providers of financial services (as well as the companies that issue securities), but costs associated with regulation can flow through the providers and be ultimately borne, in part, by different entities, including financial institutions; consumers; the government; corporations and their stakeholders; and the economy at large. Regulatory relief may face tradeoffs between reducing regulatory burden and potentially reducing the benefits of regulation (e.g., safety and soundness, consumer and investor protection, and financial stability).

Source: CRS In Focus IF10162, *Introduction to Financial Services: "Regulatory Relief"*, by Sean M. Hoskins and Marc Labonte.

This report examines selected securities-related legislation that has been marked up by committee or has seen floor action in the 114th Congress. Many can be characterized as *backward-looking* regulatory relief proposals, meaning that they would modify existing regulations. A few—such as Title LXXII of P.L. 114-94 (the FAST Act, which was enacted on December 4, 2015); Title X of

[1] For example, see Susan Chaplinsky, Kathleen Weiss Hanley, and S. Katie Moon, "The JOBS Act and the Costs of Going Public," *SSRN*, August 14, 2014, at http://ssrn.com/abstract=2492241 or http://dx.doi.org/10.2139/ssrn.249224.1.

[2] U.S. Securities and Exchange Commission (SEC), "Speech on the Path Forward on Disclosure by Chair Mary Jo White before the National Association of Corporate Directors—Leadership Conference 2013," SEC, October 15, 2013, at http://www.sec.gov/News/Speech/Detail/Speech/1370539878806.

H.R. 37; H.R. 1525; and H.R. 2354—can be characterized as *forward-looking* legislative proposals, meaning that they would modify or potentially modify the regulatory rulemaking process to reduce burdens associated with future rulemakings, offering the possibility of future regulatory relief. At least one bill, H.R. 3032, can be described as regulatory relief for the SEC itself because it would relieve the agency of certain reporting obligations to Congress.

Among other subjects, this report examines legislation that would

- Ease shareholder threshold requirements for savings and loans to make it easier for them to either remain private companies or to move from public company to private company status: Title LXXXV of P.L. 114-94, Title III of H.R. 37 (which passed the House on January 14, 2015), H.R. 1334 (which passed the House on July 14, 2015), Section 601 of S. 1484, and Section 971 of S. 1910.
- Provide regulatory relief from registration requirements for brokers who facilitate the acquisition of small companies: Title IV of H.R. 37 and H.R. 686.
- Provide regulatory relief to Emerging Growth Companies (EGCs): Title LXXI of P.L. 114-94, Title VI of H.R. 37, H.R. 2064 (which passed the House on July 14, 2015), Section 604 of S. 1484, and Section 974 of S. 1910.
- Provide regulatory relief from certain SEC registration requirements for advisers to Small Business Investment Companies (SBICs): Title LXXIV of P.L. 114-94, Title IX of H.R. 37, and H.R. 432 (which passed the House on July 14, 2015).
- Increase the threshold amounts of securities sales to employees and directors under compensatory benefit plans over a 12-month period at non-public companies before the companies must provide additional disclosure to such employee-investors: Title XI of H.R. 37, H.R. 1675, Section 602 of S. 1484, and Section 972 of S. 1910.
- Provide regulatory relief to certain smaller companies by exempting them from the required submission of their financial disclosures to the SEC through eXtensible Business Reporting Language (XBRL), a digital reporting protocol: Title VII of H.R. 37 and H.R. 1965.
- Repeal the requirement the companies disclose the ratio between their CEO's compensation and the pay of their median worker outside of the CEO: H.R. 414.
- Revise initial registration Form S-1 to permit companies with less than a public float of $75 million (smaller reporting companies) to use the form for forward incorporation by reference, referring to the information in the form to reduce the burden of obligation of some subsequent SEC filings: Title LXXXIV of P.L. 114-94 and H.R. 1723.
- Allow certain SEC-regulated entities, such as national securities trading entities that are assessed transaction fees by the SEC, to have the agency credit earlier fee overpayments to future fee obligations: H.R. 1975.
- Streamline disclosure rules for EGCs and certain smaller publicly traded companies and eliminate duplicative, outdated, or unnecessary disclosure requirements for all publicly traded companies: Title LXXI of P.L. 114-94, Title X of H.R. 37, and H.R. 1525.
- Statutorily codify the right of holders of certain privately placed securities to resell them to private entities outside of public securities trading markets: Title LXXVI of P.L. 114-94 and H.R. 1839.

- Require the SEC to evaluate and vote on all "significant regulations" within the first 5 years after enactment and then every 10 years thereafter: H.R. 2354.
- Require the SEC to provide a legal safe harbor for research reports issued by brokers or dealers on Exchange Traded Funds (ETFs) so that these reports are not considered securities "offers" and thus proscribed under federal securities laws: H.R. 2356.
- Amend the SEC's Form S-3 registration statement to give smaller reporting companies greater access to that shelf registration protocol (registering a new securities issue in advance so that later it can be quickly offered to the public during favorable market conditions): H.R. 2357.
- Repeal a statutory requirement that the SEC annually report to Congress on how often it sought customer records at financial institutions: H.R. 3032.
- Provide regulatory relief to certain investment advisers: H.R. 5424.
- Extend an Emerging Growth Company's (under the JOBS Act of 2012) exemption from auditor attestation: H.R. 4139.
- Provide additional exemptions from securities registration requirements for limited securities offerings: H.R. 4850.
- Prohibit the implementation of certain SEC regulatory proposals for private placement securities offerings under Regulation D: H.R. 4852.
- Subject proxy advisory firms to regulation: H.R. 5311.
- Exempt securities traded on alternative stock exchanges from state securities regulation: H.R. 5421.

Changing Shareholder Threshold Requirements for Savings and Loans (P.L. 114-94, Title LXXXV; H.R. 37, Title III; H.R. 1334; S. 1484, Section 601; and S. 1910, Section 971)

Traditionally, under the Securities Act of 1933, banks and bank holding companies (BHCs)[3] were generally required to register securities with the SEC if they had total assets exceeding $10 million and the shares were held (as per shareholders of record) by 500 shareholders or more, as was the case with nonfinancial firms. Banks and BHCs were also allowed to stop registering securities with the SEC, a process known as deregistration, if the number of their shareholders of record fell to 300 or fewer.

Generally speaking, a central perceived benefit of SEC registration is enhancing investor protection by ensuring that investors have access to significant financial and nonfinancial data about firms and the securities they issue. The cost of SEC registration is a regulatory burden on the firm issuing securities associated with complying with SEC requirements, which potentially raises the cost of capital and reduces how much capital a firm can raise. For small firms, the regulatory burden of registration is thought to be greater than for larger firms.[4] Policymakers

[3] A bank holding company is a corporation that holds at least a quarter of the voting stock of a commercial bank.

[4] See Independent Community Bankers of America (ICBA), "ICBA Statement on Senate Passage of JOBS Act," press release, March 22, 2012, at http://www.icba.org/news/newsreleasedetail.cfm?ItemNumber=123582.

often strive to reach the optimal trade-off between costs and benefits of SEC registration by exempting firms below a certain size from registration requirements.

Title VI of the JOBS Act raised the SEC shareholder registration threshold from 500 to 2,000 and increased the upper limit for deregistration from 300 to 1,200 for those banks and nonfinancial firms. In other words, the JOBS Act made it easier for banks and BHCs to increase the number of their shareholders while remaining unregistered private banks and, if already registered, to voluntarily deregister while also adding more shareholders.[5] The provision went into effect immediately upon the enactment of the JOBS Act on April 5, 2012.

These changes made by the JOBS Act did not apply to savings and loan holding companies (SLHCs).[6] Title LXXXV of P.L. 114-94; H.R. 37; H.R. 1334; Section 601, S. 1484; and Section 971, S. 1910 would extend the higher registration and deregistration shareholder thresholds in the JOBS Act for banks and BHCs to SLHCs. Savings and loans (also known as thrifts and savings banks) are similar to banks in that they take deposits and make loans, but their regulation is somewhat different.[7]

Under the provision, an SLHC would be required to register with the SEC if its assets exceed $10 million and it has 2,000 shareholders of record, up from the current requirement of 500 shareholders of record. SLHCs that want to deregister from the SEC would have to have no more than 1,200 shareholders of record, an increase over the current 300 or fewer shareholders.

Reports indicate that after passage of the JOBS Act, a number of privately held banks and BHCs took advantage of Title VI's reduction in shareholder ownership registration triggers by raising capital from additional shareholders without having to register with the SEC.[8] Some banks have also taken the opportunity to deregister from the SEC.[9] One study found that the act was generally financially beneficial to banks. For example, it found that, on average, the legislation resulted in $1.31 in higher net bank income and $3.28 lower pretax expenses for every $1.00 of bank assets and was responsible for $1.54 million in increased assets per bank employee.[10] The study did not attempt to estimate the costs to investors of reduced disclosure under the changes made by the JOBS Act.[11]

Potentially expanding the exemption threshold on SEC registration for thrift holding companies raises two main points to consider. First, should exemption levels from SEC registration requirements be different for thrifts and savings and loans than for banks? Current law makes it

[5] This section largely derives from Katherine Koops, "The JOBS Act and SEC Deregistration: New Thresholds and Special Considerations for Banks and Bank Holding Companies," Bank Bryan Cave Law Firm, June 8, 2012, at http://www.bankbryancave.com/2012/06/the-jobs-act-and-sec-deregistration-new-thresholds-and-special-considerations-for-banks-and-bank-holding-companies/.

[6] Under federal law, a savings and loan holding company includes any company that directly or indirectly controls either a savings association or any other company that is a savings and loan holding company.

[7] See CRS Report R42572, *The Consumer Financial Protection Bureau (CFPB): A Legal Analysis*, by David H. Carpenter.

[8] For example, see ICBA, "Key JOBS Act Provision Must Be Addressed to Benefit Thrifts," press release, September 13, 2012, at http://www.icba.org/files/ICBASites/PDFs/test091312.pdf.

[9] For example, see Jeff Blumenthal, "100-plus Banks Deregister Stock Since JOBS Act," *Philadelphia Business Journal*, February 15, 2013, at http://www.bizjournals.com/philadelphia/print-edition/2013/02/15/100-plus-banks-deregister-stock-since.html; Brian Yurcan, "Small Banks Deregister in Droves Due to JOBS Act," *Bank Tech*, May 30, 2012, http://www.banktech.com/compliance/small-banks-deregister-in-droves-due-to-jobs-act/d/d-id/1295425.

[10] Joshua Mitts, "Did the JOBS Act Benefit Community Banks? A Regression Discontinuity," *SSRN*, April 25, 2013, at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2233502.

[11] Ibid.

more difficult for small thrifts to raise capital than for small banks. Second, are the costs and benefits of registration requirements for small banks better balanced at the higher thresholds enacted for banks in the JOBS Act or the lower thresholds in current law for thrifts?

Regulatory Relief for Small Business Merger and Acquisition Brokers (H.R. 37, Title IV; and H.R. 686)

Merger and acquisitions (M&A) brokers, often referred to as *Main Street brokers*, are intermediaries who negotiate privately negotiated "sale of business" transactions involving small and mid-sized companies that often do not involve the exchange of securities. This role has been described as somewhat akin to the role that "Wall Street" investment firms play as intermediaries for transactions involving changes in ownership of the securities of publicly traded firms.[12] As is the case with other broker-dealers—such as Wall Street investment firms, which can act as broker-dealers themselves and also employ individuals who also perform that role—M&A brokers are also required to register as broker-dealers with the SEC and to be members of Financial Industry Regulatory Authority (FINRA, the frontline regulator of securities brokerage firms and their brokers overseen by the SEC).

M&A brokers are commonly described as doing a fairly small volume of corporate sales transactions, which some observers say limits their ability to spread fixed regulatory costs among large numbers of transaction clients. Given these conditions, there are significant concerns that brokers oftentimes end up passing their regulatory costs on to the handful of the relatively small-sized corporate clients they serve.

