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EXAMINING HOW CAPITAL MARKETS SERVE DIVERSE ENTREPRENEURS AND INVESTORS

HEARING

BEFORE THE

SUBCOMMITTEE ON
SECURITIES, INSURANCE, AND INVESTMENT

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED SEVENTEENTH CONGRESS

SECOND SESSION

ON

EXAMINING THE DIVERSITY OF PUBLICLY TRADED COMPANIES AND HOW CAPITAL MARKETS CAN BETTER SERVE ALL AMERICANS

DECEMBER 13, 2022

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C O N T E N T S

TUESDAY, DECEMBER 13, 2022

WITNESSES

Additional Material Supplied for the Record

EXAMINING HOW CAPITAL MARKETS SERVE DIVERSE ENTREPRENEURS AND INVESTORS

TUESDAY, DECEMBER 13, 2022

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON SECURITIES, INSURANCE, AND INVESTMENT,
Washington, DC.

The Subcommittee met at 2:39 p.m., in room SD–538, Dirksen Senate Office Building, Hon. Robert Menendez, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF CHAIRMAN ROBERT MENENDEZ

Chairman MENENDEZ. This hybrid hearing of the Senate Subcommittee on Securities, Insurance, and Investment will come to order. Thank you for being here today.

A few reminders before we begin. For those who are participating virtually, once you start speaking there will be a slight delay before you are displayed on the screen, so do not get terrorized thinking we will not see you. We will. Also, to minimize any background noise please make sure you remain muted until it is your turn to speak.

Turning now to the subject of today's hearing, we are here because our economy has a fundamental problem. Across corporate America, those in charge are overwhelmingly White and disproportionately male. In a recent analysis of over 3,000 United States firms listed on either the New York Stock Exchange or the NASDAQ, researchers at Cornell found that racial minorities held only about 12 percent of board seats in 2019, with over 40 percent of all U.S. boards composed of only White directors.

In asset management we see a similar story. Of the $70 trillion in global financial assets under management, less than 1 percent are managed by women- or minority-owned firms.

Now some may wonder why is this a problem. Why should the Federal Government have an interest in the diversity of publicly traded companies? The answer to me is simple. It is because it is material information that investors should have when deciding where to put the money, and in study after study, including those conducted by the consulting firm McKinsey, researchers have found that a diverse workforce leads to a more productive and profitable company. The reasons for this are varied, but whether it is because of smarter and more inclusive decisionmaking, increased creativity and problem-solving, or greater recruitment and retention, the bottom line is this: a company whose governing structure looks like America is a company that can compete on the global market.

Which brings us to this hearing. The current lack of diversity in capital markets, businesses, and financial institutions creates a ripple effect across the financial ecosystem. It negatively affects entrepreneurs and investors, it makes companies less competitive, and stalls our Nation's progress toward a truly equitable marketplace. In short, a lack of diversity means that American companies are fighting to compete with one hand tied behind their backs.

It is an issue that I have been personally following for years, and in the past my office has issued corporate diversity surveys of Fortune 100 companies. And what we have found is that while many of these companies believe in the idea of increasing diversity among their senior leadership, very few have made any real progress on the matter.

So I introduced the bill, the Improving Corporate Governance through Diversity Act of 2021. My legislation would promote greater transparency in corporate America by requiring public companies to disclose specific information related to the racial, gender, ethnic makeup and veteran status of corporate boards and senior management, and whether they have policies in place to promote diversity in their leadership. It is a bill that I am proud to say has strong support across the ideological spectrum, from the U.S. Chamber of Commerce to the National Urban League.

And it goes hand-in-hand with what SEC's Asset Management Advisory Committee has urged the asset management industry to adopt. The AMAC Subcommittee on Diversity and Inclusion has pushed for greater disclosure of the gender and racial makeup of firms. This increased transparency would not only improve performance to the benefit of investors, it would also further the SEC's diversity and inclusion goals and its mandate to facilitate fair and open markets. It is my hope that the SEC soon enacts all of these recommendations and that we can pass my Improving Corporate Governance Through Diversity Act.

Last, I would just like to note what greater diversity means for investors and entrepreneurs in minority communities. I say this because I know it is of particular interest to both Ranking Member Scott and myself. The fact of the matter is that underrepresentation has a trickle-down effect. When corporate leadership at the top is not diverse, unsurprisingly, the firms that manage their pensions are also not diverse. When corporate leadership only reflects one thin slice of the population, their decisions will only benefit one slice of the population. And despite contributing trillions of dollars to the economy, being among the most likely to start a small business, many minorities across the country still lack access to the capital they need to thrive. We all saw this firsthand during COVID when minority business owners struggled to access the PPP program.

So the goal of today's hearing is to explore these issues further, to discuss solutions that work for women and minority communities who are too often neglected by traditional financial services and in the capital markets.

And with that I want to thank our witnesses for appearing, for sharing their testimony with us today. And I am pleased to turn it over now for his remarks to my friend, the distinguished Ranking Member, Senator Scott, for his opening remarks.

STATEMENT OF SENATOR TIM SCOTT

Senator SCOTT. Thank you, Mr. Chairman, for holding this very important Committee hearing, and thank you to the witnesses, both here with us and joining us virtually, for being a part of this process and part of the conversation as well.

As a young man growing up in an at-risk world, I was blessed to meet a mentor, a guy named John Moniz [phonetic], a Chick-fil-A operator who really taught me the power of opportunity, the power of free markets and capitalism. It was a great lesson that I needed to learn, and I learned it at a very ripe age of 15 years old.

I also learned along the way, after a few years in the insurance industry, that there are basically three ways to create wealth in America. The first way is really real estate, and for most of us that real estate means home ownership. The American dream, for so many people, the epitome of the American dream really is that sense of owning your own home, equity in the real estate market.

The second way to create wealth is owning your own business, and through the lessons of John Moniz, learning that profits were better than wages, 1 day I opened my own business, and thank God that I did. It changed not only my life economically but my mother's life and frankly, members of my community.

The third way of being able to create wealth in America is having an equity position in the marketplace. Making sure that everyday Americans have access to the market is so critically important. It does not matter whether you are Black or White, male or female, where you live in rural South Carolina or inner-city Chicago, the truth is that those three ways—home ownership, entrepreneurship, and having an equity position in the marketplace—are the ways that we create wealth, and it is one of the ways that we find a more fair path in what seems like an unfair world.

Millions of Americans have discovered the magic that is made when we, in fact, understand and appreciate opportunity and opportunity for all. No matter your color, your creed, opportunity exists for all of us.

To be clear, all Americans have not always had equal access to these wealth-building opportunities that their peers have. However, I believe that there is more opportunity today in the United States than at any other time in American history. Founders and entrepreneurs of diverse backgrounds, minorities, women, veterans, and those who live outside of Boston, New York, and the Bay Area, where at once almost completely unable to access the same early stage and growth funding opportunities as their peers. Today, these groups are now receiving a growing share of investment capital to start and scale their businesses.

In 1989, less than a third of American families owned any stocks or bonds. Now over half of U.S. households have access to these U.S. capital markets, and they are taking advantage of this very powerful and transformative tool to create economic growth, job creation, and wealth accumulation. Even better, the most rapid growth in the share of stock ownership has occurred among lower-and middle-income households. Now, 4 in 10 households that own stock have annual family incomes of less than $74,000. That is something we should celebrate.

During this hearing, I look forward to hearing more about the key challenges that diverse founders and entrepreneurs, including women and minorities, veterans, and rural residents, face in accessing seed capital, whether it is angel, public capital relative to their peers outside of these groups, potential approaches to mitigate any existing barriers to enter such markets for these diverse entrepreneurial groups.

I would also like to hear about the challenges associated with low- and moderate-income individuals—women, active-duty military, and veterans, and ethnic minorities—as it relates to accessing investment opportunities. I would also enjoy hearing about the possible frameworks to improve the scale and scope of investment opportunities for retail investors and whether there are any existing legislative or regulatory threats that may curb market participation for investors.

I appreciate all of today's witnesses for joining the Subcommittee and to examine the most important issues that are relevant to our investors. Thank you.

Chairman MENENDEZ. Thank you, Senator Scott.

So let me introduce today's witnesses. Testifying before us today is Mr. Gilbert Garcia, Managing Partner of Garcia Hamilton & Associates. Since joining the firm in 2002, Mr. Garcia has been consistently recognized for his advocacy to diversify the asset management industry. He was named Outstanding Diversity Champion by the Houston Business Journal this year, and in 2020, received the Maynard Holbrook Jackson, Jr., Award from the National Association of Securities Professionals.

Mr. Garcia currently serves on the SEC's Asset Management Advisory Committee, where he leads a Diversity and Inclusion Subcommittee. In addition, he serves on the

Department of Treasury's Advisory Committee on Racial Equity. He is from Houston, Texas, and a graduate of Yale University.

Also testifying is Mr. Thomas Quaadman, Executive Vice President for the Center for Capital Markets Competitiveness at the U.S. Chamber of Commerce. He has been with the Chamber here in Washington since 2008, where he advocates for policies in the capital market that protect investors, promote capital formation, and ensure U.S. leadership in the global markets. He is also the Executive Vice President of the Chamber Technology Engagement Center and the Global Innovation Policy Center.

Mr. Quaadman graduated cum laude from New York Law School and he earned his bachelor's degree from the College of Staten Island.

Thank you both for being here. We will start off with Mr. Garcia. Both of your statements will be fully included in the record, without objection. I am going to ask you to try to summarize it in about 5 minutes or so, so that Senator Scott, I, and when other Members come, can have an engagement with you back and forth. And I will start off by recognizing you, Mr. Garcia.

STATEMENT OF GILBERT ANDREW GARCIA, CFA, MANAGING PARTNER, GARCIA HAMILTON & ASSOCIATES, L.P.

Mr. GARCIA. Thank you very much. My statement is there for all of you Senators, and Chairman Menendez, Ranking Member Scott, and other Members of the Committee, thank you.

