February 27, 2019

The Honorable Mike Crapo
Chairman, Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20515

The Honorable Sherrod Brown
Ranking Member, Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20515

Dear Chairman Crapo and Ranking Member Brown,

The Securities Industry and Financial Markets Association ("SIFMA")[1] and its member firms strongly support your efforts to evaluate the range of capital formation proposals that have been put forward by policymakers, stakeholders, and others over the past several years. Your efforts to review the current regulatory structure and consider amendments to the various laws governing our capital markets can serve to improve market efficiency for the benefit of those who rely on our markets to invest in new businesses, plant and equipment and create jobs.

We believe there are many opportunities to boost economic growth, encourage job creation, and support entrepreneurs by improving our securities laws and regulations. U.S. capital markets are a critical source of financing for businesses – especially small and mid-sized businesses – and SIFMA and its members are concerned about the ongoing decline in the number of public companies and initial public offerings (IPOs). Congress should address this trend by tailoring securities regulations to facilitate access to the U.S. capital markets.

In 2017, Securities and Exchange Commission (SEC) Chairman Jay Clayton stated that by expanding to all companies the Jumpstart Our Business Startups (JOBS) Act provision allowing the submission of draft IPO registration statements on a non-public basis, "we hope that the next American success story will look to our public markets when they need access to affordable capital…We are striving for efficiency in our processes to encourage more companies to consider going public, which can result in more choices for investors, job creation, and a stronger U.S. economy."[2] Further to that end, on February 19, 2019, the SEC voted to propose expanding the JOBS Act "test-the-waters" accommodation to all issuers, including investment company issuers. Chairman Clayton stated in connection with the proposal that "I have seen first-hand how the modernization reforms of the JOBS Act have helped companies and investors. The proposed rules would allow companies to more effectively consult with investors and better identify

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

[2] https://www.sec.gov/news/press-release/2017-121

information that is important to them in advance of a public offering."[3] SIFMA has previously advocated for these and other changes that we believe would enhance access to capital, providing the opportunity for greater economic growth and job creation, while maintaining protections for investors.[4]

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SIFMA has supported and continues to support the following legislation:

S. 2126 – the Fostering Innovation Act of 2017
This bill would grant a five-year exemption from the auditor attestation requirements found in Section 404(b) of Sarbanes-Oxley for emerging growth companies and companies with less than $50 million in annual gross revenues. These tailored and narrow exemptions will reduce the compliance and reporting costs for small public companies, while leaving requirements in place for management to assess the internal controls at those companies. SIFMA applauds this bill and urges both Committee and Senate passage of this commonsense legislation. We appreciate the bipartisan attention that has been paid to this issue.

S. 2347 – the Encouraging Public Offerings Act of 2018
This bill would allow all issuers of public securities to take advantage of the testing the waters and confidential draft registration submission provisions of the JOBS Act of 2012.

The testing the waters and confidential draft registration submission allowances made by the JOBS Act for emerging growth companies have proven incredibly popular with issuers due to the flexibility it grants them to access public capital markets on more favorable terms. More importantly, these changes to the initial public offering process have not resulted in investor harm and may have encouraged more companies to go public. Extending these provisions to all issuers should improve the vibrancy of our public capital markets.

The Securities and Exchange Commission's Division of Corporate Finance recently permitted all companies to submit draft registration submissions on a confidential basis but codifying this change into law will improve issuer confidence and ensure this constructive regulatory change is a lasting one. SIFMA applauds this bill and urges both Committee and Senate passage of this commonsense legislation. We appreciate the bipartisan attention that has been paid to this issue.

[3] https://www.sec.gov/news/press-release/2019-14
[4] https://www.sifma.org/resources/submissions/legislative-proposals-to-facilitate-capital-formation-economic-growth-and-job-creation/

S. 2756 – the Fair Investment Opportunities for Professional Experts Act

This bill is notable as it would allow Americans to qualify as accredited investors by virtue of their education and job experience. Financial professionals are uniquely well-suited to evaluate the risks and merits of prospective investments, and access to accredited investors is critical for private businesses unable to access public capital markets. Unfortunately, the current definition of accredited investor relies on net worth thresholds for individuals and households irrespective of the sophistication of the would-be investors. By excluding individuals whose professional experience or financial knowledge qualifies them to purchase restricted securities, the current standard unfairly limits Americans' participation in capital markets and should be amended.