Some observers say that initial SEC registration costs for M&A brokers can run more than $150,000, with annual registration running as high as $75,000.[13] To avoid these costs, some sellers and acquirers have reportedly fled to unregistered M&A brokers, who are said to be a majority of such brokers.[14] Unregistered brokers are, however, in technical violation of the registration requirements under federal securities laws. And a major concern with the use of unregistered brokers is that the absence of registration may ultimately put their clients' corporate sales transactions at risk of being rescinded in the event that the newly owned business falters.[15]

H.R. 37, Title IV; and H.R. 686 would exempt M&A brokers from registration with the SEC and FINRA for M&A transactions involving companies with annual earnings of less than $25 million and annual gross revenue of less than $250 million unless the broker (1) directly or indirectly, in connection with the transfer of ownership of an eligible privately held company, receives, holds, transmits, or has custody of the funds or securities to be exchanged by the parties to the transitions; or (2) engages on behalf of an issuer in a public securities offering that is registered or is required to be registered with the SEC.

[12] For example, see written statement by Shane B. Hansen, Partner, Warner Norcross & Judd, LLP, in U.S. Congress, House Committee on Financial Services, Subcommittee on Capital Markets and Government Sponsored Enterprises, *Reducing Barriers to Capital Formation*, hearing, June 12, 2013, at http://financialservices.house.gov/uploadedfiles/hhrg-113-ba16-wstate-shansen-20130612.pdf.

[13] Office of Representative Bill Huizenga, "Huizenga Legislation to Boost Long-Term Growth for Small Businesses," June 17, 2013, at http://huizenga.house.gov/news/documentsingle.aspx?DocumentID=339334.

[14] For example, see the testimony by Hansen.

[15] Ibid.

Similar legislation in the 113th Congress, H.R. 2274, received support from various entities in the M&A industry. After that bill passed the House, proponents argued:

> [It] would create a simplified system for brokers performing services in connection with the transfer of ownership of smaller privately held companies. By simplifying the regulation and reducing the cost of these business brokerage services, these smaller privately-owned companies would be able to safely, efficiently and effectively transfer their company.[16]

In January 2014, the staff of the SEC's Division of Trading and Markets issued a no-action letter, which had the effect of permitting certain M&A brokers to business sale intermediation services involving a "privately-held company," without having to register as broker-dealers with the agency under the federal securities laws.[17]

Although some could argue that the letter effectively precludes the need for M&A exemptive relief legislation, others stressed that "[t]he SEC interprets the laws of Congress, and until a bill is passed into law, the no-action letter serves as interpretive guidance, effectively granting M&A Brokers relief from broker-dealer registration, subject to the conditions therein…. M&A Brokers should proceed with caution—relief is transaction-based and state regulations will still apply."[18]

By contrast, the North American Securities Administrators Association (NASAA), an association of state and provincial securities regulators and a frequent investor advocate, lent its support to the original version of H.R. 2274. The group, however, subsequently withdrew its support for the bill after an amended version of the legislation "removed key investor protection features, including the bill's statutory 'bad actor' disqualification requirements, prohibitions on 'shell' transactions; and a requirement for electronic registration by notice filing with the SEC."[19] That version of the bill can currently be found as Title IV of H.R. 37 and as H.R. 686.

Elaborating on concerns raised over the inclusion of "bad actors,"[20] a critic of the current legislation argued that it "would allow brokers who have been barred from the industry to continue to hold themselves as qualified professionals to the business owners that rely on them.... There is no rational basis for barring bad actors in virtually every other similar situation but not in this context."[21]

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[16] Office of Representative Bill Huizenga, "Huizenga Legislation Soars Through House," press release, January 14, 2014, at http://huizenga.house.gov/news/documentsingle.aspx?DocumentID=366805.

[17] The letter is available at https://www.sec.gov/divisions/marketreg/mr-noaction/2014/ma-brokers-013114.pdf.

[18] Matt Catalano, "What the SEC's No-Action Letter Means for M&A Brokers, March 25, 2014, *Axial*, at http://www.axial.net/forum/sec-action-letter-2/.

[19] NASAA, "Letter to the Honorable Joe Manchin and the Honorable David Vitter re: The Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2014 (S. 1923)," September 8, 2014, at http://www.nasaa.org/wp-content/uploads/2013/10/NASAA-Letter-to-Senators-Manchin-and-Vitter-Re-S.-1923-09.08.2014-Final-PDF.pdf.

[20] Generally, bad actors are described as relevant parties who have been convicted of, or are subject to, court or administrative sanctions for securities fraud or other violations of specified laws.

[21] Testimony by Mercer Bullard, Distinguished Lecturer and Professor of Law, University of Mississippi School of Law, in U.S. Congress, House Committee on Financial Services, Subcommittee on Capital Markets and Government Sponsored Enterprises, *Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens, Part II*, hearing, May 13, 2015, at http://financialservices.house.gov/uploadedfiles/hhrg-114-ba16-wstate-mbullard-20150513.pdf.

Regulatory Relief for Emerging Growth Companies (P.L. 114-94, Title LXXI; H.R. 37, Title VI; H.R. 2064; S. 1484, Section 604; and S. 1910, Section 974)

One goal of the JOBS Act was helping to reduce the direct costs of corporate issuance of publicly traded securities. To that end, the act created a new class of public company known as an emerging growth company (EGC), which generally must have less than $1 billion in revenues in its last fiscal year. Among other things, the act phased in certain regulatory requirements for EGCs during a five-year period known as an initial public offering (IPO) "on-ramp." EGCs are also permitted to confidentially file their registration statement with the SEC, reduce their mandatory SEC financial disclosures for their IPOs and subsequent mandatory public filings, and delay the implementation of various Sarbanes-Oxley Act of 2002 and Dodd-Frank Act corporate governance requirements. Among them is a Sarbanes-Oxley requirement that a company's external auditor attest to the company management's report on the effectiveness of the company's internal controls.[22]

Between April 2012 (when EGCs began) and mid-2014, EGCs reportedly dominated initial public offerings, accounting for about 84% of domestic IPOs that went into effect during that time.

Unlike other companies that pursue IPOs, an EGC may submit its IPO registration statement confidentially as a draft for informal SEC staff review, enabling it to have a non-public "back and forth" with the agency over the contours of the projected IPO. In the event of unfavorable market conditions and thus perceived weak investor demand, under the confidential SEC review, an EGC may withdraw its draft registration statement, ending its pursuit of an IPO. Having that preliminary confidential SEC review option thus gives EGCs greater flexibility with respect to "pulling the trigger" to launch an IPO.

If an EGC does decide to move forward with its IPO, its initial confidential submission, registration statement, and prospectus must be formally submitted to the SEC at least 21 days before commencing an IPO roadshow. Companies must also provide the SEC with their latest as well as some historical financial disclosures prior to an IPO launch.

Title LXXI of P.L. 114-94, Title VI of H.R. 37, and H.R. 2064 would reduce the minimum amount of time between an EGC's initial confidential draft registration statements and roadshows from the current 21 days to 15 days. They would also exempt EGCs from having to submit certain historical financial disclosures to the SEC before to launching an IPO.

Title LXXI of P.L. 114-94, Title VI of H.R. 37, H.R. 2064, Section 604 of S. 1484, and Section 974 of S. 1910 would enable a company that was an EGC when it filed a confidential registration statement for SEC review, but is no longer an EGC, to still be treated as an EGC for regulatory purposes through the earliest of these two events: (1) when the company completes its IPO; or (2) one year after the company ceases to be an EGC. Currently, a company that qualified as an EGC when it filed its confidential registration statement with the SEC, but later lost that qualification, would have no recourse for regaining EGC status for regulatory purposes.

[22] Internal controls are corporate protocols aimed at helping to ensure the integrity of corporate financial and accounting information meet operational and profitability targets, and transmit management policies throughout the firm.

Proponents have argued that reducing the time between registration and the roadshow would reduce the likelihood that external events could have a negative impact on an IPO.[23] The provisions have, however, been criticized by those who argue that while a number of EGCs are relatively large in size and are likely to garner "fairly immediate" attention from securities analysts, some will likely be rather small and will not attract such immediate analytical attention. As such, the concern is that compressing the time for public reaction to such smaller and unanalyzed EGCs in particular could be "a poor and untested idea."[24]

A 2014 study of EGCs concluded that a sample of EGCs began their roadshows an average of 43 days after they had publicly filed their registration statements with the SEC. That 43-day average, more than twice the current 21-day minimum window, suggests that a reduction to 15 days is not likely to have a significant overall impact on the EGC IPO process.[25]

Advocates have also argued that not having to provide historical information to the SEC would translate into meaningful cost savings. Critics, however, have countered that, due to the central role that financial statements play in the overall scheme of mandatory corporate disclosures to the SEC and investors, the ability to compare multiple years of such statements is critical.[26]

By contrast, there appears to be little substantial criticism of enabling an EGC that filed confidential registrations statements but subsequently no longer qualified for EGC status to still be treated as an EGC from a regulatory perspective.

Regulatory Relief for Small Companies for Their XBRL Disclosures (H.R. 37, Title VII and H.R. 1965)

EXtensible Business Reporting Language (XBRL) is a freely available global standard developed to improve the way financial data is disseminated, compiled, and shared. XBRL employs tags to identify individual components of each piece of financial data, which then allows it to be used programmatically by an XBRL-compatible program.

Historically, publicly traded companies were required to submit paper-based filings of mandatory financial statement disclosures to the SEC. In 2009, the SEC adopted additional requirements that such disclosures would also have to be submitted to the agency in XBRL. Phased in over the next four years, the XBRL requirement began with larger companies, eventually extending to all publicly traded firms.[27]

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[23] Testimony of A. Heath Abshure, Arkansas Securities Commissioner and Immediate Past-President of the North American Securities Administrators Association, in U.S. Congress, House Committee on Financial Services, Subcommittee on Capital Markets and Government Sponsored Enterprises, *Legislation to Further Reduce Impediments to Capital Formation*, hearing, October 23, 2013.

[24] Statement of Theresa A. Gabaldon, Lyle T. Alverson Professor of Law at the George Washington University Law School, in U.S. Congress, House Committee on Financial Services, Subcommittee on Capital Markets and Government Sponsored Enterprises, hearing, April 29, 2015, at http://financialservices.house.gov/uploadedfiles/hhrg-114-ba16-wstate-tgabaldon-20150429.pdf.

[25] "The JOBS Act, Two Years Later: An Updated Look at the IPO Landscape," *Latham and Watkins*, April 5 2014, at http://www.jdsupra.com/legalnews/the-jobs-act-two-years-later-an-update-11568/.

[26] "Statement of Professor Theresa A. Gabaldon."

[27] SEC, "Interactive Data to Improve Financial Reporting. Final Rule," January 30, 2009, at http://www.sec.gov/rules/final/2009/33-9002.pdf.

XBRL imposes a computer-readable data structure on the financial statements and their associated notes and footnotes through assigning electronic tags to each item. The protocol also reports on the relationship between individual items in the financial statements. And unlike the conventional paper-based disclosures, data in the XBRL format can be easily converted into spreadsheets for analysis.

When it adopted the XBRL protocol, also known as *interactive data*, the SEC claimed that it would provide an array of investor information benefits, including the fact that such data "can be dynamically searched and analyzed, facilitating the comparison of financial and business performance across companies, reporting periods, and industries.... Interactive data [will] also provide a significant opportunity to automate regulatory filings and business information processing, with the potential to increase the speed, accuracy, and usability of financial disclosure. Such automation could eventually reduce costs."[28]

Through the years, concerns have emerged that the costs of compliance with the XBRL protocol tends to have a particularly disproportionately burdensome impact on smaller companies. For example, a report based on a survey of New York Stock Exchange–listed small public companies found that exempting them from XBRL requirements "would save time and money for smaller reporting companies ... [which] have less complicated financial statements and therefore the value associated with being able to hyperlink to financial schedules and tagged footnotes [through XBRL] is very low."[29]

Title VII of H.R. 37 and H.R. 1965 would provide a voluntary exemption to both EGCs and public companies with total annual gross revenues of less than $250 million from current requirements to do their SEC financial reporting via XBRL. In addition, within a year of enactment, the legislation would require the SEC to provide an analysis of the costs and benefits to issuers of the XBRL financial statement requirements to Congress.