I will not go through my background because the Senator went through my background. I am product of public schools. I am a first-generation college. Financial services was something that was not even on the table for me as a young Latino in Corpus Christi, Texas, until I found an organization called SEO, which is called Sponsors for Educational Opportunity, which places minority undergraduates on Wall Street. Had it not been for that program in the summer of 1983, I would have never been in this field. And, of course, Salomon Brothers was the prince of capitalism, and I flourished.

And I moved back to Texas in 1990, and started managing money, and I joined our firm in January of 2002, when we had only $200 million in fixed income assets, and now we are just at $18 billion, making us the largest Hispanic-owned money manager in the country.

In 2019, I had the honor to serve on a FACA committee for the SEC, called AMAC, the Asset Management Advisory Committee. So that is why I am here. I want to share with you a few challenges that our firm has faced, I want to tell you my experience on the Diversity and Inclusion Subcommittee as the chairman, and I want to talk about our recommendations and where they are today.

And of course, please know that diversity can be a difficult topic to talk about, just because some people can be uncomfortable. But at the end of the day we need to talk about it.

So I am going to go to AMAC, and if you are following I am near the bottom of my first page. AMAC consisted of 22 professionals, all leaders in their firms, from some of the industry giants such as Goldman Sachs, Schwab, Morningstar, and the like. I was the only Hispanic on the committee, and there was only one African-American member, and we went on a 2-year journey, and we had many different panels and had many different experts testify or give expert testimony, and also received many research papers.

And we started with data, and that is when we discovered that data is very limited. We even discovered that the SEC's own Diversity Demographic Survey has a poor response rate, probably because it is voluntary.

But talent in the diverse community is undeniable, and there is numerous research out there, that Senator Menendez already reference. But at the end of the day, if you look, and no matter what studies you find, there is roughly $70 trillion in investable assets, and whether you look at 2017 or 2019 or even now, the amount of assets managed by diverse firms—women-owned, minority-owned—is less than 1.1 to 1.3 percent.

Now one key area that I believe could move the needle greatly, and it was part of our testimony that we received over our 2-year period, was the investment consultant industry. Many of them are SEC registrants. They are often the allocators of the asset management industry, and are the gatekeepers for many foundations and endowments and pension funds. So they are the ones that recommend money managers for hire. Some, though, receive economic benefit for managers without clear disclosure, and the concentration is very clear.

If you look at the latest consultants, according to the 2020 report from P&I Magazine, the largest 10 have $36 trillion, or 85 percent market share. So the largest 10 control 85 percent of the assets. The largest 20 are 94 percent. So you have a semi-closed system where the largest consultants recommend the largest managers. But see, if the consultants only recommend large managers there is virtually no opportunity for diverse firms to compete, since they, by definition, are smaller in size.

And what has happened is many of the consultants have now started these arbitrary and unnecessary barriers of entry, such as length of track record, firm asset size, amount of insurance, or other factors that indirectly exclude almost all minority firms from participating. And then, of course, there is direct exclusion, and I will just give you one example. A colleague of mine and I were the focus of a very hostile and unprofessional meeting by one of the largest 10 consultants. They advise over $1 trillion. And they rudely proclaimed that they would never recommend our firm to any of their clients and would never put us in a new business search. The reason, they boldly stated, was because we did not have enough White male partners in our firm, and we did not have enough White male portfolio managers.

Now this was not the ’40s and ’50s, like the stories of my grandfather, or the ’60s and ’70s, like the stories of my father. This was just a few years ago. And if they say that to us, the best in class, what do they say to the newer, smaller diverse firms? And if they say that to our face, imagine what they say in the deliberations behind our back. And sadly, that is just one example.

Clearly, many consultants, the large ones that are the most guilty culprits, realize that the greater transparency is inevitable. But instead of trying to improve their numbers, they are just simply moving the goalpost, and how they are doing it, they are circumventing established Federal and State laws and practices which use a 50 percent ownership threshold to define diverse-owned. How? They have created a new term called “substantially diverse,” some as low as 25 percent diverse ownership.

Now the entire recommendations are summarized for you. I will just hit the highlights. The first, we suggest two additional goals to the SEC’s strategic plan, one, that diversity and inclusion should be elevated to a core value and a material fact for all SEC activities. Second, they should promote diversity practices among all registrants. Second, we suggest that the SEC issues guidance and bulletins, and we suggest that they issue one that clearly discourages the use of parameters for manager selection that have the impact of excluding minority-owned firms.

And what is very interesting is even Commissioner Uyeda, on September 29, 2022, in some of his remarks from a keynote luncheon speech, said that one specific AMAC recommendation that deserves attention is that when fiduciaries select asset managers, their selection criteria should not exclude managers simply based on a minimum level of AUM, or minimal length of track record. Selection criteria tend to result in the elimination of women- and minority-owned firms from further consideration. Rather, fiduciaries should consider using relevant factors that do not involve automatic exclusion of managers.

Those are his comments.

On number 3, the SEC already has a registration process called the ADV. We suggest that the SEC starts including diversity data already on their ADV. That way there is not a new process. They already have information that they request on their voluntary form, such as transparency of ownership, transparency of workforce, demographics of ownership, and the like.

Next, we suggest enhancing the ADV for consultants and asset allocators to provide sunlight on the selection process of registered investment advisors.

Next, and I will be quick, there——

Chairman MENENDEZ. I would like you to try to—Mr. Garcia, I would like you to try to wrap up because we are 2 minutes over the 5 minutes, so we are at 7 minutes.

Mr. GARCIA. Very good. The other are pay-to-play practices laws where even Commissioner Peirce has suggested that they are outdated. And the next relates to other pay-to-play practices.

Let me just say this. There are already statements by Commissioners Lizárraga and Crenshaw suggesting the support of all the AMAC recommendations, and they themselves, and I will just quote them quickly, have said, "I believe it is our responsibility to the public to explain why the AMAC's four recommendations cannot be fully implemented."

Chairman MENENDEZ. Thank you.

Mr. GARCIA. And that is simply what we are asking here today.

Chairman MENENDEZ. Thank you very much.

Mr. GARCIA. Because right now, Senator, there has been virtually only two items that have been implemented, and they are the least impactful. I will stop there.

Chairman MENENDEZ. Thank you very much. I am sure we will get into more questions.

Mr. Quaadman, thank you for appearing. Your testimony.

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

Mr. QUAADMAN. Thank you, Chairman Menendez and Ranking Member Scott and Members of the Subcommittee.

Main Street businesses need to access diverse forms of capital in order to start and grow. Democratized marketplaces allow for retail investors to have more opportunities for wealth creation. Historically, this Subcommittee has led in those issues in a bipartisan basis.

Ten years ago, many members of the House and Senate took a look at the landscape and decided that there were problems, including the persistent decline of public companies within the United States, that were harming the American economy. What they did is they took a series of recommendations that had been languishing within SEC advisory committees for years and put them together to create the JOBS Act. As a result of that initiative, we have a new class of emerging growth companies. We have balanced progrowth policies with regulatory mandates. We have also liberalized private and public financing rules. The JOBS Act was a success. In the years before the JOBS Act, the average number of IPOs was 121. In the years since the JOBS Act passed, the average number of IPOs is 344. Innovative industries in the United States as a global leader have benefited most. Forty percent of IPOs have been with biotech firms. Those firms, within 3 years of their IPO, have expanded their workforce by 150 percent. In fact, it is not an understatement to say we would not have had COVID vaccines or mRNA technology without the JOBS Act.

However, history is repeating itself, and unfortunately we find ourselves in an eroding competitive environment. The number of public companies within the United States is flat. Chinese venture capital now rivals the United States venture capital. Financial centers around the world, such as London, Dublin, Frankfurt, Singapore, Dubai, Hong Kong are now vying for capital that normally would have gone to American companies.

Earlier this year the ACCF released a report that showed that as a result of obstacles to growth we have 800 fewer public companies in the United States. There is a steep cost to those lost companies. We have 500,000 less jobs, we have $250 billion less in corporate revenue, and we have $600 billion less in market capitalization.

Now the SEC, through its legal mandates of investor protection, competition, and capital formation, actually can address these issues on its own. However, with the 53 rule proposals that are on the SEC's docket, not one of them deals with either capital formation or competition. Therefore, it is imperative that Congress act.

In our 2021 capital formation letter to Senator Toomey, who has been a leader on these issues, we outlined 27 recommendations to reverse this trend. We believe that the following bills that are before the Subcommittee can help create a new JOBS Act. The bipartisan Helping Startups Continue to Grow Act would extend the minimum period for EGC status to 10 years. Equal Opportunity For All Investors Act helps businesses access new sources of capital by expanding the accelerated investor qualification. The Seed Act would allow for micro-offering safe harbors, allowing for small businesses and entrepreneurs to raise small amounts of capital.

The Gig Worker Equity Compensation Act would allow companies to give their employees equity compensation without triggering a registration incident. The Expanding American Entrepreneurs Act would allow angel funds to better raise capital as well as to deploy capital to startup firms. The bipartisan Empowering States to Protect Seniors from Bad Actors Act moves the responsibility for administering the Senior Investor Protection Grant Program to the SEC, whose mandate they have for investor protection.

Additionally, we must address the needs of minority entrepreneurs who have traditionally been underserved by the financial ecosystem. A 2018 Kellogg Foundation study showed that closing the racial equity gap would add $8 trillion to the economy.

In November 2020, the Chamber made several recommendations to promote minority access to capital. Congress should direct the SEC's small business advocate to analyze the needs of minority-owned businesses and entrepreneurs and make recommendations for improving their access to capital. Policymakers should encourage the use of alternative data for underwriting and other business purposes, when appropriate. Congress should expand and strengthen both community development financial institutions as well as minority depository institutions.

We have also worked with the NACD to create a pipeline to identify Black candidates and Hispanic candidates for board seats as well.