S. 2756 will facilitate capital formation by increasing the total number of Americans eligible to purchase restricted securities and allowing broker-dealers and financial advisors and other sophisticated investors to invest in early-stage and private companies. SIFMA applauds this bill and urges both Committee and Senate passage of this commonsense legislation. We appreciate the bipartisan attention that has been paid to this issue.

S. 3004 – the Small Business Audit Correction Act of 2018

This bipartisan bill would provide much-needed regulatory relief to small, privately held, non-custodial broker-dealers from the requirement to use a Public Company Accounting Oversight Board (PCAOB) registered audit firm for their annual audits.

The Dodd-Frank Act required that all broker-dealers hire a PCAOB registered audit firm to conduct audits using more complex guidelines that are designed for larger, public companies. This requirement has been burdensome for small broker-dealers. In 2015, the FINRA Small Firm Advisory Board surveyed members to quantitatively determine the impact of PCAOB audits to small firms.

- 80% of respondents saw an increase in audit costs.
- 59% of respondents stated that the increase in audit cost would materially impact the operation of their firms.
- 37% of respondents have had to replace their PCAOB-registered auditor at least once since the standards went into effect.
- 35% found it somewhat to very difficult finding a PCAOB auditor either initially or as a replacement.

S. 3004 would exempt these privately held, smaller non-custodial broker-dealers from having to hire a PCAOB-registered audit firm in connection with their annual reporting under Securities Exchange Act of 1934 ('34 Act) Rule 17a-5, instead reinstating Generally Accepted Audit Standards (formally AICPA auditing standards).

SIFMA applauds this bill and urges both Committee and Senate passage of this commonsense legislation. We appreciate the bipartisan attention that has been paid to this issue.

S. 3283 – the Options Markets Stability Act

This bill would rationalize Federal banking regulators' treatment of listed options positions for market makers when calculating a bank's counterparty credit risk exposure. Listed options are an important tool used by investors to hedge their exposure in our markets and U.S. bank holding company subsidiaries play an important role clearing trades for market makers. Unfortunately for investors, bank holding companies are subject to counterparty credit rules that place risk-insensitive capital requirements on the notional amount of option positions instead of their actual exposure. Current regulations require banks to calculate charges for cleared options using the current exposure method (CEM), which is disproportionate to the actual economic exposures presented by listed options positions. Market makers routinely take offsetting positions to reduce their own risk, and accordingly, capital requirements should be calculated on a net basis to better capture the actual exposure of any given firm. Without netting, the current capital regime constrains the ability of options market makers to accumulate positions (even off-setting positions), which hinders their ability to provide liquidity.

Most investor orders are executed against market-maker quotations, and due in part to the dispersion of trading interest across hundreds of options series in a single options class, most individual options series would have limited displayed liquidity if market-makers were not present. The impact of the capital regulations on liquidity is concerning to SIFMA's members because it is passed along to end-users in the form of reduced access to the listed options market, potentially reducing market stability in times of stress. S. 3283 will improve the health of the listed options market and help both retail and institutional investors hedge their positions. SIFMA applauds this bill and urges both Committee and Senate passage of this commonsense legislation. We appreciate the bipartisan attention that has been paid to this issue.

S. 3323 – the National Senior Investor Senior Initiative Act of 2018

This bipartisan bill creates a "Senior Investor Taskforce" within the Securities and Exchange Commission charged with identifying problems senior investors encounter, including financial exploitation and cognitive decline, and identifying regulatory changes that could help senior investors. The Taskforce would report to Congress every two years on key observations, best practices, and areas for improvement identified throughout its work. Additionally, the bill requires the GAO to conduct a study on the economic costs of the financial exploitation of elder investors. The lack of good, recent data on senior financial exploitation is a problem that this section would significantly aid in resolving.

The population of senior investors is rapidly increasing. By 2030, seniors aged 65+ will account for 18% of the nation's population. Americans over the age of 50 already account for roughly 77% of financial assets in the United States. It is estimated that senior investors are being exploited out of billions of dollars a year (roughly $3 billion per year in media-reported cases alone, while only an estimated 1 in 44 cases are reported to the authorities). This cost does not even begin to consider the wide-ranging non-financial impacts and the increased reliance on government services.