Proponents of this provision argue that the overall costs of conforming with the XBRL reporting protocol generally exceed its benefits.

With respect to smaller public firms in particular, the legislation's proponents give special emphasis to the observation that those companies frequently spend tens of thousands of dollars or more annually on XBRL compliance.[30]

In this context, the American Institute of Certified Public Accountants and XBRL US, a national XBRL consortium, surveyed XBRL vendors who provide XBRL tagging and filing services to some 1,300 smaller reporting companies (public companies with $75 million or less in market capitalization). The survey found that (1) 69% of the companies paid $10,000 or less annually for fully outsourced creation and filing solutions of their XBRL filings; (2) 18% of the companies had annual costs of $10,000 to $20,000 for full-service outsourced XBRL solutions; (3) 8% of the companies paid in excess of $25,000 annually; and (4) no annual XBRL-based costs exceeded $50,000.

The survey also found that in the case of companies with higher XBRL-based expenditures, their outsized costs derived from exceptional circumstances, namely the "complexities in their

[28] Ibid.

[29] Paul Dorfman, "SEC Advisory Committee on Small and Emerging Companies," *NYSE Euronext*, 2012, at http://www.sec.gov/news/otherwebcasts/2012/dorfman_060812.pdf.

[30] For example, see Office of Representative Robert Hurt, "Robert Hurt Introduces Bill to Reduce the Regulatory Burden on Small Companies," press release, April 29, 2015, at http://hurt.house.gov/index.cfm/press-releases?ID=919047B9-E08F-420A-9243-FF439694EE43.

financial statements and rush charges imposed given the many last minute changes to the filings (e.g., filing changes for an IPO)."[31]

Overall, the study concluded that XBRL "is not overly burdensome on small companies and in fact [is] ... worth the additional cost."[32] Examining trends in the cost of XBRL compliance for companies in general, a complementary study reported that for many companies, costs were declining as many companies moved to financial management programs that incorporate the XBRL process.[33]

The other side of the XBRL cost/benefit debate involves the XBRL user side, which a few studies have tried to throw some light on.

For example, one survey of smaller reporting companies[34] listed on the New York Stock Exchange found that many of the firms believed that because smaller companies tended to produce relatively less complicated financial statements, the benefit from XBRL-based attributes (such as the ability to hyperlink to financial schedules and tagged footnotes) is insignificant.[35]

In addition, a study from the Columbia University Business School found that less than 10% of investors and analysts surveyed used XBRL-tagged SEC data, and none tried to access XBRL data from corporate websites. It also reported that the relatively small number of analysts and investors who had attempted to use the data tended to be disappointed with both its usability and its general quality.[36]

Some of the legislations' detractors, however, counter that exempting smaller firms from using it would ultimately harm investors because they would lose access to small company financial data that they had benefited from heretofore.[37] Relatedly, the head of the SEC's Office of the Investor Advocate, an SEC office charged with assisting retail investors in their dealings with the agency, has argued that the XBRL regulatory relief legislation "would seriously impede the ability of the SEC to bring disclosure into the 21st Century" and that proper congressional intervention would entail urging the SEC to continue in its efforts to make corporate disclosures "more accessible and useful" to the investing public.[38]

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[31] Ibid.

[32] Ibid.

[33] Jason Bramwell, "Opposition Mounts for House XBRL Exemption Legislation," Accounting Web, March 17, 2014, at http://m.accountingweb.com/article/opposition-mounts-house-xbrl-exemption-legislation/223155. (Hereinafter, Bramwell, "Opposition Mounts.")

[34] Generally, the SEC defines a smaller reporting company as one that has a public float of less than $75 million.

[35] Dorfman, "SEC Advisory Committee on Small and Emerging Companies."

[36] Trevor S. Harris and Suzanne Morsfield, "An Evaluation of the Current State and Future of XBRL and Interactive Data for Investors and Analysts," Columbia University Business School, December 2012, at http://www8.gsb.columbia.edu/rtfiles/ceasa/An%20Evaluation%20of%20the%20Current%20State%20and%20Future%20of%20XBRL%20and%20Interactive%20Data%20for%20Investors%20and%20Analysts.pdf.

[37] Bramwell, "Opposition Mounts."

[38] SEC, "Speech by Rick A. Fleming, SEC Investor Advocate, Effective Disclosure for the 21st Century Investor," February 20, 2015, at http://www.sec.gov/news/speech/022015-spchraf.html.

Regulatory Relief for Advisers to Small Business Investment Companies (P.L. 114-94, Title LXXIV; H.R. 37, Title IX; and H.R. 432)

Small business investment companies (SBICs) are privately owned, pooled investment companies that are licensed by the Small Business Administration (SBA). The SBIC program was conceived in 1958 as a vehicle to bolster small business access to venture capital by stimulating and supplementing the flow of private equity capital and long-term loan funds to them. SBICs fund small businesses through the private capital that each SBIC raises in addition to funds that they generally borrow at favorable rates (as the SBA guarantees the loan obligations).[39] SBICs are generally created as limited partnerships, with their managers generally acting as both general partner and investment adviser. The limited partners, who supply the majority of the private funding, are typically institutional investors, including banks and high-net-worth individual investors.[40]

Historically, SBIC advisers were generally not required by federal securities law to register with the SEC as investment advisers due to an exemption available to advisers with fewer than 15 clients or funds. The Dodd-Frank Act eliminated that broad exemption for entities that fell within a generic category of pooled investment entities, called private funds, including SBICs and venture capital funds. The act basically replaced that broad exemption with several narrower registration exemptions, including exemptions for advisers who solely advise SBICs and venture capital funds. However, advisers who manage at least one SBIC and one venture capital funds, as many have historically done, must now register with the SEC. According to various sources, the costs of such adviser registration can be significant.[41]

The Dodd-Frank Act also created a new category of advisers known as mid-sized advisers, who manage between $25 million and $100 million for their clients and are generally not required to register with the SEC. They, however, are subject to state registration from the states where they have their principal offices and places of business. The act also requires advisers to private funds to register with the SEC if in the aggregate they control $150 million or more in assets under management[42] (AUM) in those private funds.

Title LXXIV of P.L. 114-94, Title IX of H.R. 37, and H.R. 432 would exempt SBIC advisers from SEC registration requirements if they also advise venture capital funds. The provision would also exempt the inclusion of an SBIC's assets in the calculation of AUM and exempt advisers to SBICs from state and local registration requirements. Currently, if such an adviser advises both venture capital funds and SBICs, the adviser must register with the SEC. And according to

[39] For more information, see CRS Report R41456, *SBA Small Business Investment Company Program*, by Robert Jay Dilger.

[40] Law360, "SBIC Relief Act Will Be Good for Advisers—And Business," April 07, 2014, at http://www.law360.com/articles/525896/sbic-relief-act-will-be-good-for-advisers-and-business.

[41] For example, see Tom Quaadman, "Statement of the U.S. Chamber of Commerce," October 23, 2013, http://financialservices.house.gov/uploadedfiles/hhrg-113-ba16-wstate-tquaadman-20131023.pdf.

[42] Assets under management refers to the market value of assets that an investment company manages on behalf of investors.

industry testimony, 25 states and the District of Columbia have exemptions from registration for advisers to SBIC funds.[43]

Supporters of the legislative provisions, including the U.S. Chamber of Commerce and the Small Business Investor Alliance, have said that the overall small business capital funding market will benefit from the ability of venture capital fund advisers to use their expertise to build SBICs. They have also argued that the SBA operates a robust oversight regime for SBICs and that subjecting SBIC advisers to registration requirements constitutes costly (especially for the many small SBICS) and essentially duplicative regulation.[44]

NASAA indicated that adviser relief legislation similar to the aforementioned legislation did not appear "to directly threaten retail investors." Having said that, the group expressed concerns that the legislation's preemption of both state and federal registration for SBIC advisers could have unforeseen negative consequences for retail investors. It then recommended that the legislation be amended to give states the authority to register entities who acted solely as advisers to SBICs.[45]

Modernizing SEC Disclosures (P.L. 114-94, Title LXXII; H.R. 37, Title X; and H.R. 1525)

As described earlier, one element of the SEC's statutory mission "is to protect investors,"[46] and a central means by which the agency strives to do this is by ensuring that investors and prospective investors "have access to certain basic facts about an investment prior to buying it, and so long as they hold it … [by requiring] public companies to disclose meaningful financial and other information to the public."[47]

One part of this disclosure regime is Form 10-K, an annual mandatory corporate disclosure that includes a wealth of corporate information, including a company's history, organizational structure, stockholdings, and details about its officials, financial performance, and corporate subsidiaries.

[43] Testimony of William Spell, president, Spell Capital Partners, before U.S. Congress, Senate Banking Committee Subcommittee on Securities, Insurance, and Investment, March 25, 2015, at http://www.banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=72b34807-258f-41be-ae69-42bcdb0c150a&Witness_ID=e8eb8d56-6b4c-43a0-a254-a339d869d7e2.

[44] For example, see testimony by Gayle G. Hughes, partner and founder, Merion Investment, in U.S. Congress, House Committee on Financial Services, Subcommittee on Capital Markets and Government Sponsored Enterprises, *Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Barriers*, hearing, April 29, 2015, at http://financialservices.house.gov/uploadedfiles/hhrg-114-ba16-wstate-ghughes-20150429.pdf; and testimony by Thomas Quaadman, vice president, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, in U.S. Congress, House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises, hearing," *Federal Information & News Dispatch*, April 29, 2015, at http://financialservices.house.gov/uploadedfiles/hhrg-114-ba16-wstate-tquaadman-20150429.pdf.

[45] See written testimony of William Beatty, Washington Securities Division director and president-elect of NASAA, in U.S. Congress, House Committee on Financial Services, Subcommittee on Capital Markets and Government Sponsored Enterprises, *Legislative Proposals to Enhance Capital Formation for Small and Emerging Growth Companies, Part II*, hearing, May 1, 2014, at http://www.nasaa.org/30660/legislative-proposals-enhance-capital-formation-small-emerging-growth-companies-part-ii/. (Hereinafter, "Beatty, testimony.")

[46] SEC, "The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation," at http://www.sec.gov/about/whatwedo.shtml#.VOemZC7JYm8.

[47] Ibid.

Another part of the SEC's investor disclosure regime is Regulation S-K, which lays out the SEC's reporting requirements. It consists of a set of SEC rules that dictate non-financial corporate disclosure requirements for various mandatory corporate disclosure documents under federal securities laws, including registration statements for securities offerings and proxy statements.[48]

An additional part of the disclosure regime is Regulation S-X, which provides a framework for the form and content of financial statements submitted to the SEC by securities issuers.

Through the years, with the encouragement of a range of stakeholders, the SEC has had an ongoing interest in streamlining, simplifying, and modernizing disclosure documents so that they are less costly, more efficient for securities issuers to use, and more accessible to and understandable for investors.[49] Some observers, however, say that even more streamlining and simplification of SEC disclosure documents is needed.

In this context, Title LXXII of P.L. 114-94, Title X of H.R. 37, and H.R. 1525 would permit issuers to provide a summary page for their Form 10-K disclosures and direct the SEC to revise Regulation S-K to (1) scale back or eliminate requirements within the regulation; (2) reduce the burden on EGCs, accelerated filers, and smaller reporting companies;[50] and (3) eliminate provisions of Regulation S-K that are duplicative, outdated, or unnecessary. The SEC would also be required to provide Congress with a study that identified ways in which requirements in Regulation S-K could be simplified, made more readable, and be less repetitious.

In 2008, the SEC-sponsored Advisory Committee on Improvements to Financial Reporting advised the agency to consider permitting issuers to use an executive summary at the beginning of their Form 10-K disclosures as well as material updates in their quarterly reports and a page index indicating where investors could find greater detail on more specific subjects. It argued that many individual investors may find an issuer's periodic disclosures to be too complex and overly detailed and that a summary would concisely describe the most important corporate developments or other salient managerial issues.[51]

Others, however, have argued that any expectation that Form 10-Ks can be transformed into a shorter and more concise summary page is probably unrealistic. It has also been argued that Form 10-Ks are generally not targeted at retail investors—who would probably benefit most from a Form 10-K summary page—but are basically geared toward professionals, including securities analysts and other investment intermediaries.[52]

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[48] A proxy statement has information that a company is required by the SEC to provide to their shareholders to enable them to make informed decisions about matters that will be brought up at a company's annual stockholder meeting. Proxy statements may include proposals for new members of the board of directors, information on directors' compensation packages, and declarations by a company's management.