So, Mr. Chairman, Mr. Ranking Member, we want this to be a dialogue to start the process for a new JOBS Act, and we are willing to work with both sides of the aisle to get there.

Chairman MENENDEZ. Well, great. Thank you, Mr. Quaadman. We will start a round of 5-minute discussions, and then depending on attendance we can extend that.

Let me start off with you, Mr. Garcia. The Diversity and Inclusion Subcommittee submitted their recommendations on July 7, 2021. That is after the long, 2-year period you described. It has been about a year since then, and wanted to get your thoughts on the progress that has been made.

In your view, what, if anything, has changed about the overall state of diversity in asset management since you released these recommendations, and how would you rate the SEC's progress in responding to your recommendations?

Mr. GARCIA. Sure. Thank you, Senator. First, it is remarkable that the AMAC—there are only two minority members on the whole committee—unanimously supported all of these efforts, and many of them come from the biggest institutions in this country. It has been extremely disappointing that here we are today, Senator, and only the two least impactful items have been implemented.

If I were a teacher I would give it an "I" for incomplete, because not only did they do the two least impactful with very little fanfare, but there have already been comments by the other commissioners that suggest that they want to have a discussion and a dialogue, and it sounds like, from their own comments, that they are supportive of most, if not all, of them.

And I believe the public deserves, and we, on the AMAC, deserve if they are not going to be implementing them, why not? We spent hundreds of hours under the guise that this FACA committee was relevant and important, and we sure would like to see a conclusion, one way or the other, Senator.

Chairman MENENDEZ. Yeah. Let me ask you, I think it is important to note that using the excuse of fiduciary duty to exclude women- and minority-led firms runs contrary to the actual data. There is a large and growing body of evidence, including AMAC study, that shows diversely led firms outperform their nondiverse counterparts. So this is about the bottom line, not even talking about any societal benefit. I am just talking about the bottom line.

Given this data, do you agree that a firm's diversity, particularly at the management level, is material information that investment advisors should be able to consider when making recommendations to their clients?

Mr. GARCIA. Absolutely. Senator, I would go a step further. I would suggest that the elimination of women- and minority-owned firms that have already been proven to perform just as well, if not better, than the nondiverse firms, by excluding them you might very well be in violation of your fiduciary duty. Because after all, your duty is to source good managers, regardless of who they are.

And so my view is by casting a very narrow net on purpose to bring up barriers of entry to exclude these firms is not right, and is costing your clients.

Chairman MENENDEZ. And last question to you. Do you believe the SEC currently has the authority to implement these enhanced disclosures?

Mr. GARCIA. Yes, sir. In fact, we worked very closely with many of the SEC staff, legal staff, and one of the members of our subcommittee was a former SEC legal staffer. And we were very careful to make sure that everything that we recommended is within their lane of their authority. So that has already gone through the process or we would not have even recommended it.

I would even suggest that one of the items, which is the pay-to-play rules, all we asked was to reevaluate it and to study it. My own view is it should be discarded entirely, because all it does is favor other industries to the disfavor of the financial community, and as a person who has worked very hard, it just does not feel good to suggest that there are more people in my industry doing things they should not do than any others.

And Commissioner Peirce said it best when she said there are already laws on the books.

Chairman MENENDEZ. Yeah. So I think about this question as a question of improving the bottom line, right, and there are many elements of it. For example, years ago Chevrolet tried to sell the Chevy Nova in Latin America. "Nova," in Spanish means it will not move. I do not care how good a marketing plan you have, if you are trying to sell a car that is called "it will not move" is not going to do very well.

That is just a simple example of language, but understanding language, business customs, culture, in the C suite and senior executive management is helpful to the bottom line. I think about the Hispanic community that has $2 trillion domestic marketplace, younger by a decade than the rest of the population, growing exponentially. For bottom line reasons, I would want to be on them like white on rice, which means having individuals who understand the nature of how you get greater market share, and in doing so there is a ripple effect, a benefit to those communities that if I can help my company make better investment decisions that would inure to the benefit of places in the country that they might otherwise look like, the would have opportunities for enhancement of economic opportunity for people there.

So that is how, in part, I look at this. Senator Scott.

Senator SCOTT. Thank you, Mr. Chairman.

Strong, competitive, and perhaps most importantly accessible capital markets are essential to fostering a healthy entrepreneurial ecosystem and the U.S. economy. That is why the passage of the JOBS Act, Mr. Quaadman, as you said, 10 years ago was a game-changer, a game-changer. Lawmakers recognized that there was nothing partisan about making it easier for our country's companies to spur innovation, hire new workers, invest in their communities, and power U.S. economic growth, and work together on a bipartisan basis to pass commonsense legislation aimed at doing just that.

And now, as our economy looks to complete its rebound from the impacts of the pandemic, this body is present with an opportunity to build on the enormous success of the JOBS Act, and once again, to jumpstart capital formation and the creation of good jobs by companies that serve as the life blood of the American economy. The JOBS Act's creating of emerging growth company, or EGC, status to provide a flexible regulatory regime for small companies that are still working to scale their businesses has been a resounding success. Case in point: since 2014, roughly 90 percent of companies have gone public using the EGC status.

Mr. Quaadman, EGC designation has made IPOs more attractive for low-revenue, high-growth companies by smoothing the transition to the public markets without compromising investor protection. However, some companies, like biotech firms, have long product development timelines, reach the end of their 5-year exemption limit, and still are not generating enough revenue to support the much steeper compliance costs that come with a loss of EGC status.

How would my legislation extending the EGC scaled regulatory regime to 10 years benefit companies and the broader economy?

Mr. QUAADMAN. It does two very important things, Senator Scott. Number one, it allows regulations to be tailored to that company. So if you take a biotech firm as an example, they have very heavy capital needs, but they are not necessarily selling anything yet. So if you take a look at, let us say, all the controls around revenue, they just create costs with no meaning. And, in fact, what those extra dollars do for regulatory compliance, which is meaningless, actually takes money away from research as well as job creation.

Number two, what it does is it allows those companies actually to grow into the appropriate levels of controls and process that are needed to have the certainty that they do need when they do reach their full-bloom public company status. So it allows for a greater ramp-up because, quite frankly, with those innovative firms, 5 years is not long enough and 10 years is a better timeframe.

Senator SCOTT. Thank you, sir. I look forward to working with my colleagues to build bipartisan support for this commonsense legislation. U.S. capital markets are the gold standard globally and help make the American economy the envy of the world. They provide a system where the average American working family can invest their savings into projects and earn a tangible economic reward, enabling their dreams of buying a house, sending their children to college, and retiring with economic security.

A little over a year ago, I sat right here and had a conversation with SEC Chair Gary Gensler about the significant ways the retail investment landscape has evolved over the last couple decades, and discovered that we both strongly agree on one point in particular—increased retail investment market participation is a good thing for America.

Now, it is not that often that Gary Gensler and I find common ground, and that point would be supported by Chairman Brown if he were here. So it was encouraging that we both seemed to see eye-to-eye about the benefits of more people finally beginning to gain access to this powerful wealth-building engine.

Do you agree with that statement, and is more Main Street investors getting involved in the market a positive thing?

Mr. QUAADMAN. It is a very positive thing. So allowing Main Street investors to enter into the marketplace creates wealth on Main Street, right. So the problem that we have seen over the last 20 years or so, many of the capital-raising measures that are happening are only happening in 20 counties in the United States. So we have actually seen a calcification, to some degree, of our marketplace.

What the JOBS Act and one of the reasons why we think it is important to do additional amendments to it, so let us say with crowdfunding, the credit investor rules expanding those, it will actually allow for retail investors to have more opportunities to create wealth, and it can be done in a particular way that will actually strengthen investor protections. And frankly, if the SEC is on the job, that should not be a problem.

Senator SCOTT. Thank you, sir.

Chairman MENENDEZ. OK. Well, we look forward to working with Senator Scott on some of these issues.

Mr. Quaadman, let me ask you some final questions. I think it is important to understand, as I suggested at the close of my comments, that diversity is not just a fanciful idea but rather a goal that can improve a company's bottom line and our country's economic competitiveness.

Why is it necessary for public companies to disclose the diversity within their senior management to investors?

Mr. QUAADMAN. So first off, Mr. Chairman, we appreciate the partnership that we have had working with you in terms of gender and racial diversity on corporate boards. It is important for boards and management to look like their consumer base, to look like their employee base, and to be able to make decisions that are impactful for both. So we think that it is important to have a multistakeholder approach to address these issues, and it is important for investors to have that information as well.

What I would also say, working with you as well as with Congresswoman Maloney and with Congressman Meeks over the years on these issues, even just the introduction of those bills I think have changed the landscape as well as have pushed forward in terms of having more minorities and women on boards, and quite frankly, the reason why I discussed the pipeline we created with the NACD, we not only want to support those positions, we actually want to actually do it as well.

Chairman MENENDEZ. I appreciate that. And let me ask you one other question. Why should disclosure be uniform across all public companies' reporting?

Mr. QUAADMAN. Well, I believe for the boards themselves, you want to have comparable information that investors can have and to be able to look at and make their decisions moving forward from there.

Chairman MENENDEZ. Yeah. That is why I introduced that Improving Corporate Governance Through Diversity Act, and we certainly thank the Chamber for their enforcement to it.

I want to turn briefly to a corollary issue. Access to capital is a persistent issue for minority-owned businesses. According to the Chamber of Commerce's Equality of Opportunity Agenda, Black-owned businesses are less than half as likely to get financing as White-owned firms, and nearly three times more likely to have profits negatively impacted by a lack of capital. The Agenda further states that lower family wealth exacerbates these disparities.

Can you expand on the Chamber's research in this area, and in particular, how the racial wealth gap contributes to the divide in access to credit?

Mr. QUAADMAN. So what it does, it simply does this, right, where by having less access to capital, what often happens is Black entrepreneurs then have to actually start businesses that have a higher failure rate. So it creates a very vicious cycle that does not allow them to break out of it. The reason why we worked on these minority access to capital issues is if we can actually help minority entrepreneurs get better access to capital they are going to have a better success rate.