Most appalling is that the great majority of exploiters are friends, neighbors or other trusted individuals. A recent New York State study found that family members and caregivers were the bad actors in about 67% of all confirmed exploitation cases, and some studies place that number even higher. SIFMA strongly supports any efforts that focus on the most immediate and most damaging dangers faced by senior investors and believes S. 3323 will strengthen efforts to protect these investors from those bad actors closest to them. SIFMA applauds this bill and urges both Committee and Senate passage of this commonsense legislation. We appreciate the bipartisan attention that has been paid to this issue.

S. 3578 – the Improving Investment Research for Small and Emerging Issuers Act
This legislation would direct the Securities and Exchange Commission to study the provisioning of research on small issuers – a critically important issue affecting our capital markets. Research is one of the most important, but least understood, facets of our public capital markets. Research coverage of companies can improve liquidity in thinly traded stocks by increasing investor interest and awareness. Unfortunately, most smaller issuers have little research coverage, with many only having two or three analysts covering their stock. Limited research coverage prevents prospective investors from learning about promising small companies and reduces the liquidity available to current investors, making smaller issuers less attractive investments overall. We are pleased that there is strong bipartisan recognition of the importance of research to our capital markets. SIFMA applauds this bill and urges both Committee and Senate passage of this commonsense legislation.

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America's capital markets are the deepest and most liquid in the world and are a critical source of financing for domestic and foreign businesses and government, especially small and mid-sized businesses.

While we continue to support the above proposals, we have concerns with some of the other proposals the Committee is considering as they will unduly hamper capital formation and may reduce small investors' access to investment opportunities. We outline below these proposals and our concerns:

H.R. 3555 – Exchange Regulatory Improvement Act
While SIFMA neither supports nor opposes the bill as amended in the House, we do believe there is an underlying and unanswered question as to the need for legislation to potentially limit the scope of the SEC's regulation of exchanges. Without the benefit of a legislative hearing or robust public debate, there remains ambiguity over whether there is an actual public policy problem and if so, what tailored solution could be more appropriate. There is also a question of how investors and market participants will benefit beyond the relief intended to be provided to the for-profit exchanges.

The Securities Exchange Act of 1934 grants the SEC broad legal authority to regulate national securities exchanges, including the "facilities" of an exchange. Indeed, the term "facilities" can be found in numerous places in the statute. Comprehensive SEC regulation over exchanges is critical to the

operation of the markets and the fulfilment of the SEC's mandate to protect investors, to maintain fair, orderly, and efficient markets, and to facilitate capital formation. In this regard, the definition of an exchange "facility" gives the SEC crucial oversight over both exchanges and their related activities, such as market data and co-location products and services. If enacted, H.R. 3555 would mandate that the SEC develop a specific standard for interpreting this longstanding definition. There are two key points that must be considered when re-defining what is or is not a "facility" of an exchange:

> First, the definition of "facility" must continue to include market data products and services offered by the exchanges. The national securities exchanges hold an effective monopoly on market data and even under SEC oversight, they use this position to unreasonably increase fees—a primary revenue source for the for-profit exchanges. To curb the significant increases, SIFMA has brought several legal actions against the exchanges. In SIFMA's most recent case, the SEC blocked exchanges' market data fee increases, and the SEC's decision is currently under appeal with the D.C. Circuit. Any new interpretation of the term "facility" must maintain the SEC's authority and oversight of market data.
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> Second, it should be clear that the rulemaking contemplated by H.R. 3555 does not alter any of the SEC's previous findings on what constitutes a "facility" of an exchange. Rather, H.R. 3555 should be treated as changing only the SEC's process for making facility determinations on a going forward basis. For example, the directive that the SEC should "apply the facts and circumstances" in its new regulation on the term "facility" should be considered only a process matter to be applied prospectively. The directive should not be considered as influencing the substance of any previous SEC determination.

S. 1744 – the Brokaw Act

The Brokaw Act targets activist hedge funds by changing Section 13 of the '34 Act to require disclosure of derivatives positions, requiring disclosure of short interests in excess of 5%, shortening the Schedule 13D filing window to 4 days (from 10), and explicitly defining hedge fund "wolf packs" as a group for reporting purposes.