[49] For example, see SEC, "Report of the Task Force on Disclosure Simplification," March 5, 1996, at http://www.sec.gov/news/studies/smpl.htm.

[50] Accelerated filers are public companies with a market cap between $75 million and $700 million. Smaller reporting companies are generally defined as public companies with a public float of less than $75 million.

[51] SEC, "Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission," August 1, 2008, at http://www.sec.gov/about/offices/oca/acifr/acifr-finalreport.pdf.

[52] Testimony by John Coffee, Adolf A. Berle Professor of Law, director of the Center on Corporate Governance at Columbia Law School, in U.S. Congress, House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises, *Legislative Proposals to Enhance Capital Formation for Small and Emerging Growth Companies*, hearing, April 9, 2014, at http://financialservices.house.gov/uploadedfiles/hhrg-113-ba16-wstate-jcoffee-20140409.pdf. (Hereinafter, "Coffee, testimony.")

The JOBS Act required the SEC to determine how Regulation S-K requirements can be updated to modernize and simplify the SEC registration process.[53] The review, completed in December 2013, recommended comprehensively examining the disclosure requirements for SEC registrants, including for EGCs.[54]

Title LXXII of P.L. 114-94, Title IX of H.R. 37, and H.R. 1525 would also require the SEC to complete significant modernization to the Regulation S-K regime within 180 days of enactment. Proponents of the bills have argued that the short timeframe for SEC action was necessary because there had been too much "studying [of] disclosure reform" and that it was time for action.[55]

Others, however, have portrayed the 180-day timetable as unrealistic given the SEC's substantial backlog of mandated work, including remaining rulemaking needed to implement parts of the Dodd-Frank Act.[56] Additional rulemaking to implement remaining parts of the JOBS Act are also a part of the agency's current agenda.

In early 2014, SEC Chair Mary Jo White observed that the Regulation S-K report had given the agency a framework for future reform of the disclosure regime. To that end, she announced that she had directed agency staff to provide recommendations for updating its rules that dictate the contents of corporate disclosures, a venture that would involve input from a range of corporations and investor stakeholders.[57]

Increasing the Threshold Amounts of Securities That Can Be Sold to Corporate Employees and Directors (H.R. 37, Title XI; H.R. 1675; S. 1484, Section 602; and S. 1910, Section 972)

In general, under federal securities laws, when a company issues securities, it is required to register the securities with the SEC unless the transaction qualifies for an exemption from registration. Adopted by the SEC in 1988, Rule 701 of the Securities Act provides an exemption from such registrations requirements to non-public companies (often startups) that offer their own securities (including stock options and restricted stock)[58] as part of formal written compensation agreements to employees, directors, general partners, trustees, officers, and specified advisers and

[53] SEC, "Report on Review of Disclosure Requirements in Regulation S-K as Required by Section 108 of the Jumpstart Our Business Startups Act," December 2013, http://www.sec.gov/news/studies/2013/reg-sk-disclosure-requirements-review.pdf.

[54] Ibid.

[55] Joe Mont, "SEC Disclosure Simplification Bill Approved in House," *Compliance Week*, December 4, 2014, at http://www.complianceweek.com/blogs/the-filing-cabinet/sec-disclosure-simplification-bill-approved-in-house#.VO5fki7Jbng.

[56] Coffee, testimony.

[57] SEC, "Speech by SEC Chair Mary Jo White before the 41st Annual Securities Regulation," January 27, 2014, at http://www.sec.gov/News/Speech/Detail/Speech/1370540677500#.VO5mgS7Jbng.

[58] A stock option gives its holder the right, but not the obligation, to buy or sell a particular stock at an agreed-upon price within a certain period or on a specific date. Restricted stocks are stocks or other securities that are acquired directly or indirectly from a public or private company or from an affiliate of the company (for example, a gift) in a transaction that is not registered by the SEC, also known as a private offering. They are non-transferrable and are subject to certain trading limitations.

consultants.[59] Certain conditions must be met for eligibility, chiefly: Total sales of stock to the aforementioned corporate entities during a 12-month period cannot exceed the greater of $1 million, 15% of the issuer's total assets, or 15% of all the outstanding securities of the class of securities being offered.

In addition, during any 12-month period, if the sale of securities to the aforementioned corporate personnel exceeds $5 million, the company must provide the employee/investors with additional information, including risk factors, copies of the plans under which the offerings are made, and certain financial statements.

Title XI of H.R. 37, H.R. 1675, Section 602 of S. 1484, and Section 972 of S. 1910 would increase the amount of aggregate securities sales to corporate personnel over any 12-month period to $10 million before the additional disclosure requirement is triggered.

Various business interests, including the U.S. Chamber of Commerce, have said that expanding the current $5 million cap under Rule 701 to $10 million would (1) encourage more privately held companies to provide company equity to their employees, as many are reportedly wary that rival firms could exploit the information;[60] and (2) better align the $5 million figure (established in 1999) with its inflation-adjusted current valuation.[61]

Another supportive argument is that the legislation would not affect retail investors outside of the companies, since companies with Rule 701 exemptions can issue stock only to corporate-affiliated personnel.[62]

Detractors, however, charge that (1) Rule 701 was originally intended exclusively for small startups and that by expanding the securities sales cap to $10 million, large corporate issuers would be included under the rule, enabling them to deny their employee/investors corporate disclosures that are generally available to other investors;[63] and (2) the bills would "encourage employees to problematically "over concentrate" their retirement accounts in employer stock, potentially moving them away from generally safer, more diversified portfolios.[64]

Enabling Broker-Dealers to Publish Research on Exchange Traded Funds (H.R. 2356)

An exchange traded fund (ETF) is fund that tracks a securities index like a mutual fund but is traded and priced throughout the trading day like a stock. ETFs can target a wide spectrum of industry sectors, including energy, health, biotech, and finance, thus giving investors an alternative means to invest in them. Sales of ETFs have grown significantly through the years.[65]

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[59] See SEC, "Final Rule: Rule 701–Exempt Offerings Pursuant to Compensatory Arrangements," at http://www.sec.gov/rules/final/33-7645.htm.

[60] For example, see the hearing transcript: "Legislative Proposals to Enhance Capital Formation for Small and Emerging Growth Companies, Wednesday, House of Representatives, Subcommittee on Capital Markets and Government Sponsored Enterprises, Committee on Financial Services," April 9, 2014, http://financialservices.house.gov/uploadedfiles/113-74.pdf.

[61] Ibid.

[62] Beatty, testimony.

[63] Gabaldon, testimony.

[64] Bullard, testimony.

[65] For example, see *Investor's Business Daily*, "ETFs Resume Record Growth Pace," August 12, 2015, at

Currently, SEC-registered broker-dealers face restrictions in the issuing of certain research reports on ETFs because the reports are broadly defined to be currently prohibited securities "offers."[66]

H.R. 2356 would give broker-dealers a legal safe harbor with respect to the publication of research reports on ETFs if 120 days elapse after the legislation's enactment and the agency had not yet done the required rulemaking.

Among other things, the bill's proponents, including the Securities Industry and Financial Markets Association (SIFMA), say that as ETFs have become a growing share of retail and institutional investor portfolios, there is a growing need to bolster what some characterize as the undeveloped state of ETF research. The legislation is touted as a mechanism that would help address this perceived shortfall.[67]

While acknowledging the importance of broadening ETF research, the bill's critics say that it would problematically insulate companies and broker-dealers from private antifraud claims under federal securities laws and preclude SEC enforcement action under Section 17 of the Securities Act, which prohibits fraud and misrepresentations in the offer or sale of securities.[68]

Requiring the SEC to Evaluate and Vote on Its Significant Regulations (H.R. 2354)

Among other things, the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (P.L. 104-208) requires various financial regulatory agencies—including the Federal Financial Institutions Examination Council, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and the Board of Governors of the Federal Reserve System—to review their regulations at least every 10 years and identify any outdated or otherwise unnecessary regulations that are imposed on insured depository institutions.

The SEC, however, is currently not subject to such required reviews. H.R. 2354 would require (1) that 5 years after a regulation's adoption, and every subsequent 10 years, the SEC must conduct a retrospective review of all significant agency rules and regulations;[69] and (2) a vote by the five SEC commissioners on whether each regulation identified by the aforementioned review is outmoded, ineffective, insufficient, excessively burdensome, or no longer necessary in the public interest or not consistent with the agency's statutory mandate to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The bill would also prohibit the

http://www.nasdaq.com/article/etfs-resume-record-growth-pace-cm508057#ixzz3j6io00cY.

[66] For example, see Sanford Bragg, "New Legislation Would Allow ETF Research from Brokers," *Integrity Research*, June 3, 2015, at https://www.integrity-research.com/new-legislation-would-allow-etf-research-from-brokers/.

[67] See written statement of Ronald J. Kruszewski, chairman and CEO, Stifel, in U.S. Congress, House Committee on Financial Services, Subcommittee on Capital Markets and Government Sponsored Enterprises, May 13, 2015, at http://financialservices.house.gov/uploadedfiles/hhrg-114-ba16-wstate-rkruszewski-20150513.pdf; Bragg, "New Legislation Would Allow ETF Research from Brokers." (Hereinafter, "Kruszewski, testimony.")

[68] Bullard, testimony.

[69] Significant regulations would be defined as (1) those with an annual economic impact of $100 million or more as defined by the Office of Management and Budget, or (2) those that result in a major increase in costs or prices for consumers, individual industries, governments, or geographic regions, or (3) cause significant adverse effects on competition, employment, investment, productivity, innovation, or the ability of U.S. enterprises to compete against their foreign counterparts.

judicial review of any decisions made by the agency to eliminate or amend its rules and regulators as part of the aforementioned regulatory review.

In its support of the legislation, SIFMA argued that the SEC should periodically examine all of its significant rules and regulations, as is currently done by most executive branch agencies. The trade group also advocated for policies beyond what H.R. 2354 would require, saying that "SEC rules that impose a relatively high cost on market participants and investors should be prioritized and reviewed with a frequency that is directly based on the costs and impact of the rule or regulation."[70]

By contrast, a point made by critics of the bill is that the legislation is simply unnecessary: The SEC is already said to conduct retrospective regulatory reviews under both the Regulatory Flexibility Act[71] and Paperwork Reduction Act[72] and is said to voluntarily comply with Executive Order 13563,[73] which directs the agency to develop a retrospective rule review protocol aimed at identifying rules "that may be outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them" as appropriate.[74] An additional criticism is that the legislation would impose additional administrative burdens on the SEC, which is already said to be both overburdened and inadequately funded.[75]

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[70] Kruszewski, testimony.

[71] "The Regulatory Flexibility Act (RFA) of 1980 (5 U.S.C. §§601-612) requires federal agencies to assess the impact of their forthcoming regulations on 'small entities,' which the act defines as including small businesses, small governmental jurisdictions, and certain small not-for-profit organizations. Under the RFA, Cabinet departments and independent agencies as well as independent regulatory agencies must prepare a 'regulatory flexibility analysis' at the time proposed and certain final rules are issued. The RFA requires the analysis to describe, among other things, (1) the reasons why the regulatory action is being considered; (2) the small entities to which the proposed rule will apply and, where feasible, an estimate of their number; (3) the projected reporting, recordkeeping, and other compliance requirements of the proposed rule; and (4) any significant alternatives to the rule that would accomplish the statutory objectives while minimizing the impact on small entities." See CRS Report RL32240, *The Federal Rulemaking Process: An Overview*, coordinated by Maeve P. Carey.