Now what I would also say—and this is one of the reasons why I think a multistakeholder approach is very important here—there are companies who are members of ours that we have worked with. They have actually dedicated more of their cash deposits with minority bank depository institutions to ensure that those institutions actually have a better ability to deploy money to minority entrepreneurs.

The second is there is one corporate Fortune 250 company that we have worked with as well, and what they have done is they have actually put a consortium together of Black financial firms to help them with bond issuances. Now obviously one is to make sure that they have more business, but number two, and this is the real reason for doing it, I to ensure that those firms buildup the muscle and expertise that they can then use to help ensure that minority entrepreneurs have better access to capital.

Chairman MENENDEZ. Yeah. And obviously we want to see that because that contributes not only to a declining disparity in the wealth gap but it also leads to more prosperous economic communities, beyond the racial community that might benefit from it.

Mr. QUAADMAN. That is true, and that is why I cited that Kellogg study in our report because it has been an $8 trillion addition to the American economy. That is a lot.

Chairman MENENDEZ. That is a lot. One final question to you. One of the ways that Congress can most efficiently expand access to credit for minorities is to fund community development financial institutions and minority deposit institutions. We have ample evidence from the pandemic demonstrating how these institutions serve to provide credit and other financial services to underserved communities. Can you talk about the critical role that CDFIs and MDIs play in supporting minority small business as we are tackling the difficult problem like the racial credit access gap?

Mr. QUAADMAN. They are a cornerstone of the financial ecosystem that minority entrepreneurs rely on. However, they have either been underfunded or there are not enough of them, and it is very important for Congress to act, which is why we made that recommendation in our growth engine report. It is important for Congress to act to strengthen them and to make sure we have more MDIs as well in order to help with that.

But as I said, this is an ecosystem, so we need many different pieces of this to work. But they are a critical part of it.

Chairman MENENDEZ. Thank you.

Mr. Garcia, one last question to you. The Thrift Savings Plan is the world's largest defined contribution retirement plan, with approximately $735 billion in assets. The Federal Retirement Thrift Investment Board internally manages a portion of the TSP funds while the rest is managed by BlackRock and State Street Global Advisors. Unfortunately, all three of these entities significantly underrepresent minorities and women at the executive level.

The Federal Retirement Reform Act of 2009 granted the board the authority to establish a mutual fund window for the TSP, which provides participants with more self-directed investment options. However, the board has yet to use this authority to make more women- and minority-owned firms available for Federal workers and retirees to invest in.

So given what we know about the link between diversity and performance, would it not make sense to give Federal workers the options to investment in women- and minority-owned asset management firms?

Mr. GARCIA. Senator, it makes incredible sense. It is so obviously that by not doing it—and forget about desires and people who may want to hire people like themselves; just forget all that—at the end of the day if they are performing better it should be an option for the retirees and for the workforce, and by not having it as an option you are preventing them from really having the most robust returns that are out there available to them.

On a sidebar, it is just a natural that I think many of those people are people of color, and I think they already are sensitive to opportunity for people of color. So I do think that is an element as well.

You should know, Senator, that it is not just in your example but many of the other large pots of Federal monies have virtually no minority representation in their management roster.

Chairman MENENDEZ. OK. Well, I agree with you, which is why I led a letter with my colleagues to the board calling on them to do just that. I think Federal workers are retirees who deserve an alternative that both aligns with their values, and it is also good for their investments, and this is one simple step the Federal Government can make to create a more inclusive economy. We will continue to call upon the board to make that a reality.

Let me just turn to Mr. Quaadman. Anything that we have not asked you, that you did not testify to—I am going to give you a black opportunity here—that you want to speak to in terms of the subject matter of our hearing? I will give you that opportunity and then I will turn to Mr. Garcia and give him the same opportunity.

Mr. QUAADMAN. Chairman Menendez, I appreciate that a lot. What I would say, and that is why I talked about a dialogue here, is that it is important that we do some form of a JOBS Act. Many of the issues that I was raising in terms of either crowdfunding amendments or credit investor qualifications help all investors.

They would also help minority entrepreneurs as well. So I think it is really important to do that.

And I would just leave with this one last thought. Very often—and Senator Menendez, I know you have been involved in these issues for many, many years—we always talk about the United States having the most liquid, deep financial markets. And that is true, but the fact of the matter is we have a lot of global competition we have never had before, and there are different parts that we could lose, and if we do that we are going to lose our competitive edge.

So this is much more than some of the issues we have talked about in the past. This is about the future of our economy.

Chairman MENENDEZ. We look forward to having that continuing engagement with you and others, and making sure that we continue to be at the apex of our opportunities. I do not like losing anything to anybody, so we will work with you.

Mr. Garcia, final comments?

Mr. GARCIA. Yes, sir, Senator. I will give you one more example and then I will give a final comment, and I will go fast.

You know, on your comments you talked about language. I just want to give you another example of some of the inherent bias, whether it is sort of underneath or over. At the end of the day, another very large consultant—again, the intermediaries of money and allocators—was at our office doing a due diligence, which is a very serious process, Senator, that took almost 4 hours, and we really displayed a showcase of all parts of our firm.

And when we completed, the first thing out of their mouths was not that they never realized our staff was strong, nor that our outperformance was excellent nor that our resources were robust. No. The first thing out of their mouth was, "Golly, you talk a lot about being a Hispanic firm, and we have been here almost all day, and we have not seen any Hispanics."

Senator, that should be irrelevant. And what is even worse is in that meeting we were all so dumbfounded, one by one we raised our hands and said, "I am Hispanic." "I am Hispanic." "I am Hispanic." See, they have an image of us, whether it is having a large mustache, a big hat and bullets across our chest. At the end of the day, those are the biases that exist out there, that we are trying to dispel.

So my final comment is we have spent an extraordinary amount of time on these recommendations. The SEC has it handed to them, right here. We have a very long track record, a very long record of comments and expert testimony. The AMAC of industry leaders themselves unanimously supported all of these recommendations.

So the SEC, in my opinion, it is all there. They should either, in my view, opine as to why they are not going to do them, or we should implement them all right away. It is clear it would do a lot in furtherance of meeting those objectives, which are both material and in the interest of the investors, to ensure that they are getting the best performance and the best transparency possible.

Chairman MENENDEZ. Well, thank you. I am sorry that there are those that went to visit you that could not identify someone as Hispanic simply because they did not wear a sombrero and a serape.

That is a sad statement in the year 2022. But we will continue onwards.

I will say that when we have the SEC before us, and the Committee will, we will continue to press them, because getting an absolute unanimous recommendation is rare in any of the processes, much less in this process, and after 2 years of study I cannot imagine that a unanimous set of recommendations cannot be ultimately pursued. So we will continue to ask the SEC's leadership why.

This concludes today's hearing on diversity in the U.S. capital markets. Let me thank the witnesses again, and my Ranking Member for a productive discussion on this issue in terms of diversity in our markets, the challenges it poses for women and minorities, as well as some other elements of capital formation and possible solutions to achieving the challenges that we have. I look forward to continuing the conversation in the future.

For Senators who wish to submit questions for the record, those questions are due at the close of business 1 week from today, Tuesday, the 20th. To the witnesses, we ask you to please submit your responses to questions you may receive for the record as promptly and as thoroughly as possible.

Again, with the thanks of the Committee, this hearing is adjourned.

[Whereupon, at 3:30 p.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF CHAIRMAN ROBERT MENENDEZ

Turning now to the subject of today's hearing, we are here because our economy has a fundamental problem.

Across corporate America, those in charge are overwhelmingly White and disproportionately male.

In a recent analysis of over 3,000 U.S. firms listed on either the New York Stock Exchange or the NASDAQ, researchers at Cornell found that racial minorities held only about 12 percent of board seats in 2019—with over 40 percent of all U.S. boards composed of only White directors. [1]

In asset management we see a similar story.

Of the $70 trillion in global financial assets under management, less than 1 percent of are managed by women- or minority-owned firms.

Now some may wonder why this a problem.

Why should the Federal Government have an interest in the diversity of publicly traded companies?

The answer is simple—it's because it is material information that investors should have when deciding where to put their money.

In study after study—including those conducted by the consulting firm McKinsey—researchers have found that a diverse workforce leads to a more productive and profitable company.

The reasons for this are varied, but whether it's because of smarter and more inclusive decision making, increased creativity and problem solving, or greater recruitment and retention, the bottom line is this:

A company whose governing structure looks like America is a company that can compete on the global market.

Which brings us to this hearing.

The current lack of diversity in capital markets, businesses, and financial institutions creates a ripple effect across the ecosystem.

It negatively affects entrepreneurs and investors, makes companies less competitive, and stalls our Nation's progress towards a truly equitable marketplace.

In short, a lack of diversity means that American companies are fighting to compete with one hand tied behind their backs.

It's an issue that I have been following personally for years—and in the past, my office has issued corporate diversity surveys of Fortune 100 companies.

What we have found is that, while many of these companies believe in the idea of increasing diversity among their senior leadership, very few have made real progress on the matter.

It is why I introduced a bill, the Improving Corporate Governance Through Diversity Act of 2021.

My legislation would promote greater transparency in corporate America by requiring public companies to disclose specific information related to the racial, gender, ethnic makeup and veteran status of corporate boards and senior management and whether they have policies in place to promote diversity in their leadership.

It's a bill that I'm proud to say has strong support across the ideological spectrum—from the U.S. Chamber of Commerce to the National Urban League.

And it goes hand in hand with what SEC's Asset Management Advisory Committee has urged the asset management industry to adopt.

The AMAC Subcommittee on Diversity and Inclusion has pushed for greater disclosure of the gender and racial makeup of firms.

This increased transparency would not only improve performance to the benefit of investors, it would also further the SEC's diversity and inclusion goals and its mandate to facilitate fair and open markets.