The changes, as proposed, would have significant negative consequences for market participants other than the intended targets of this legislation, including passive investors, market makers, and corporate end users of derivatives. The legislation a. does not distinguish between position takers/activists on the one hand and market makers on the other hand and b. does not acknowledge that the definition of "beneficial ownership" under Section 13 (which the bill would amend to include cash settled derivatives) is also used for the purpose of Section 16 calculations and insider status. As such, the legislation may inadvertently cause many market participants to become subject to the short swing profit disgorgement provisions for reasons that do not relate to its policy rationale (preventing trading on Material Non-Public Information (MNPI) by corporate insiders).

The Brokaw Act would make it more difficult for derivatives dealers to act as market makers, since the calculation of beneficial ownership on a gross basis including cash settled derivatives would make it easier for dealers to become Section 16 insiders subject to short swing profit recapture. The decrease in derivatives market liquidity would cause "real economy" harm to non-activist derivatives users, such as mutual funds, asset managers and passive hedge funds, which manage the retirement and pension assets of ordinary citizens, and to corporations (and ultimately, their shareholders), which often use derivatives in connection with capital raising transactions to manage their balance sheets and capital structure.

In addition, SIFMA recommends a provision for an institutional investor exemption on 5% short interest disclosures, which allows broker-dealers, banks, insurance companies and other institutional investors exceeding the reporting threshold to file a short form disclosure once annually. Currently, this rule stands under Rule 13d-1, for long position reporting.

S. 2499 – Unpaid Arbitration

With respect to the securities arbitration system, SIFMA is generally supportive. There is no serious debate that securities arbitration is faster and less expensive than court. Investors fare well in it, recovering through settlements or awards in the vast majority of cases. Statistics collected by FINRA bear this out. Arbitrator selection and rulings are consistently fair and transparent. Multiple regulators oversee the system and maintain its focus on investor protection and fairness. Problems are promptly addressed, and rule changes are approved by a committee of practitioners from all constituencies.

The system is essentially premised upon 'mandatory' arbitration. FINRA Rules grant clients the right to require broker-dealers to arbitrate disputes with them if the clients elect to do so. Firms secure the same right for themselves by including arbitration clauses in client contracts. Thus, today most broker-dealer client contracts include arbitration clauses so that all parties know in advance that any dispute that does arise will be dealt with on a level playing field.

Although most broker dealers pay their arbitration awards on time and in full, SIFMA recognizes that over the years there has been a concern with unpaid arbitration awards by certain bad actors and grossly undercapitalized firms. SIFMA strongly supports exploring reforms to reduce the number of unpaid arbitration awards. An industry-financed pool, however, is a poor public policy choice to achieve that end because it is unfair to the broker-dealers who honor their arbitration award obligations, is essentially a tax on investors and introduces numerous moral hazard. For those reasons, SIFMA strongly opposes S. 2499, legislation introduced by Senators Elizabeth Warren (D-Mass.) and John Kennedy (R-La). If enacted into law, this harmful legislation would force FINRA to create a pool of money of infinite size to pay-off unpaid FINRA arbitration awards.

That is the fundamental flaw of the bill. FINRA's funding sources derive in substantial part from its members (i.e., thousands of brokers). Thus, the bill would require the many firms that pay their arbitration awards to pay for the few firms that do not.

The underlying issue is unpaid arbitration awards which FINRA already possesses the authority it requires to address that issue ands currently taking active steps – Congress should allow FINRA's regulatory process to run its course. Policymakers can then evaluate the efficacy of those efforts and later determine whether further action is required.

S. 3518 – the Small Business Mergers, Acquisitions, Sales & Brokerage Simplification Act
As SIFMA has previously testified, the bill as currently drafted would expose small business owners and investors to unnecessary risks without any meaningful benefit from reduced regulatory compliance. Many of our member firms, particularly small and regional registered broker-dealers, have helped small businesses successfully navigate change of ownership transactions through their mergers and acquisitions (M&A) practices. Registered broker-dealers are subject to a variety of regulatory requirements that non-broker-dealer M&A advisors are not, and this bill risks promoting lower standards, less rigor, and an unlevel playing field in the provisioning of this important advice.

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Efforts by the Committee to consider proposals to enhance capital formation, reduce regulatory burdens, and support entrepreneurs while protecting investors will help maintain strong, sustainable economic growth. We appreciate the bipartisan approach being taken towards capital formation legislation and welcome this chance to submit recommendations on improvements to U.S. capital markets. We look forward to engaging with the Committee in the future on these and other matters.

Sincerely,

Kenneth E. Bentsen, Jr.
President and CEO, SIFMA