[72] "The Paperwork Reduction Act (PRA) (44 U.S.C. §§3501-3520) was originally enacted in 1980. One of the purposes of the PRA is to minimize the paperwork burden for individuals, small businesses, and others resulting from the collection of information by or for the federal government. The act generally defines a 'collection of information' as the obtaining or disclosure of facts or opinions by or for an agency by 10 or more nonfederal persons. Many information collections, recordkeeping requirements, and third-party disclosures are contained in or are authorized by regulations as monitoring or enforcement tools. In fact, these paperwork requirements are the essence of many agencies' regulatory provisions. The PRA requires agencies to justify any collection of information from the public by establishing the need and intended use of the information, estimating the burden that the collection will impose on respondents, and showing that the collection is the least burdensome way to gather the information." Ibid.

[73] "Executive Order 13563, issued by President Obama in January 2011 ... says that covered agencies (Cabinet departments and independent agencies) must (to the extent permitted by law): (1) propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs, (2) tailor regulations to impost the least burden on society, and (3) select regulatory approaches that maximize net benefits. It also directs agencies to 'use the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible.' Section 6 of the executive order requires covered agencies to develop a plan under which they would periodically review their existing significant rules. Although the executive order does not apply to independent regulatory agencies, a February 2011 memorandum from the OIRA Administrator encouraged those agencies to give consideration to all its provisions." CRS Report R41974, *Cost-Benefit and Other Analysis Requirements in the Rulemaking Process*, coordinated by Maeve P. Carey.

[74] Bullard, testimony.

[75] Comments of Honorable Maxine Waters in "House Financial Services Committee Holds Markup on Financial Services Legislation, *CQ Financial Transcripts*, May 20, 2015.

Requiring the SEC to Provide Future Credits for Previous Excessive Fee Payments to it by Various Entities that it Regulates (H.R. 1975)

Under Section 31 of the Securities Exchange Act of 1934, national securities exchanges and other securities-related self-regulatory organizations (SROs) are required to pay transaction fees to the SEC. The fees are used to recoup costs incurred by the government, including the SEC, for supervising and regulating both securities markets and securities professionals.[76]

Historically, there have been a number of reported instances when SEC-regulated entities have remitted such fee payments to the SEC in excess of actual required amounts.[77] When that happens, a SEC staffer told CRS that the agency does not currently believe that it has the authority to refund requests for such fee overpayments.[78] H.R. 1975 would authorize the SEC to offset future fees levied on regulated entities by the amount of their cumulative excess fee payments.

Citing a reported SEC staff estimate that FINRA overpaid the SEC by approximately $6 million between 2005 and 2015, proponents of H.R. 1975 have argued that Section 31 fee overpayments tend to stem from either human "error" or "system failures."[79]

H.R. 1975 has been described as providing a mechanism that would enable the SEC to refund or credit regulated entities that have paid excessive Section 31 fees.[80] In phone conversations with the SEC in August 2015, an agency staffer told CRS that the agency was currently awaiting guidance on whether it had the authority to refund overages under Section 31.

Requiring the SEC to Revise Directions for Initial Registration Form S-1 (P.L. 114-94, Title LXXXIV and H.R. 1723)

Form S-1 is the initial registration form that the SEC requires before a private company may publicly issue securities in order to become a public company. Among other things, the form requires a description of the security, the terms of the issuance, and the company's planned use of proceeds from the securities issuance. Form S-1 filings are available for public view online on the SEC's website.

Some SEC registration statements and other filing documents submitted to the agency under both the Securities Act and the Securities Exchange Act allow *incorporation by reference*. This refers to the ability to incorporate certain data that is required in a filing by referring to other forms, documents, or registration statements previously filed with the SEC. Incorporation by reference can enable a company to reduce the amount of text required (and any additional man-hours

[76] SEC, "Section 31 Transaction Fees," https://www.sec.gov/answers/sec31.htm.

[77] "Audit of the SEC's Filing Fee's Program," *SEC Office of the Inspector General*, March 29, 2013, at http://www.sec.gov/about/offices/oig/reports/audits/2013/514.pdf.

[78] Phone conversations between SEC staff and CRS during August 2015.

[79] For example, see the comments of Honorable Greg Meeks in "House Financial Services Committee Holds Markup on Financial Services Legislation," May 20, 2015, *CQ Financial Transcripts*, May 20, 2015.

[80] Ibid.

required to write the text) for particular filings and can help to simplify the registration or filing process.

Title LXXXIV of P.L. 114-94 and H.R. 1723 would allow smaller reporting companies—generally public companies with less than $75 million in public float—to incorporate by reference other documents filed with the SEC after registering through Form S-1.

The SEC's 2012 Government-Business Forum on Small Business Capital Formation recommended that smaller reporting companies should be permitted to use incorporation by reference for Form S-1 registration statements. The report noted that, given the advanced state of the SEC's EDGAR database and the ease of accessing supplementary documents through the Internet, such a policy change made good sense.[81]

Similarly supportive sentiments have come from a variety of business interests, including the U.S. Chamber of Commerce. An official with the group has argued that smaller reporting companies are particularly burdened by copious amounts of disclosure obligations and that the aforementioned types of legislation would enable smaller reporting companies to avoid repetitive disclosures while still enabling investors to receive material information on the firms.[82]

Columbia law professor John Coffee Jr. said that this kind of legislation would "have real efficiency justifications and could help smaller issuers."[83]

Expanding Smaller Reporting Company Access to Form S-3 Shelf Registration (H.R. 2357)

Form S-3, known as shelf registration, is a simplified SEC securities registration form for public companies that is also known as a shelf offering. It is less detailed than the Form S-1 and can be used only by companies that fulfill a certain set of SEC guidelines. A company may file Form S-3 a couple of years in advance of an IPO, allowing it to immediately issue securities when market conditions are the most favorable for going public.

Generally, companies registering via Form S-3 must (1) have been filing with the SEC for at least a year, and (2) have a float of *at least* $75 million. Smaller reporting companies, however, are allowed to conduct Form S-3 registrations if they (1) are traded on a national securities exchange, (2) are not shell companies, and (3) have not issued common stock greater than one-third of the value of their public floats in the last 12 months.

H.R. 2357 would allow companies to register primary securities offerings that exceed one-third of the aggregate market value of their combined voting and non-voting common equity held by their non-affiliates. Smaller reporting companies that are not traded on a national securities exchange would then be able to register primary security offerings via Form S-3 of up to one-third of their public floats.

Proponents of H.R. 2357 argue that the bill would bolster smaller companies' opportunities to secure securities-based funding.[84] Relatedly, a report from the SEC's Government-Business

[81] SEC, "2012 SEC Government-Business Forum on Small Business Capital Formation Final Report." April 2013, at http://www.sec.gov/info/smallbus/gbfor31.pdf.

[82] Quaadman, statement.

[83] Coffee, testimony.

[84] For example, see the comments of Honorable Ann Wagner in "Rep. Scott Garrett Holds a Hearing on Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens, Committee Hearing," *SEC Wire*, May 13,

Forum on Small Business Capital Formation also recommended giving smaller reporting companies more generous access to Form S-3 registration, arguing that traditional investor protection concerns over doing so have been "substantially eliminated with [the advent of] advanced information technology, including EDGAR."[85]

By contrast, critics of similar legislation to H.R. 2357 have warned that expanding smaller reporting company eligibility to Form S-3 registration would constitute a major shift in "long-standing" policies at the SEC. Historically, they note that Form S-3-based shelf registration was generally confined to seasoned corporate issuers with significantly sized public floats and generally benefited from an established network of securities analysts who tracked them. However, under such legislation, the concern is that less reputable companies that are exclusively traded on the Pink Sheets or the OTC Bulletin Board[86] might then be able to use shelf registration to make large securities offerings without giving prior notice to the public.[87]

Making It Easier for Holders of Privately Placed Securities to Resell Them (P.L. 114-94, Title LXXVI and H.R. 1839)

Currently, after holding securities for a certain length of time, investors in securities issued in a private placement[88] are allowed to resell the securities in a public trading market. An investor's ability to resell such securities on the private market, however, is more limited. Investors, particularly institutional investors, often circumvent this restriction through reference to what is popularly known as Section 4(a)(1½) of the Securities Act of 1933. While Section 4(a)(1½) does not formally appear in the Securities Act of 1933, reference to it has developed through years of case law and SEC no-action letters.[89] The section is often invoked to provide a non-statutory

2015.

[85] EDGAR is the electronic disclosure filing system administered by the SEC. SEC, "32nd Annual SEC Government-Business Forum on Small Business Capital Formation, Final Report," June 2014, at http://www.sec.gov/info/smallbus/gbfor32.pdf.

[86] Over-the-counter (OTC) securities are traded outside of a formal exchange such as the New York Stock Exchange or the American Stock Exchange. The companies that are traded in the OTC market tend to be smaller companies that do not meet the listing requirements to be traded on exchanges. Instead, OTC securities are traded by broker-dealers. The OTC Bulletin Board is a regulated electronic trading service offered by the National Association of Securities Dealers that shows real-time quotes, last-sale prices, and volume information for OTC equity securities. Companies listed on this exchange are required to file current financial statements with the SEC or a banking or insurance regulator. The Pink Sheets are a daily publication compiled by the National Quotation Bureau with bid and ask prices of OTC stocks and the market makers who trade them. Unlike companies on a stock exchange, companies quoted on the Pink Sheets do not need to meet minimum requirements or file with the SEC. Pink sheets also refers to OTC trading.

[87] See Coffee, testimony.

[88] A private placement is a securities offering that is not registered with the SEC and is not available to the general public. Generally, one must be an "accredited investor" to invest in a private placement. Accredited investors include financial institutions such as banks and mutual funds. They also include individuals with a net worth (excluding their primary residence) of over $1 million—either alone or with a spouse. Alternatively, such an investor must have income greater than $200,000 during each of the last two years or $300,000 if that person has a spouse.

[89] A no-action letter is a letter from the SEC indicating that the agency does not intent to take a civil or criminal action against an individual who engages in a particular activity. It is typically sent in response to a request for clarification when the legality of an activity in question has not been well established.

federal exemption of sorts for the resale of restricted securities (securities acquired in an unregistered, private sale from the corporate issuer) via a private placement.[90]

Title LXXVI of P.L. 114-94 and H.R. 1839 would codify the ability of holders of restricted securities to resell those securities in private markets as is currently done through reference to the non-statutory reference Section 4(a)(1½).

Proponents of such legislation say that codifying the ability of holders of restricted securities to resell those securities in private markets, issuers of such securities should benefit from a more robust secondary market for them.[91]

The legislations' detractors, however, say that such legislation lacks important investor protections that are a part of private placements under the Securities Act's Rule 506, which governs private placements made to accredited investors, and Rule 144A, which permits the resale of securities solely to qualified institutional buyers—that is, institutional entities that have portfolios of at least $100 million in assets (or meet other criteria). In contrast to various investor restrictions associated with private placement conducted under Rule 506, critics also warn that the bill would allow securities to be resold to "much smaller, and presumably less sophisticated, buyers, including individuals who have one million in net worth."[92]

Removing the SEC's Obligation to Report on its Requests for Customer Information from Financial Institutions (H.R. 3032)

The Right to Financial Privacy Act of 1978 (RFPA; P.L. 95-630) established procedures that government authorities must follow when requesting customers' financial records from banks or other financial institutions. In general, federal agencies must provide individuals with a notice and an opportunity to object before a bank or another financial institution can disclose their personal financial information to such agencies. The act also required federal agencies to annually report to Congress on the number of requests made to financial institutions for their customer's financial records.[93]

The SEC was not initially subject to the RFPA. However, in 1980, the agency was given access to customer records from a financial institution without giving prior notice to the customer when it demonstrated to an appropriate district court that it (1) sought such records pursuant to a subpoena issued in conformity with the requirements of federal securities laws; and (2) has reason to believe that specified acts or results would occur.

In 1995, under the Federal Reports Elimination and Sunset Act of 1995 (P.L. 104-66) Congress repealed the congressional reporting mandate under the RFPA. The repeal generally rescinded the

[90] For example, see "The Section '4(1½)' Phenomenon: Private Resales of 'Restricted' Securities," *The Business Lawyer*, vol. 34, no. 4, July 1979, pp. 1961-1978, at http://www.jstor.org/stable/40686262?seq=1#page_scan_tab_contents.