It is my hope that the SEC soon enacts all of these recommendations and that we can pass my Improving Corporate Governance Through Diversity Act.

Lastly, I'd just like to note what greater diversity means for investors and entrepreneurs in minority communities, and I say this because I know it's of particular interest to both Ranking Member Scott and me.

The fact of the matter is that underrepresentation has a trickle-down effect.

When corporate leadership at the top is not diverse, unsurprisingly, the firms that manage their pensions are also not diverse.

When corporate leadership only reflects one thin slice of the population, their decisions will only benefit one slice of the population.

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[1] *https://corpgov.law.harvard.edu/2022/01/17/what-drives-racial-diversity-on-u-s-corporate-boards/*

And despite contributing trillions of dollars to the economy—being among the most likely to start a small business—many minorities across the country still lack access to the capital they need to thrive.

We all saw this firsthand during COVID when minority business owners struggled to access the PPP program.

So the goal of today's hearing is to explore these issues further—to discuss solutions that work for women and minority communities who are too often neglected by traditional financial services and in the capital markets.

And with that I want to thank our witnesses for appearing and for sharing their testimony with us today.

I now turn it over to Ranking Member Scott for his opening remarks.

PREPARED STATEMENT OF SENATOR TIM SCOTT

As a young man at risk of being left behind in the world, I was blessed to meet to meet a man who would go on to change the path of my life: my mentor, John Moniz.

John taught me a lot of important lessons but I'm going to share one of the most valuable ones with you right now.

There are three paths to accumulate wealth in America:

First—Home ownership; this is often the biggest and most important purchase a person will make in their life.

Second—Owning a business; John taught me early on that PROFITS are better than any paycheck and that having a job is a good thing but CREATING jobs is an even better thing.

Third—Having an equity position in the market; helping to grow your wealth and the economy at the same time.

It does not matter whether you are Black or White, a man or woman, or living in rural South Carolina or downtown Charleston; these three tools—home ownership, entrepreneurship, and investing in markets—are the great equalizer.

In a sometimes unjust and unfair world, millions of Americans have discovered the magic that made—and makes—our country so great: opportunity.

For all!

No matter your color or creed, opportunity exists for you.

To be clear, all Americans have not always had equal access to these wealth-building opportunities that their peers have. However, I believe that there is more opportunity today in the United States than at any time in our history.

Founders and entrepreneurs of diverse backgrounds—minorities, women, veterans, and those who live outside of Boston, New York, and the Bay Area—were once almost completely unable to access the same early stage and growth funding opportunities as their peers.

Today, these groups are now receiving a growing share of investment capital to start and scale their businesses.

In 1989, less than one-third of American families owned any stocks or bonds.

Now, over half of U.S. families are accessing the U.S. capital markets—one of the most powerful and transformative drivers of economic growth, job creation, and wealth accumulation in the world.

Even better: the most rapid growth in the share of stock ownership has occurred among lower- and middle-income households. Now, 4 in 10 households that own stock have annual family incomes of less than $74,000. During this hearing, I look forward to hearing more about:

- The key challenges that diverse founders and entrepreneurs, including women, ethnic minorities, veterans, and rural/exurban residents, face in accessing seed, angel, growth, and public capital relative to their peers outside of these groups;
- Potential approaches to mitigate any existing barriers to enter such markets for these diverse entrepreneur groups;
- The challenges associated with low- and moderate-income (LMI) individuals, women, active duty military and veterans, and ethnic minorities accessing investment opportunities;
- Possible frameworks to improve the scale and scope of investment opportunities for retail investors; and
- Whether there are any existing legislative or regulatory threats that may curb market participation for investors.

I appreciate all of today's witnesses for joining the Subcommittee this morning to examine this very important issue and look forward to our discussions.

PREPARED STATEMENT OF GILBERT ANDREW GARCIA

CFA, MANAGING PARTNER, GARCIA HAMILTON & ASSOCIATES, L.P.

DECEMBER 13, 2022

Chairman Menendez, Ranking Member Scott, and Subcommittee Members: Thank you, Senators.

My name is Gilbert Andrew Garcia, and I am the Managing Partner of Garcia Hamilton & Associates.

I am a native Texan, product of public schools, first-generation college, and a graduate of Yale University. The financial services industry was foreign to me until I went through a program called SEO that places minority undergraduates on Wall Street for summer internships. It changed my life.

In the summer of 1983, SEO placed me at Salomon Brothers, the prince of capitalism, and I ultimately flourished as a full-time employee starting in 1985. With time, I returned home to Texas in late 1990 to start a fixed income money management firm. In early 2002, I joined Garcia Hamilton and we had only $200 million in bond assets. We crossed $18 billion early this year, making us the largest Hispanic-owned firm in the country and the largest independent bond firm in Texas. We are almost 90 percent minority and women-owned and almost 65 percent minority-owned. Furthermore, 75 percent of our employees are women, and almost 70 percent are Black and Brown. We have received numerous awards for performance, leadership, and diversity. We are extremely proud of the firm. However, relative to many mainstream trillion-dollar firms, we are hardly a monthly cash flow.

In October 2019, I had the honor to serve on a FACA committee for the SEC called AMAC (Asset Management Advisory Committee). As stated in the Federal Advisory Committee Act (FACA), under Findings and Purpose, (paraphrasing), "the Congress finds that there are numerous committees which have been established to advise officers and agencies in the Executive branch of the Federal Government and that are frequently a useful and beneficial means of furnishing expert advice, ideas, and diverse opinions to the Federal Government." So, this is largely why I am here today as I wish to share some challenges my firm has faced, my experience serving as Chair of the Diversity and Inclusion (D&I) subcommittee of AMAC, our recommendations to the SEC and their current status.

The topic of Diversity can be challenging to talk about openly. It often uses terminology and facts that can make some people uncomfortable. However, the conversation must take place as the vast income inequality in our country among demographic groups has clearly led to disparities in wealth, access to health care, access to education and the like. This wealth gap has grown considerably the past 30 years and has only exasperated the great division and social unrest we have experienced the past few years in our country. President Biden signed an Executive order on Racial Equity and said, "We need to make the issue of racial equity not just an issue for any one department of Government; it has to be the business of the whole Government. Every White House component and every agency will be involved in this work because advancing equity has to be everyone's job."

AMAC consisted of 22 industry professionals, all leaders in their firms. The members came from such prestigious firms as Goldman Sachs, Charles Schwab Corp, Morningstar Research Services, T. Rowe Price, Apollo Global Management, and Fidelity Institutional. I was the only Hispanic member and we had only one African-American member. We had a 2-year journey and my D&I subcommittee held three panels of expert testimony from industry leaders and reviewed several research papers.

We started with data. We soon learned that data is limited as many have been unwilling to disclose demographic information or have not tracked such information in the past. Even the SEC's own diversity demographic survey has a poor response rate, probably because it's voluntary.

Talent in the diverse community is undeniable, including in the asset management industry. One of my panelists presented research by the Bella Research Group in 2017 and 2019. The studies looked at what percentage of assets were managed by diverse-owned firms within the U.S. based asset management field. The 2017 results showed 1.1 percent of $71.4 trillion in assets were managed by diverse-owned firms. The 2019 results showed 1.3 percent managed by diverse-owned firms. The results also revealed that diverse managers performed on par with nondiverse firms, and in many cases outperformed mainstream firms. Keep in mind that the *Washington Post* reported that 69 percent of the U.S. population are women and minorities. In a system where 69 percent of the population are unable to reach their full potential because of institutional barriers of entry or outright bias, then talent is not being fully realized to the detriment of the investing public and the Nation.

One key area that the testimony showed would improve these statistics considerably is the Investment Consultant industry, many of whom are SEC registrants. They are often the allocators to the asset management industry, and they are the gatekeepers for many foundations, endowments, and pension funds by recommending money managers to them for hire. While notable efforts are now being made, most consultants lack diversity both internally and externally in their manager recommendations. Some even receive economic benefit from managers without clear public disclosure. Pensions & Investments Magazine (P&I) publishes an annual list of the largest consultants and, according to the 2020 report, they advise $42.7 trillion in assets. The concentration of assets is notable as the largest 10 advise $36 trillion or over 85 percent of the assets.

The largest 20 consultants have 94 percent market share. Likewise, the concentration of assets in the asset management industry is similar. As an example, according to P&I, as of December 31, 2019, there were 148 Active Domestic Fixed Income Money Managers that have approximately $2.2 trillion in assets under management. The largest 10 have 69 percent market share and the largest 20 have 84 percent of the market share.

Thus, one sees a semi-closed system where the largest consultants appear to be recommending the largest money managers. If consultants only recommend large managers, there is little to no opportunity for diverse firms to compete since diverse firms are still smaller in size. Many consultants avoid consideration of minority-owned firms by setting arbitrary and unnecessary barriers such as length of track record, firm asset size, amount of insurance, and other factors that indirectly exclude nearly all minority-owned firms. Then, there is direct exclusion. A colleague and I were the focus of a very hostile and unprofessional meeting by one of the largest ten consultants advising over $1 trillion. They rudely proclaimed that they would never recommend our firm to any of their clients and would never put us in a new business search. The reason they boldly stated was because we did not have enough White male partners in our firm, and we did not have enough White male portfolio managers. This was not the 40s and 50s like the stories my grandfather shared, nor the 60s and 70s like the stories my father shared, this was just a few years ago. And if they say it to us, the best in class, what do they say to the newer, smaller firm? And if they say it to our face, what do they say when they deliberate behind our back? Sadly, this is just one example.

Many in the consultant community and others realize that greater transparency is inevitable. Instead of greater effort to improve, some are simply moving the goal post to improve their abysmal diversity statistics. How? They are circumventing established Federal and State laws and practices which use a 50 percent ownership threshold to define diverse-owned and are creating a new term called “substantially diverse”, some as low as 25 percent diverse ownership.