[91] Quaadman, statement.

[92] Gabaldon, testimony.

[93] See Federal Reserve, "The Right to Financial Privacy Act," at http://www.federalreserve.gov/boarddocs/supmanual/cch/200601/priv.pdf.

requirement that federal agencies had to provide the annual RFPA reports to Congress. The repeal, however, did not apply to the SEC.[94]

H.R. 3032 would repeal the requirement that the SEC annually report to Congress on the number of times that it sought the customer records of financial institutions.

Proponents of the legislation argue that it would address what they describe as a regulatory oversight when other federal agencies were removed from the RFPA's congressional reporting requirements (through P.L. 96-433) but the SEC was not.[95] The legislation received unanimous approval at the House Financial Service Committee's markup on July 29, 2015.

Repealing a Public Company's Obligation to Report on the Pay Ratio between the CEO and the Median Corporate Employee (H.R. 414)

Section 953(b) of the Dodd-Frank Act, known as the *pay ratio provision*, requires the SEC to write rules to implement a requirement that public companies disclose the ratio between the total compensation of a company's chief executive officer (CEO) and the median compensation of all other employees. Before the rule, SEC regulations required public companies to disclose various data on CEO compensation. Although a few companies have voluntarily done so, disclosing data comparing CEO compensation with that of other employees was not traditionally required.

On September 18, 2013, the agency released proposals to implement the pay ratio provision. On August 5, 2015, the agency's commissioners voted to adopt a rule to implement the pay ratio provision.[96] The rule includes the following provisions:

- Subject to certain exceptions, the company would be required to include all employees—U.S. and non-U.S., full-time, part-time, temporary and seasonal—employed by the company or any of its consolidated subsidiaries in performing its pay ratio calculation. Individuals employed by unaffiliated third parties or independent contractors would not be considered to be employees of the company.
- A company's pay ratio will have to be disclosed in its registration statements, proxy statements, and annual reports, but not in certain other mandatory corporate disclosures, including quarterly reports. A company will also have to choose the methodology for identifying its median employee and the employee's compensation as the chosen methodology is "reasonable." Such methodologies may involve a statistical sampling of a company's eligible worker population.
- The rule would also allow companies to exclude non-U.S. employees from the pay ratio formula if the foreign company data privacy laws or other regulations proscribe companies from disclosing worker compensation data. Certain small

[94] See §21(h)(6) of the Securities Exchange Act of 1934, at http://www.gpo.gov/fdsys/pkg/PLAW-104publ66/pdf/PLAW-104publ66.pdf.

[95] For example, see House Committee on Financial Services, "Financial Services Committee Staff Memo on Full Committee Markup of 14 Bills," July 28, 2015, at http://financialservices.house.gov/UploadedFiles/072815_FC_Markup_Memo.pdf.

[96] SEC, "Pay Ratio Disclosure, Final Rule," August 5, 2015, at http://www.sec.gov/rules/final/2015/33-9877.pdf.

companies with public floats of less than $75 million and investment companies are not required to comply with the rule.

Supporters of Section 953(b), including unions and investor interests, have said that the pay ratio data would give investors valuable corporate data that would enhance their capacity to assess workforce morale and potential employee productivity.[97] Additionally, supporters, including its sponsor Senator Robert Menendez,[98] have argued that the public company data on CEO-worker pay disparity that will result from the provision will help to pressure corporate boards to be more restrained in their pay packages to company CEOs, which some contend are often unjustifiably large and others assert are generally justifiable. Advocates also have argued that the data would better inform investors in their exercise of the Dodd-Frank Act's right of say-on-pay. Say-on-pay refers to Section 951 of the act, which requires companies to include a provision in certain proxy statements for a nonbinding shareholder vote on the compensation of their executives.

The pay ratio provision has been criticized by various companies and groups who represent them. Among others, they have charged that the provision is a politically motivated act designed to shame companies for their levels of CEO pay. They have also argued that the provision does not provide valuable information to investors since such a ratio would be potentially misleading to investors since it would have little value for making corporate comparisons given the variety of corporate operational structures, sizes, industry sectors, geographic locales, and business models. As such, critics have also claimed that the considerable costs of implementing the pay ratio provision lack little justification.

For example, in response to the SEC's earlier pay ratio proposals, some individual commenters indicated that initial compliance costs for provision of pay ratio data at large corporations registrant would range from $15,000 to $2 million annually. Also in response to the SEC proposals, corporate surveys conducted by the Center on Executive Compensation Survey and the U.S. Chamber of Commerce found markedly higher compliance cost estimates. Between the two surveys, aggregate initial external compliance cost estimates for a company's provision of pay ratio data were found to range between $187 million and $711 million.[99] In its final rule, the SEC indicated that the various cost estimates appeared to be reasonable, also noting that the estimates might eventually prove to be too high given the greater amount of flexibility in calculating the employee pay median allowed in its final rule vis-a-vis the earlier proposed rule.[100]

On the utility of the pay ratio's value for inter-corporate and single company intertemporal investor comparisons, the SEC also argued in its final rule that "using the ratios to compare compensation practices between registrants, and for a registrant over time ... without taking into account inherent differences in business models between registrants and for a registrant over time ... could potentially lead to unwarranted conclusions."[101]

Regarding the question of the pay ratio provision's potential benefit, the SEC said that the benefits could not be quantified: In its final rule, the agency noted that the statutory language

[97] For example, see "Dodd-Frank Section 953(b): Why CEO-to-Worker Pay Ratios Matter For Investors," *AFL-CIO*, at http://www.aflcio.org/content/download/1090/9807/version/1/file/Why-CEO-to-Worker-Pay-Ratios-Matter-For-Investors.pdf.

[98] For example, see "Menendez Calls on SEC to Expedite Adoption of CEO-to-Median Pay Disclosure Rule," press release, March 12, 2013, at http://www.menendez.senate.gov/news-and-events/press/menendez-calls-on-sec-to-expedite-adoption-of-ceo-to-median-pay-disclosure-rule.

[99] "Pay Ratio Disclosure, Final Rule," p. 183.

[100] Ibid., p. 90.

[101] Ibid., p. 209.

accompanying the provision did not provide an explicit goal for the pay ratio data but that "despite our inability to quantify the benefits, Congress has directed us to promulgate this disclosure rule [and that it is thus] … reasonable to rely on Congress's determination that the rule will produce benefits for shareholders and that its costs … are necessary and appropriate in furthering shareholders' ability to meaningfully exercise their say-on-pay voting rights."[102]

One limited experimental empirical study from Singapore on the impact of CEO-worker pay ratios found that (1) incrementally disclosing a higher-than-industry pay ratio in addition to higher-than-industry CEO pay decreased perceived CEO pay fairness and perceived employee satisfaction, while not affecting a company's perceived ability to attract and retain CEO talent; and (2) neither disclosing higher-than-industry CEO pay nor incrementally disclosing higher-than-industry CEO-worker ratios affected the potential judgments of investors about such a company.[103]

Another limited empirical study investigated CEO-worker pay ratios among companies in the banking sector. It found a relationship between both comparatively high and more pronounced shareholder say-on-pay voting dissent over executive pay levels. On the reported relationship between banking sector companies with higher CEO-worker pay ratios and heightened shareholder say-on-pay dissent, the study's authors argued that the increased shareholder voting dissent in the face of higher pay ratios was consistent with arguments that disclosure of the ratios could be a catalyst for reigning in CEO pay that is perceived to be excessive. But, potentially undercutting the significance of that perspective, the research also found a positive relationship between relatively low bank sector CEO-worker pay ratios and more pronounced say-on-pay shareholder dissent.[104]

Immediately after the SEC adopted the final pay ratio rule, an official with the U.S. Chamber of Commerce Center for Capital Markets Competitiveness Congress, an affiliate of the large business trade group, the U.S. Chamber of Commerce, a consistent critic of the pay ratio provision, said that the new disclosure requirement was "... a favor to union lobbyists who misguidedly think it will help their organizing efforts [and] [w]hen disclosure is used to advance special interest agendas rather than provide investors with better information, it is a step in the wrong direction."[105]

By contrast, Senator Robert Menendez said "I am pleased to see the SEC take the final step to clear the way for the CEO-to-Worker Pay Ratio to become a reality. While this common-sense proposal never should've fallen victim to controversy, today's rule is an important step towards fairness and transparency. The CEO-to-Worker Pay Ratio will provide a valuable tool for investors who have every right to weigh this important metric in their investment decisions."[106]

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[102] Ibid., p. 176.

[103] Khim Kelly and Jean Lin Seow, "Investor Reactions to Company Disclosure of High CEO Pay and High CEO-to-Employee Pay Ratio: An Experimental Investigation," Singapore Management University School of Accountancy Research Paper Series vol. 3, no. 2, 2015, at http://ssrn.com/abstract=2498308.

[104] Brian Rountree, Karen Nelson, and Steve Crawford, "The CEO-Employee Pay Ratio," *HLS Forum on Corporate Governance and Financial Regulation*," February 23, 2015, at http://corpgov.law.harvard.edu/2015/02/23/the-ceo-employee-pay-ratio/.

[105] Eric Nelson, "SEC's New Pay-Ratio Rule in LeBron Terms: Hoops and Some Harm," U.S. Chamber of Commerce, August 5, 2015, at https://www.uschamber.com/above-the-fold/sec-s-new-pay-ratio-rule-lebron-terms-hoops-and-some-harm.

[106] Office of Senator Bob Menendez, "Menendez Reacts to SEC Vote Approving CEO-to-Worker Pay Ratio Rule," press release, August 5, 2015, at http://www.menendez.senate.gov/news-and-events/press/menendez-reacts-to-sec-vote-approving-ceo-to-worker-pay-ratio-rule.

H.R. 414 would repeal the pay ratio provision in Dodd-Frank Act. The bill was marked up by the House Financial Services Committee, which on September 30, 2015, voted 32-25 to report it (H.Rept. 114-504). During the legislation's markup, some supporters argued that the pay ratio provision would effectively reduce corporate jobs, so that its supporters could score political points.[107] Some of the bill's critics, however, countered during the markup that by repealing the provision, the legislation would effectively help to exacerbate national income inequality.[108]

Outside of Congress, legal challenges to the pay ratio disclosure mandate are also a possibility.[109]

Extending an Emerging Growth Company's Exemption from Auditor Attestation (H.R. 4139)

Internal controls are the policies and procedures that a company employs to maintain the accuracy of its financial reporting. Section 404(b), one of the most controversial parts of the Sarbanes-Oxley Act of 2002 (SOX; P.L. 107-204), requires that a public company's outside auditor attest to its senior managers assertions about the company's internal controls for its financial reporting (ICFR). A 2011 SEC study required by the Dodd-Frank Act observed that "[T]here is strong evidence that the auditor's role in auditing the effectiveness of ICFR improves the reliability of internal control disclosures and financial reporting overall and is useful to investors."[110]

Small corporations are generally seen to be disproportionately affected by the often significant costs of implementing the attestation provision. In response to such concerns, the Dodd-Frank Act included an exemption from Section 404(b) for public companies with a public float of less than $75 million. In 2011, the SEC reported that such companies represented about 60% of all public companies.[111]

The JOBS Act of 2012 created a new class of public company known as an Emerging Growth Company (EGC), the recipients of various forms of regulatory relief ultimately aimed at stimulating the number of initial public offerings (IPOs). From an investor perspective, the regulatory relief provided to EGCs meant the absence of certain disclosure-based investor protections generally given to public company investors.

A few studies have looked at the EGCs and subsequent IPO activity. A mid-year 2015 study from the consulting firm of Ernst and Young observed that "IPO activity has rebounded since 2008 [the JOB's Act's EGC regime went into effect in spring of 2010], but it has slowed during the first half of 2015 after 2014 proved to be the strongest year by number of IPOs in the past 10 years. Although the JOBS Act may have accelerated the plans of some IPO candidates, the IPO market is affected by a number of factors, including macroeconomic conditions, equity market stability and investor confidence."[112]

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[107] "House Financial Services Committee Holds Markup on Consumer Protection Legislation," CQ Financial Transcripts, September 30, 2015, at http://www.cq.com/doc/financialtranscripts-4765440?5&print=true.