After great discussion, the D&I subcommittee produced a series of recommendations that are material and in the interest of the investing public. The entire list of recommendations was reviewed publicly and was unanimously passed by the full AMAC committee on July 7, 2021.

I will summarize them here:

1. The SEC has a Diversity and Inclusion Strategic Plan. We suggest two additional goals. The first, that Diversity and Inclusion is elevated to a core value and a material fact for consideration through all SEC activities. The second, to promote business diversity practices among SEC registrants.
2. The SEC issues guidance and bulletins regularly for clarification or to address new initiatives. We suggest that the SEC issues guidance clearly discouraging the use of parameters for manager selection that have the impact of exclusion of minority-owned firms, and that the inclusion of diverse firms in a manager search is not a violation of one’s fiduciary duty. The importance of this cannot be overstated as many of the same participates who foster a closed financial system often do so under the shield of violating fiduciary duty.
3. Another recommendation relates to transparency where the SEC has clear authority-through ADV Disclosures (Uniform Application for Investment Adviser Registration). We suggest requiring additional demographic data of the work force of SEC-Registered Investment Advisers including (1) transparency of ownership; (2) transparency of workforce demographics that provide a window into gender and racial diversity at four levels: (a) ownership; (b) board level; (c) officer level; and (d) all employees.
4. We suggest enhancing the ADV Disclosure for consultants and asset allocators to provide sunlight on the consulting and selection process for RIAs (Registered Investment Advisor) with services or products including: (a) consulting on asset manager; (b) managing fund-of-funds; (c) services as manager-of-managers; and

(d) RIAs providing trustee services, where trustee responsibilities include selecting other managers/funds.

5. Despite stringent pay-to-play regulations currently, large assets managers have incredible access to policymakers providing the appearance of unfair bias particularly as it relates to managing Federal monies. Clearer guidance and better transparency would be helpful to all, including the investing public. At a minimum, we suggest to study whether modern political contribution practices have evolved to permissibly do indirectly, through mediums such as PACs and lobbyists, what pay-to-pay rules sought to prohibit directly. We suggest a thorough review of pay-to-play rules to ensure that they have not disadvantaged small firms, including diverse firms.
6. Presently, there is no avenue for a firm to bring forward discriminatory business practices by financial services companies, like the one I described earlier. We suggest the SEC develop a forum for complaints to be shuttled through the SEC to other appropriate Federal agencies.

After the recommendations passed unanimously by AMAC, I thought action would be taken quickly as a FACA committee was represented to all of us to be important. Our expectations were high since my committee, my staff and I personally spent hundreds of hours on this project creating a large record over 2 years of expert testimony, letters of support, research and the like. In fact, many of the individual commissioners have expressed support publicly in speeches and other comments on the record. Regrettably, after nearly 2 years, only two items were recently implemented and with minimal fanfare. The two are listed above as item 2, clarification that consideration of a diverse manager is not a violation of one's fiduciary duty, and item 6, where the SEC website will now allow discriminatory complaints to be shared on their website.

I have been extremely disappointed to date. As a reminder, the diverse community is not calling for any quotas nor any thumb to be paced on a scale. We just want a fair chance to compete and deliver superior performance to the investing public. All the remaining recommendations are material and relevant to the investing public. They are also part of today's modern-day civil rights movement, or what some of us call the financial civil rights movement. With the growing population of the minority community, the future of our Nation is intimately intertwined with the financial success of the minority community. All of us here have an incredible opportunity and history is on our side. Justice, transparency and the facts are on our side. So, I please urge you to support these recommendations and to unequivocally call for their immediate adoption. At a minimum, we deserve an open and transparent discussion by the SEC Commissioners as to why they are not being implemented.

Congressman John Lewis said "When you see something that is not right, not just, not fair, you have a moral obligation to say something. To do something. Our children will ask us 'What did you do? What did you say?'" We need to act so when our children ask us the questions in the future, we can tell them that we did THE RIGHT THING!

PREPARED STATEMENT OF THOMAS QUAADMAN

EXECUTIVE VICE PRESIDENT, CENTER FOR CAPITAL MARKETS COMPETITIVENESS, U.S. CHAMBER OF COMMERCE

DECEMBER 13, 2022

Chairman Menendez, Ranking Member Scott, and Members of the Subcommittee on Securities, Insurance, and Investment: my name is Tom Quaadman, executive vice president of the U.S. Chamber's Center for Capital Markets Competitiveness. Thank you for the opportunity to testify today regarding progrowth legislation and the importance of helping small businesses and entrepreneurs raise capital.

Over a decade ago, Members of this Committee and the House Financial Services Committee began working on a bipartisan basis on a series of capital formation initiatives intended to lower barriers to capital access for young businesses and improve the regulatory framework for businesses considering an initial public offering (IPO). These efforts eventually culminated in passage of the Jumpstart Our Business Startups (JOBS) Act, a bill that President Obama accurately described as a "game changer."

By just about any measure, the JOBS Act has been a success. The JOBS Act revived U.S. public listings and encouraged more companies to enter the public markets. In the 5 years preceding the JOBS Act, there were roughly 121 IPOs per year in the United States; from 2013–2021, the annual average was 344 per year.[1] The majority of these companies filed as emerging growth companies (EGCs) under Title I of the JOBS Act. In 2021, the IPO market in the U.S. hit an all-time high in terms of offerings, including roughly 400 traditional IPOs completed during that year.[2]

The JOBS Act also created opportunities for private and startup businesses to connect with investors. While some of these provisions—for example crowdfunding rules under Title III and the general solicitation rules under Title II—could benefit from further improvement, many businesses have been able to avail themselves of these new capital raising methods. Additionally, Title IV of the JOBS Act increased the threshold for companies to raise under Regulation A (Reg A) offerings. Since the initial JOBS Act was passed, Congress has subsequently passed (again on a bipartisan basis) further capital formation reforms, including provisions of the 2015 FAST Act[3] and the 2018 Economic Growth, Regulatory Relief, and Consumer Protection Act.[4]

It is important to keep in mind the context in which the JOBS Act was passed and draw parallels to today. Congress was concerned that a lack of capital access would have negative short and long-term consequences for our economy, and that job creation would suffer as a result. The report of the 2011 IPO Task Force—whose work contributed significantly to the JOBS Act—stated that: "The dearth of emerging growth IPOs and the diversion of global capital away from the U.S. markets—once the international destination of choice—have stagnated American job growth and threatened to undermine U.S. economic primacy for decades to come." The U.S. economy is again at a precarious moment, necessitating the need for Congress to prioritize progrowth legislation that will help create jobs and maintain the competitive edge of the United States in global capital markets.

Congress was compelled to pass the JOBS Act because the Securities and Exchange Commission (SEC) for years demonstrated a benign neglect towards its statutory mandate to "facilitate capital formation." Regrettably, the benign neglect once shown by the SEC has today become outright avoidance. Of the 53 items on the SEC's current rulemaking agenda, not a single one could conceivably be considered a capital formation initiative. Indeed, many of the rule proposals the SEC has issued over the last 18 months would impose new burdens on the economy and likely make it more difficult for small businesses to raise capital.

The SEC has also actively sought to undermine recent reforms that would have improved the regulatory environment for companies to go and stay public. For example, the SEC recently finalized a rulemaking that cripples reforms to the proxy advisory system the SEC adopted just 2 years ago. The SEC has also proposed rules to undermine reforms to the shareholder proposal system under Rule 14a-8 that were designed to protect investors from abusive practices by special interests. There is again an opportunity—and a need—for Members to work on a bipartisan basis to make capital formation a priority for the next Congress.

Much has been learned in the 10+ years since the JOBS Act was signed into law. We've learned that the JOBS Act boosted job creation and helped hundreds of businesses access the capital markets that otherwise may have stayed private or sold themselves to larger companies. We've learned that businesses and entrepreneurs have engaged with the SEC and Congress regarding capital formation ideas on a level not seen before. And perhaps most importantly, despite some of the dire predictions made 10 years ago, we've learned that barriers to capital can be lowered without compromising critical investor protections.

There's another reason why it's imperative for Congress to act on the capital formation agenda. It is well known that the United States capital markets are the deepest and most liquid in the world, creating a crucial advantage for our economy and contributing to its success. The competitive edge that the U.S. has in its capital markets cannot and must not be taken for granted. It is important, therefore, for Congress to act in a bipartisan fashion to address growing competition from other major markets around the globe to ensure we maintain that edge and the U.S. remains the premier location to pursue ideas and create jobs.

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[1] "Ten Years of the Jumpstart Our Business Startups (JOBS) Act of 2012: How the Law Spurred Capital Formation, and How Congress Can Build on Its Success". House Financial Services Committee Republican Staff Report, April 2022. Available at *https://republicans-financialservices.house.gov/uploadedfiles/jobs-act-at-10-report-final.pdf.*

[2] "A Record Year for IPOs in 2021". Phil Mackintosh (Nasdaq) Available at *https://www.nasdaq.com/articles/a-record-year-for-ipos-in-2021.*

[3] Division G-2015 Fixing America's Surface Transportation Act (Pub. L. 114-94).

[4] Title V-2018 Economic Growth, Regulatory Relief, and Consumer Protection Act (Pub. L. 115-174).

The Importance of Public Companies to Job Growth and Investor Opportunity

The Chamber has long held concerns about the secular decline in U.S. public companies over the last 25 years. When more companies access public markets, more jobs are created and overall economic growth increases. Past research has shown the vast majority of a company's job creation occurs after an IPO, while a recent study estimates that companies that go public double their employment by the second post-IPO year relative to firms that withdraw an offering and remain private. [5]

The report accompanying the initial House version of the JOBS Act noted:

> The President's Council on Jobs and Competitiveness found that if the U.S. had maintained its 2007 level of start-up activity, nearly two million more Americans would be working today. Research indicates that 90 percent of the jobs that companies create are created after their IPO . . . Small companies are critical to economic growth in the United States. In order to grow and create jobs, small companies must have access to capital. [6]

Another recent study estimated the positive impact that the JOBS Act has had on the biotechnology industry and its workers. The study found that from 2012 to 2018, biotechs made up roughly 40 percent of all U.S. IPOs, and that these companies expanded their workforce by an average of 150 percent in the first 3 years following the IPO. The relationship between IPOs and job creation is incontrovertible. [7]

Increasing the number of public companies also benefits the millions of households in America who depend on robust public markets to make investments for retirement, higher education, or other financial goals. Since the SEC's accredited investor rules restrict the vast majority of Americans from participating in private offerings, the public markets are typically the only way for individuals to invest their savings. When options in these markets are limited and companies are disincentivized from going public due to regulatory costs, Main Street investors can be harmed.

A 2022 report from the American Council for Capital Formation (ACCF) estimated that there are currently roughly 800 fewer companies traded on U.S. exchanges due to the high regulatory cost of going public. [8] This public company "gap" has hurt job creation in particular. Specifically, the ACCF report found:

- There were at least 800 fewer U.S. companies traded on major U.S. exchanges at the end of 2019 because of mandatory reporting requirements. Because they have a significant initial fixed cost, mandatory reporting requirements primarily contribute to a reduction in IPOs.
- The median U.S. company that would have been public—but is now, instead, private—is estimated to have 650 workers. Across the approximately 800 fewer public companies in 2019, this amounts to more than 500,000 workers.
- The median U.S. company that would have been public—but is now, instead, private—is estimated to have nearly $300 million in revenue. Across the approximately 800 fewer public companies in 2019, this amounts to upwards of $250 billion in revenue.
- The median U.S. company that would have been public—but is now, instead, private—is estimated to have over $750 million in market capitalization. Across the approximately 800 fewer public companies in 2019, this amounts to nearly $600 billion in market capitalization.
- More costly reporting requirements could be expected to reduce the number of public companies. The ACCF analysis estimates that a 10 percent increase in reporting requirement cost over the 2000–2019 period would have reduced the number of U.S. companies traded on major exchanges further by 80 companies, with a combined 51,000 employees, $60 billion in revenue, and over $23 billion of market capitalization.

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[5] "Access to Public Capital Markets and Employment Growth" (A. Borisov, A. Ellul, M. Sevilir) May 2021. Available at *https://papers.ssrn.com/sol3/papers.cfm?abstract-id=2178101.*

[6] H. Rept. 112-406—"Reopening American Capital Markets to Emerging Growth Companies Act of 2011", available at *https://www.congress.gov/congressional-report/112th-congress/house-report/406/1.*

[7] "Deregulating Innovation Capital: The Effects of the JOBS Act on Biotech Startups", Vanderbilt Owen Graduate School of Management Research Paper (C. Lewis, J. White) December 7, 2021, available at *https://ssrn.com/abstract=3640852.*

[8] "The Declining Number of Public Companies and Mandatory Reporting Requirements". Ernst & Young, prepared for the American Council for Capital Formation (June 2022) Available at *EY-ACCF-The-declining-number-of-public-companies-and-mandatory-reporting-requirements-June-2022.pdf.*

Other recent research looked at the relationship between financial reporting directives in the European Union and innovation by small businesses. This research—conducted by Matthias Breuer (Columbia Business School), Christian Leuz (Chicago Booth School of Business) and Steven Vanhaverbeke (Erasmus University)—found that the more businesses spent to comply with financial reporting mandates, the less they spent on innovation.[9] The researchers noted that compliance burdens also disproportionately impact small business, "thereby concentrating innovation spending among a few large firms." Congress would be wise to heed this evidence from Europe as the SEC pursues new and unprecedented corporate reporting requirements.

The Need for a "JOBS Act 4.0"

For several years, the Chamber has been at the forefront of the policy conversation regarding the JOBS Act and further capital formation proposals. In 2018, the Chamber led a joint organizational effort to produce 22 recommendations to build upon the success of the JOBS Act—a number of which have already been signed into law or implemented by the SEC.[10] The Chamber also released our "Growth Engine" report in November 2020, which includes additional proposals and is our roadmap for broadly revitalizing financial markets.[11] That report includes recommendations for policies related to closing the racial wealth gap, corporate governance reforms, financial stability requirements, consumer credit, and capital formation for small businesses.

The Chamber commends the many Members of the Senate Banking Committee whose efforts are included as part of the "JOBS Act 4.0" package that was released earlier this year. As we noted in a June 2022 letter, we support several of the provisions contained in that legislation and urge the House and Senate to take them up in the new Congress. As with the initial JOBS Act and subsequent iterations, we believe many of these proposals can be taken up with strong bipartisan support.

Additionally, the Chamber also commends the work of Sen. Scott—along with Sen. Booker, Rep. Kind, and Rep. Kelly, and other bipartisan members—for introducing the Opportunity Zones Transparency, Extension, and Improvement Act earlier this year. The investments made through opportunity zones are critical to help many underserved communities bounce back from the pandemic and to navigate through an uncertain economic period. The Opportunity Zones Transparency, Extension, and Improvement Act is an important step towards progress on these goals and the Chamber looks forward to working with members on both sides of the aisle to get the bill signed into law.

Securities Litigation Reform

As noted in our June 2022 letter to the Banking Committee, the Chamber hopes that, in addition to the provisions currently included in JOBS Act 4.0, Congress will take up long overdue reforms to securities litigation. The frequent filing of frivolous and questionable securities fraud claims harms investors and undermines the integrity and reliability of the U.S. capital markets.

In 1995, Congress moved to crack down on repeat, professional plaintiffs that filed frivolous securities fraud class actions, often for cash kickbacks, by adopting the Private Securities Litigation Reform Act (PSLRA). In 1998, Congress subsequently made additional reforms in the Securities Litigation Uniform Standards Act (SLUSA). Unfortunately, research has shown that professional plaintiffs, both individual and institutional, are still taking advantage of loopholes in Congress' securities litigation reform regime, including the PSLRA and SLUSA.[12] This harms shareholders on both sides of the lawsuits: those that ultimately pay for the litigation costs and lawyers' fees, and those that receive little or no benefit when the lawsuit ends.

Building off the discussion in our June 2022 letter, to close off these loopholes, Congress could craft legislation to:

[9] "Mandated Financial Disclosure Leads to Fewer Innovative Companies". Martin Daks, *Chicago Booth Review* (June 6, 2022) Available at *https://www.chicagobooth.edu/review/mandated-financial-disclosure-leads-fewer-innovative-companies.*

[10] "Expanding the On-Ramp: Recommendations To Help More Companies Go and Stay Public". Joint report from U.S. Chamber, Biotechnology Innovation Organization, American Securities Association, National Venture Capital Association, Securities Industry and Financial Markets Association, TechNet, Nasdaq. Available at *IPO-Report—EXPANDING-THE-ON-RAMP.pdf* (centerforcapitalmarkets.com).

[11] Available at *https://www.uschamber.com/assets/documents/ccmc-growthengine-final.pdf.*

[12] U.S. Chamber Institute for Legal Reform: Frequent Filers Revisited: Professional Plaintiffs in Securities Class Actions (April 2022), available at: *https://instituteforlegalreform.com/research/frequent-filers-revisited-professional-plaintiffs-in-securities-class-actions/*.

- Ensure cases are heard in Federal court. Congress should make clear that actions filed under the Securities Act of 1933 are required to be heard in Federal court just like cases filed under the 1934 Act.
- Broaden limits on repeat filers. Much of filed securities litigation is brought by serial plaintiffs that are usually dismissed and result in no benefits to shareholders, just a payment to the plaintiff and their attorneys. The PSLRA prohibits individual shareholders from acting as lead plaintiffs in more than five class actions in a 3-year period, yet this limitation is avoided when claims are settled or dismissed before appointment of a lead plaintiff or by filing as an individual action. The prohibition should instead prevent shareholders from filing more than five lawsuits in a 3-year period. Any waivers of this limit in the class action context, such as for large institutional investors, should also be based on demonstrated results for class members in previously filed suits, rather than the de facto automatic waiver that typically occurs in most of these cases.
- Correct the mechanism for determining lead plaintiffs and determining attorney's fees. Rather than allowing lawyers to control cases at the expense of class members, courts should be required to disqualify lawyers who provide payments or legal services that would give the lawyers leverage over their clients. Furthermore, courts should look at fee agreements with plaintiff's counsel and how much of the recovery would go to attorneys' fees and then making clear that unjustified or excessive fee requests should be rejected.
- Increase Transparency. The PSLRA should also be improved by requiring disclosure of (1) any attorney payments to plaintiffs outside of their pro rata share of the recovery so any incentive payments will come to light, (2) the nature of the attorney's representation of the plaintiff outside of the current lawsuit before a court to reveal collaboration between serial filers and the law firms that enable this practice, (3) the presence of any third party litigation funding in the case, and (4) any contributions to elected officials with authority to retain counsel in these cases.

JOBS Act 4.0 Recommendations

The Chamber is pleased to support the following bills, a number of which have already been considered in the House or Senate in previous Congresses. While this is not an exhaustive list of ideas and legislation that the Chamber supports, it represents some of the priorities that the Chamber has worked closely on with policymakers for several years.

Improvements to the JOBS Act

Helping Startups Continue to Grow Act—S. 4992/H.R. 3448

This bill would allow emerging growth companies (EGCs) to continue operating under certain JOBS Act exemptions for an additional 5 years. The vast majority of EGCs have taken advantage of the options to (1) Streamline financial disclosure; (2) Confidential reviews of registration statements by SEC staff; and (3) An exemption from certain executive compensation requirements. Extending the IPO "on-ramp" an additional 5 years would allow these businesses to dedicate further resources towards hiring and growth.

The Crowdfunding Amendments Act (H.R. 4860–116th Congress)

The legislation would address some of the unnecessary compliance burdens that currently exist under the SEC's crowdfunding rules by allowing for the use of "crowdfunding vehicles" and also exempting securities issued in crowdfunding offerings from registration requirements under the Securities Exchange Act of 1934.