[108] Ibid.

[109] For example, see CRS Legal Sidebar WSLG1368, *SEC's New Rule on CEO Pay Ratio*, by Michael V. Seitzinger.

[110] "Study and Recommendations on Section 404(b) of the Sarbanes-Oxley Act of 2002." SEC Office of the Chief Accountant, April 2011, https://www.sec.gov/news/studies/2011/404bfloat-study.pdf.

[111] Ibid.

[112] Ernst and Young, "The JOBS Act: 2015 Mid-Year Update," September 2015, at http://www.ey.com/Publication/vwLUAssets/JOBSAct_2015MidYear_CC0419_16September2015/$FILE/JOBSAct_2015MidYear_CC0419_16September2015.pdf.

A major form of regulatory relief for EGCs is the Section 404(b) exemption. EGCs are exempt for up to five years if they obtain a public float in excess of $700 million, have gross revenue of more than $1 billion, or have issued debt in excess of $1 billion.

Depending on the circumstances, an EGC can maintain its EGC status up to the fifth anniversary of the date that it first sold securities pursuant to an IPO registration statement. H.R. 4139, which was passed by the House on May 23, 1016, would extend the EGC exemption under Section 404(b) for a period of 10 years after its initial IPO as long as it maintains a public float below $700 million and average annual revenues below $50 million.

Proponents of the legislation, such as BIO, a biotechnology trade group, argues that the bill would provide a cost savings—savings said to be especially critical to emerging research-based entities that are yet to generate substantial revenues. Stating, "Most emerging companies undertake the decade-long, billion-dollar biotech development pathway without the benefit of product revenue to fund their research, so they highly value resource efficiency. Cost burdens such as SOX's Section 404(b) divert capital from science to compliance and can slow a company's progress by taking funds away from R&D."[113]

However, a different perspective on the merits of auditor attestation came from a Government Accountability Office (GAO) report, which found that the preponderance of the empirical research that it examined suggested that compliance with the auditor attestation requirement had a positive effect on investor confidence in the quality of corporate financial reporting.[114]

Similarly, results from another empirical study would appear to argue against extending Section 404(b) exemptions. The study by Bedard and Graham used data from several large audit firms on their involvement between 2004 and 2005 with a random set of relatively small-sized public companies (with revenues of about $1 billion or less). Key findings included the fact that (1) outside auditors instead of company management reportedly detected about 75% of the unremediated internal control deficiencies and (2) when corporate managers uncovered internal control deficiencies, their tendency was to classify the deficiency as less severe, a designation often overridden by the auditor. The study also found that the "low level of client [managerial] detection occurs when clients are aware that auditors will soon follow with their own tests."[115]

Additional Exemptions from Securities Registration Requirements (H.R. 4850)

Companies issuing securities to the public are generally required to register those securities with the SEC unless they take advantage of certain exemptions in federal securities laws. Such exemptions tend to apply to securities that are issued to a limited number of investors, to certain types of sophisticated investors, or whose total valuation is limited.

H.R. 4850 would create three additional exemptions from such registration requirements for such limited securities offerings. It would also provide an exemption from state securities regulation

[113] Biotechnology Innovation Organization, "BIO Applauds Reps. Sinema and Fitzpatrick for Introducing the Fostering Innovation Act," press release, December 1, 2015, https://www.bio.org/media/press-release/bio-applauds-reps-sinema-and-fitzpatrick-introducing-fostering-innovation-act.

[114] U.S. Government Accountability Office (GAO), *Internal Controls: SEC Should Consider Requiring Companies to Disclose Whether They Obtained an Auditor Attestation*, GAO-13-582, July 3, 2013, at http://www.gao.gov/assets/660/655726.txt.

[115] Jean Bedard and Lynford Graham, "Detection and Severity Classifications of Sarbanes-Oxley Section 404 Internal Control Deficiencies," *SSRN*, November 4, 2010, http://ssrn.com/abstract=1334247.

where *all* of these apply: (1) a purchaser has a "substantive pre-existing relationship" with the issuing companies officers or directors, or a shareholder who owns at least 10% of the issuer's shares; (2) there are 35 or fewer purchasers; and (3) the aggregate amount of securities sold by the issuer in a 12-month period does not exceed $500,000.

On the general benefits of several bills that it had just marked up, including H.R. 4850, a House Financial Services Committee press release observed,

> Our committee is focused on solutions that more appropriately balance rules with the urgent need to provide small business entrepreneurs with more options to access capital so they can start up, hire workers and grow their companies. [They] will remove duplicative burdens, reduce costs and support smart regulation that protects investors and maintains orderly and efficient markets – because this is key to economic growth.[116]

During H.R. 4850's markup, ranking committee member Representative Maxine Waters, however, reportedly argued that there was no need for the exemption provided by the bill. She also expressed concerns over the adequacy of the bill's investor protections and the lack of proscriptions against reselling the securities, which she said could result in potential public offering loopholes that could foster financial scams.[117]

Additional criticism of the bill came from the North American Securities Association. The group of state and provincial securities regulators asserted that the legislation would "create an overly broad federal exemption that would allow public solicitation and sales to any investor regardless of sophistication or financial wherewithal, subject only to the requirement that there be a previously existing relationship—a standard that is not difficult to establish."[118]

Banning the Implementation of Certain SEC Regulatory Proposals on Private Placements under Regulation D (H.R. 4852)

Under federal securities laws, companies are allowed to raise capital through both public and private securities offerings. However, when a company seeks to conduct a securities offering to the public, the offering must be registered with the SEC and the company is required to provide the agency and the public with various disclosures about itself and the securities being offering.

Federal securities laws, however, allow for exemptions from such registration requirements and the attendant disclosure regime for small and emerging companies that conduct limited private securities offerings known as private placements. Many private placements are done under Regulation D (Reg D) of the Securities Act of 1933. And almost all Reg D offerings are

[116] House Committee on Financial Services, "Committee Approves Economic Growth Bills," press release, June 16, 2016, at http://financialservices.house.gov/news/documentsingle.aspx?DocumentID=400783.

[117] As reported in John M. Jascob, "Financial Services Committee Approves Slew of Capital Formation Bills," *Securities Regulation Daily*, June 16, 2016, at http://www.dailyreportingsuite.com/securities/news/financial_services_committee_approves_slew_of_capital_formation_bills.

[118] Letter from the North American Securities Administrators Association, Inc., to the Honorable Jeb Hensarling and the Honorable Maxine Waters of the House Committee on Financial Services, June 15, 2016, http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2013/10/NASAA-Letter-to-HFSC-Re-6-15-16-Markup.pdf.

reportedly done under the most popular offering subcategory, Rule 506. In 2014, for example, reports indicate that the 33,429 Reg D offerings fetched about $1.3 trillion.[119]

In July 2013, as required by the JOBS Act, the SEC adopted rules that lifted the historical ban on general solicitation and advertising (public marketing) of private placements under Rule 506 of Reg D.

As part of this, the agency also issued a separate proposal that would subject issuers using the Reg D exemption to additional requirements, including (1) requiring issuers to file a single Form D (i.e., the document issuers file with the SEC to facilitate the Reg D exemption) no later than 15 days after the first sale of securities in an offering (as currently required) and an additional Form D filing at least 15 days before engaging in general solicitation for an offering and updated information on their Form D filing within 30 days of completing an offering; (2) disqualifying an issuer for one year from obtaining a Reg D Form 506 exemption if the company has not complied with earlier Form D filing requirements for a Rule 506 offering; (3) requiring issuers adhere to certain cautionary statements in general solicitation materials used in a Rule 506 offerings to alert potential investors that an offering is confined to accredited investors and that such offerings may have certain risks; and (4) extending Rule 156 under the Securities Act of 1933, which gives guidance regarding the sales literature provided by SEC-registered investment companies, such as mutual funds, that could be fraudulent or misleading to the literature provided by private funds (such as hedge funds, venture capital funds, and private equity funds).

Upon adopting the proposals, the SEC argued that it would "improve the SEC's ability to evaluate the development of market practices in Rule 506 offerings and would address certain concerns raised by investors related to issuers engaging in general solicitation."[120]

H.R. 4852 as reported by the House Financial Services Committee (H.Rept. 114-726) would ensure that the aforementioned proposals are not implemented by the SEC. It would require the agency to revise its rules under Reg D to prohibit it from implementing the aforementioned proposals on new Form D filings, disqualifications, and new material for general solicitations. The SEC would also be prohibited from extending Rule 156 to private funds.

Critics of the proposals have praised H.R. 4852. For example, Paul Atkins, former SEC commissioner and current chief executive officer of Patomak Global Partners, commented that in issuing the proposals, the SEC commissioners had "put the cart before the horse" by "proposing further amendments even before the ink was dry on the [general solicitation] rule." More critically, he asserted that H.R. 4852 would help reverse the current "regulatory uncertainty" that he claimed was restraining companies from using their new general solicitation privileges under Rule 506.[121]

[119] Scott Bauguess, Rachita Gullapalli, and Vladmir Ivanovi, "Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2014," SEC Division of Risk Analysis, October, 2015, https://www.sec.gov/dera/staff-papers/white-papers/unregistered-offering10-2015.pdf.

[120] SEC, "SEC Fact Sheet: Proposing Amendments to Private Offering Rules," July 10, 2013, at https://www.sec.gov/news/press/2013/2013-124-item3.htm.

[121] Testimony of Paul S. Atkins, chief executive officer, Patomak Global Partners, LLC, before the U.S. House of Representatives Committee on Financial Services, *The JOBS Act at Four: Examining Its Impact and Proposals to Further Enhance Capital Formation*, April 14, 2016, http://financialservices.house.gov/uploadedfiles/hhrg-114-ba16-wstate-patkins-20160414.pdf.

Proxy Advisory Firm Regulation (H.R. 5311)

The investment portfolios of institutional investors, such as certain investment adviser firms, mutual funds, and pension funds, may contain the securities of hundreds of different public companies. As a consequence, for many of them, understanding the issues associated with multiple public company board member elections and shareholder proposals at corporate annual meetings can be both complicated and costly. Many institutional investors lack the size to cost-effectively conduct their own research on current and potential portfolio company investments, so they often outsource such work to consultants known as proxy advisory firms. Those firms help the institutional investors to (1) conduct research on corporate issues that may be associated with director elections and corporate proposals pushed by management and shareholders; (2) provide voting recommendations for director elections and management and shareholder proposal; and (3) directly cast their clients' votes during shareholder voting opportunities.[122]

Essentially a duopoly, the domestic advisory firm industry is dominated by two firms, Institutional Shareholder Services (ISS) and Glass-Lewis.

Over the years, several criticisms have been levied against advisory firms with respect to the voting recommendations they provide to their investor clients. Criticisms include

- the firms have often used opaque criteria to arrive at their recommendations;[123]
- the firms have made mistakes in their analysis of proxy statements,[124]
- analysis that they have not always been open to discuss or to correct; and
- the fact that ISS provides paid consulting services for public companies to model its compensation policies for corporate heads and its corporate governance policies as well as concerns of "an apparent—or at worst actual—conflict of interest in offering companies services for which a company is then scored by ISS."[125]

In 2014, in an effort to enhance proxy advisory firm accountability, the SEC staff issued a guidance document, *Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms*. Among other things, the guidance provides greater clarification regarding the SEC's Proxy Voting Rule,[126] reinforces the mandate that fiduciary[127] obligations should govern the development and the receipt of proxy

[122] "Statement of Tom Quaadman, Senior Vice President of the Center for Capital Markets Competitiveness on Legislative Proposals to Enhance Capital Formation, Transparency, and Regulatory Accountability to the House Committee on Financial Services, Subcommittee on Capital Markets and Government Sponsored Enterprises," May 17, 2016, http://financialservices.house.gov/uploadedfiles/hhrg-114-ba16-wstate-tquaadman-20160517.pdf.

[123] Orrick, Herrington & Sutcliffe LLP, "Yet Another Congressional Proposed Corporate Reform: Proxy Advisory Firms in the Crosshairs," July 20, 2016, at https://corpgov.law.harvard.edu/2016/07/20/yet-another-congressional-proposed-corporate-reform-proxy-advisory-firms-in-the-crosshairs/.

[124] A proxy statement is a document that has information that the SEC requires public companies to provide to shareholders so shareholders can make informed decisions about matters that will be brought up at an annual or special stockholder meeting.

[125] Orrick, Herrington & Sutcliffe LLP, "Yet Another Congressional Proposed Corporate Reform: Proxy Advisory Firms in the Crosshairs."

[126] Under the Investment Adviser's Act of 1940, the Proxy Voting Rule imposes a number of requirements on advisers who have proxy voting authority with respect to client securities.

[127] A fiduciary duty on behalf of another party generally entails a requirement to act in the best interest of the party whose assets they are managing.

advice, and underscores the idea that improving shareholder value should be the central focus when proxy advisory firms are providing proxy-voting[128] advice or are making proxy-voting decisions.[129]

In the aftermath of the SEC's guidance, advisory firms still faced criticism over their perceived lack of accountability. For example, in 2015, then-SEC Commissioner Daniel Gallagher observed that "too many institutional investors uncritically vote the proxy advisory firm recommendations [who] … in turn seem to have done little to address the factors that have given rise to poor research, erroneous recommendations, and conflicted advice."[130]

H.R. 5311 represents a legislative attempt to improve advisory-firm accountability and transparency. The bill, which has been ordered reported by the House Financial Services Committee, would require proxy advisory firms to register with the SEC. This registration process would include providing information about its procedures and methodologies, organizational structure, and the existence of a code of ethics; disclosing potential or actual conflicts of interest related to its ownership structure and its client services, including public company consulting services; identifying its largest clients; and describing internal policies and procedures aimed at managing conflicts that might surface.

The bill would also require advisory firms to file descriptions of their policies on proxy voting and voting recommendations with the SEC. Public companies would be entitled to both review and comment on proposed advisory firm recommendations before they are given to investors. The SEC-registered advisory firms would be required to appoint an internal compliance officer. They would also have to hire an ombudsman tasked with receiving complaints levied by corporate subjects concerning the accuracy of advisory firm information used in the development of voting recommendations on the subject. Those complaints would then have to be settled in a timely fashion. H.R. 5311 would also prohibit SEC-registered advisory firms from engaging in practices that are "unfair, coercive, or abusive." The corporate subjects of a proxy advisory firm's voting recommendations would also be given limited rights of private action against the firms in federal district court.

On the benefits of the bill, Representative Sean Duffy, its sponsor, argued that it would "foster accountability, transparency, responsiveness, and competition in the proxy advisory firm industry-thereby improving corporate governance and protecting investors."[131]

A more granular perspective came from an official with the Center for Capital Competitiveness, an affiliate of the U.S. Chamber of Commerce. The official emphasized that the bill would give all stakeholders input into the proxy voting process. The legislation's conflict of interest disclosure requirements, he also argued would enable advisory firms and their clients to handle advisory firm conflicts of interest, including the advisory firm Glass Lewis' ownership by an activist institutional investor, the Ontario Teachers' Pension Plan. The trade group official gave

[128] Proxy voting allows shareholders to vote when they are unable to attend an annual meeting, enabling them to remotely cast their votes.

[129] SEC, "Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms Staff Legal Bulletin No. 20," June 30, 2014, at https://www.sec.gov/interps/legal/cfslb20.htm.

[130] SEC, "Speech by SEC Commissioner Daniel M. Gallagher: Activism, Short-Termism, and the SEC: Remarks at the 21st Annual Stanford Directors' College," June 23, 2015, at https://www.sec.gov/news/speech/activism-short-termism-and-the-sec.html.

[131] Office of Representative Sean Duffy, "Duffy Advances Corporate Governance Reform Bill," press release, June 16, 2016, at https://duffy.house.gov/press-release/duffy-advances-corporate-governance-reform-bil.

special praise to a section of the bill that would permit companies to review and comment on proposed advisory firm client voting recommendations pertaining to them. He said that it would critically ensure that advisory firms are cognizant of all of the various aspects of issues, enabling them to "prevent mistakes from being disseminated to investors."[132]

The Council of Institutional Investors (CII) is a trade group of employee benefit plans, foundations, and endowments, many of whom are the clients of proxy advisory firms. Broadly critical of the bill, CII claimed the bill would "weaken public company corporate governance … lessen the fiduciary obligation of proxy advisors to investor clients; and reorient any surviving proxy advisors to serve companies rather than investors."[133] Furthermore, it argued that the impetus for the bill derived from several fundamentally false premises. Among them are (1) the idea that the two major advisory firms, ISS and Glass Lewis, direct proxy voting results; (2) the notion that advisory firms tend to make single recommendations for each shareholder ballot item, which their clients tend to slavishly follow; and (3) the view that the 2014 SEC staff guidance on proxy advisors has been inadequate.[134]

Exempting Securities Traded on Alternative Stock Exchanges from State Securities Regulation. (H.R. 5421)

Under Section 18 of the Securities Act of 1933, securities that are listed and traded on three SEC-registered national securities exchanges—the New York Stock Exchange, the American Stock Exchange, and Nasdaq—or whose listing standards are *substantially similar* to one of the three are exempt from additional state-based securities regulation known as the blue sky regulation. Such securities are called *covered securities*. Therefore, issuers with an interest in having their securities listed and traded on an exchange that is not substantially similar to the three would likely face the prospect that the securities would not be covered securities and would thus be subject to the blue sky regulation, a potential cost deterrent in the decision to list and trade on a particular exchange.

H.R. 5421, which has passed the House, would amend Section 18 of the act by stripping specific references to the aforementioned exchanges. It would then provide for an exemption from the blue sky regulation for any SEC-registered security that is listed on a "national securities exchange" whose listing standards receive SEC approval.
Arguing for the bill, the report accompanying the House Financial Service Committee's markup of H.R. 5421 (H.Rept. 114-684) observed that Section 18 problematically required the SEC to compare "innovative" securities listing standards with standards that may have been in effect when the section was adopted in 1996. As a consequence, the report argued that current law statutorily tilts the SEC toward a position that constrains both exchange innovation and exchange competition, a situation it indicated would be remedied by H.R. 5421.

[132] Quaadman, Statement on May 17, 2016.

[133] "Letter from Kenneth A. Bertsch et al., on behalf of the Council of Institutional Investors to the Honorable Jeb Hensarling and the Honorable Maxine Waters," June 13, 2016, at http://www.cii.org/files/issues_and_advocacy/correspondence/2016/06_13_16_FINAL_Letter_on_Proxy_Advisory_Firm_Bill.pdf.

[134] Ibid.

The North American Securities Administrators Association (NASAA), an association of state and provincial securities regulators has, however, criticized the legislation. The group observed that current law already permits "exchanges with varied listing requirements, including alternative marketplaces" but unless they conform to the substantially similar listing standards of the three big national exchanges, they are subject to state regulatory review. By eliminating Section 18's substantially similar references to the national exchanges, the NASAA argued that H.R. 5421 would "undercut" the "distinction" between the alternative trading marketplaces and the major national exchanges. It then spoke of its basic concern that investors would suffer due to the blurring of those distinctions.[135]

Additional criticism of H.R. 5421 has come from a group of minority members on the House Financial Services Committee. The members argued that the bill would remove the current substantially similar framework, replacing it with no alternative protocol. This absence of any alternative criteria was predicted to "at best create confusion and at worst encourage a race-to-the-bottom as exchanges try to compete for business by lowering their listing standards."[136]

Regulatory Relief for Investment Advisers (H.R. 5424)

The Investment Advisers Act of 1940 is the principal federal securities law overseeing investment advisers. Dodd-Frank amended the act to require private funds (i.e., private equity funds and hedge funds) with more than $150 million in assets under management to register with the SEC under the Advisers Act. Predicated on the view that various parts of the Advisers Act are both obsolete and burdensome for certain investment advisers, H.R. 5424, which has been marked up by the House Financial Services Committee, would provide regulatory relief to certain investment advisers who manage private funds as well as some who do not. Among other things, the bill would amend various federal securities laws, including the Investment Advisers Act, to (1) repeal a rule that currently prohibits investment advisers from employing testimonials and references to specific past investment recommendations when such materials are solely distributed to certain sophisticated clients and high net worth investors; (2) eliminate a current requirement that private fund investment advisers provide investors that are limited partnerships, limited liability companies, and other "pooled vehicles" with multiple disclosure documents containing largely identical information; and (3) provide for regulatory relief in the regulation of the assignment of advisory contracts[137] for investment advisers not structured as partnerships when there is a change in minority ownership so that they would face the same regulatory requirements that partnership-based advisers currently face.

[135] "Letter to the Honorable Paul Ryan and the Honorable Nancy Pelosi from the North American Securities Administrators Association Re: The National Securities Exchange Regulatory Parity Act (H.R. 5421)," July 12, 2016, http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2013/10/NASAA-Letter-Re-H-R-5421-as-Placed-on-House-Suspension-Calendar-FINAL.pdf.

[136] "H. Rept. 114-684. The minority members were Rep. Maxine Waters, Rep. Emanuel Cleaver, Rep. Keith Ellison, Rep. Gwen Moore, Rep. Stephen F. Lynch, Rep. Joyce Beatty, Rep. Al Green, and Rep. William Lacy Clay.

[137] This is a contract between an investment adviser and its clients.

In addition, the bill would direct the SEC under the Custody Rule[138] to no longer subject private funds to unannounced annual examinations when they are exclusively beneficially owned by (1) the adviser or its supervised persons (and family members of the supervised persons); (2) the adviser's affiliates; (3) the affiliates' officers, directors, or employees (or their family members); or (4) officers, directors, employees or affiliates of certain service providers to the private fund adviser; clients of the private fund advisers; or portfolio companies or issuers acquired by the private fund or the adviser's clients.

The Investment Adviser Association, a trade group of SEC-registered investment adviser firms, noted that federal investment adviser regulations had not kept pace with various financial services developments affecting investment advisers. The group then praised H.R. 5424 as needed reform that would address some of the dated parts of the Investment Advisers Act that imposed "undue burdens on investment advisers – most of which are small businesses – without commensurate benefit to investors."[139]

In the House Financial Services Committee report accompanying the markup of H.R. 5424 (H.Rept. 114-698), the various minority committee members, including ranking members Maxine Waters, criticized the bill for undoing various parts of the Dodd-Frank Act with respect to the obligations of SEC-registered investment advisers to private funds. More importantly, the minority committee members said that the bill "would create a Madoff loophole[140] by providing a broad exemption from the [unannounced] annual audit requirement for funds owned by investors who may have a tangential relationship with the adviser, such as a caterer or building manager."

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Disclaimer

[138] This is a rule under the Investment Advisers Act of 1940 that stipulates how investment advisers are to handle client assets.

[139] Investment Adviser Association, "Investment Advisers Modernization Act of 2016," June 2016, at https://www.investmentadviser.org/eweb/dynamicpage.aspx?webcode=ki_hr5424_2016.

[140] Bernard L. Madoff was the former chairman of the Nasdaq and the founder of the market-making firm Investment Securities. Mr. Madoff also managed a hedge fund and on December 11, 2008, was arrested for running an alleged $65 million Ponzi scheme. The hedge fund lost about $20 billion of his investors' money, but hid that fact by paying the earlier investors with money received from later investors. Among other things, Mr. Madoff was charged with securities fraud, mail fraud, wire fraud, money laundering, making false statements and perjury. In 2010, he was sentenced to 150 years in prison. See Grant McCool and Martha Graybow, "Madoff Faces Life in Prison on 11 Criminal Charges, *Reuters*, March 10, 2009, at http://www.reuters.com/article/us-madoff-idUSN10463499200903107;. Stephanie Yang, "5 Years Ago Bernie Madoff Was Sentenced to 150 Years in Prison – Here's How His Scheme Worked," *Business Insider*, July 1, 2014, at http://www.businessinsider.com/how-bernie-madoffs-ponzi-scheme-worked-2014-7.

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