Improving Crowdfunding Opportunities Act (S. 3967)

This bill would create legal certainty for businesses looking to crowdfund by preempting State regulation of secondary transactions involving crowdfunding vehicles and also clarifies the legal liability that applies to crowdfunding portals. These changes would help Title III of the JOBS Act achieve its intent and make crowdfunding a more a more viable path to capital-raising for certain businesses.

Public Company Registration Threshold Act (H.R. 5051–115th Congress)

The legislation would increase from 500 to 2,000 the number of nonaccredited shareholders a company may have before being required to register with the SEC. This legislation would build on the 2012 JOBS Act, and would help many companies, including companies that raise money through crowdfunding and the private markets, avoid having to undergo costly registration with the SEC.

The SEC should continue to examine develop recommendations for how to increase research coverage of pre-IPO companies and small capitalization companies. Congress should pass S. 3965, the Increasing Access to Adviser Information Act.

In 2020, Congress passed legislation requiring the SEC to examine and report on the reasons why there is an ongoing dearth of research coverage for small public companies. The SEC was also required to produce recommendations to increase research coverage. However, when the SEC staff issued its report in February 2022, its only tangible recommendation was to study the issue further.

Obtaining research coverage is critical to enhance institutional and retail investor interest in a company. Studies have shown that nearly two-thirds of companies with less than $100 million do not have any research coverage at all.[13] The Global Research Analyst Settlement, the EU's Markets in Financial Instruments Directive II (MiFID II), and certain aspects of JOBS Act implementation have all contributed to a decline in analyst coverage. Additionally, while changes made to the Securities Act to liberalize the "gun-jumping" rules to permit investment banks to publish pre-IPO research on EGCs (Sec 2(a)(3)), very few investment banks have published any pre-IPO research.

At a minimum, Congress should pass S. 3965, the Increasing Access to Adviser Information Act which would allow brokers to receive "soft dollar" payments for research without having to register as investment advisers. This bill is even more necessary given the sudden decision by SEC staff this past summer to terminate a no-action position the SEC has taken for several years regarding MiFID II and soft dollar payments.

Corporate Governance

Reestablish effective oversight of proxy advisory firms and reforms to the shareholder proposal system

Despite being plagued by conflicts of interest, a lack of transparency, and significant errors in voting recommendations, proxy advisory firms continue to carry a significant amount of influence over corporate governance at America's public companies. The two dominant proxy firms—Institutional Shareholder Services (ISS) and Glass Lewis—control roughly 97 percent of the proxy advisory industry, constituting a duopoly that has become the de facto standard setter for corporate governance in the U.S. without any meaningful input from shareholders or issuers. The status quo has created distortions in the capital markets and has made it more difficult for companies to go and stay public.

In July 2020, the SEC adopted a rule that provided investors using proxy voting advice more transparent, accurate, and complete information, along with supplemental guidance regarding proxy voting responsibilities of investment advisers. The rule codified the SEC's longstanding position that proxy advice is generally a "solicitation" under SEC rules and reaffirms that the antifraud provisions under Exchange Act Rule 14a-9 apply to proxy advisory firms. Findings from previous Chamber/Nasdaq proxy season surveys show public welcomed several aspects of the 2020 reforms, specifically the ability to "review and comment" on draft proxy advisory firm recommendations.

The SEC also adopted meaningful reforms to the shareholder proposal process under Rule 14a-8 in 2020. The SEC reforms raised the "resubmission thresholds" that determine when a proposal which previously garnered low submitted can be submitted in a subsequent year and required greater transparency and disclosure from shareholder proponents. These reforms were well-calibrated to preserve the ability of shareholders to submit proposals while protecting against some of the abuses that have increasingly plagued this system.

Unfortunately, the SEC recently decided to gut the 2020 proxy advisor reforms before those rules even went into effect. The SEC has also proposed changes to Rule 14a-8 that will likely lead to an increase in proposals that deal with immaterial social and political matters and will do little or nothing to enhance shareholder value. These efforts by the SEC will create further disincentives for companies considering an IPO.

The Chamber welcomes the inclusion of S. 3945, the Restoring Shareholder Transparency Act as part of the JOBS Act 4.0 package. This bill would restore some of the important guardrails of the 2020 Rule 14a-8 SEC reforms and allow businesses to focus on long-term strategy and shareholder value rather than getting bogged down in social and political debates that are pushed by special interests.

Modernizing Corporate Disclosure

Repealing immaterial and harmful disclosure mandates/Dodd-Frank Material Disclosure Improvement Act (S. 3923)

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[13] "Capital Formation, Smaller Companies, and the Declining Number of Initial Public Offerings"—Jeffrey Solomon, President of Cowen. (Presentation before the SEC Investor Advisory Committee) June 22, 2017, available at *https://www.sec.gov/spotlight/investor-advisory-committee-2012/jeffrey-solomon-presentation.pdf.*

For more than eight decades, materiality has been the lodestar of the public company disclosure regime under the Federal securities laws. The longstanding materiality standard—namely, what is important to a reasonable investor focused on investment returns—has instilled in investors and issuers alike a confidence in the accuracy and integrity of information that promotes market efficiency, competition, liquidity, and price discovery.

In 1975, the SEC described its views on materiality, noting: "As a practical matter, it is impossible to provide every item of information that might be of interest to some investor in making investment and voting decisions. [C]ertain types of disclosure might be so voluminous as to render disclosure documents as a whole significantly less readable and, thus, less-useful to investors generally. In addition, disclosure to serve the needs or desires of limited segments of the investing public, even if otherwise desirable, may be inappropriate, since the cost to registrants, which must ultimately be borne by their shareholders, would be likely to outweigh the resulting benefits to most investors."

In recent years, however, a variety of groups have zeroed in on SEC disclosures by pressing for new mandatory disclosure requirements to advocate for social and political change. While these may be important causes, they are not material to investors and their voting decisions. Unfortunately, the Dodd-Frank Act included a number of nonmaterial disclosure requirements for public companies and new legislation is often introduced in Congress requiring public companies to disclose information that is not material to investors.

Congress should pass S. 3923, which would repeal costly and immaterial disclosures mandates under the Dodd-Frank Act, including the conflict minerals, pay ratio, mine safety, and resource extraction disclosures.

Mandatory Materiality Requirement Act of 2022 (S. 5005/H.R. 9408)

This bill would codify the materiality standard expressed by the Supreme Court in 1976 into law and prohibit the SEC from mandating disclosure requirements that are outside the scope of the securities laws or are intended to promote objectives which are at odds with the interests of the vast majority of investors. This legislation is especially important given the unprecedented nature of the SEC's current agenda and efforts to prescriptively expand corporate disclosure on several topics including climate change, cybersecurity, human capital management, and others. The Chamber is hopeful that this bill will be included as part of JOBS Act 4.0 discussions in the coming months.

Simplify quarterly reporting requirements for public companies/Modernizing Disclosures for Investors Act (S. 3919 / H.R. 3454)

According to the 2011 report of the IPO Task Force, 92 percent of public company CEOs said that the "administrative burden of public reporting" was a significant challenge to completing an IPO and becoming a public company. As annual (10-K) and quarterly(10-Q) reports have grown in size and complexity over the years, companies find it increasingly difficult and costly to maintain compliance with a 1930's-style disclosure system. The length of annual and quarterly reports also has the potential to make it more difficult for investors to determine the most salient information about a business.

H.R. 3454 (Modernizing Disclosures for Investors Act) and S. 3919 (Reporting Requirements Reduction Act) would provide alternative means for public company quarterly reporting. H.R. 3454 would allow for quarterly reports to be issued through alternative methods (e.g., a press release) while S. 3919 would allow issuers to elect to report results semi-annually rather than quarterly. These approaches would reduce the overall cost of corporate reporting for investors while still requiring that material information be made public.

Improving Access to Capital for Businesses

Developing and Empowering our Aspiring Leaders (DEAL) Act of 2022 (S. 3914/H.R. 4227)

Registered Investment Adviser (RIA) rules promulgated by the SEC have disincentivized some venture capital funds from investing in Emerging Growth Companies (EGCs). The 2010 Dodd-Frank Act sought to exempt venture capital funds from the costs and challenges associated with becoming an RIA. However, the definition of "venture capital fund" promulgated by the SEC pursuant to Dodd-Frank was too narrow and did not meet the Dodd-Frank statutory obligations of a full venture capital exemption. The current definition ignores critical elements and developments related to the venture capital industry, including growth equity firms which can often be investors in EGCs around the time they are considering a public offering. Shares of EGCs, including the purchase of EGC shares on the secondary market, should be considered qualifying investments. Creating a more accurate venture capital exemption definition—which the DEAL Act would do—will expand the pool of possible investors for EGCs.

Access to Small Business Investor Capital Act (S. 3961/H.R. 5598)

The legislation would permit funds that invest in businesses development companies (BDCs) to disclose their acquired fund fees and expenses (AFFE) as a footnote to their prospectus fee table. The SEC adopted the AFFE rule in 2006 as a means to provide greater transparency regarding fund expenses, but in practice it has become a fundamentally misleading disclosure for funds that invest in BDCs. The AFFE rule has led to the exclusion of BDCs from certain indices which in turn has caused an outflow of investment dollars by institutions. Passage of this bill will increase institutional investment in BDCs, which are a critical source of nonbank financing for small and middle market companies throughout the country.

Small Entrepreneurs' Empowerment and Development (SEED) Act of 2022 (S. 3939)

This legislation would provide an exemption from State and Federal registration requirements for "micro" offerings that do not exceed $500,000 in the aggregate. This would benefit entrepreneurs who are looking to raise relatively small amounts of capital and cannot afford costly legal and registration requirements. Importantly, this bill also contains provision that would prevent bad actors from participating in such offerings.

Expanding American Entrepreneurship Act (S. 3976)

This bill would increase the number of investors and assets an angel fund may have without having to comply with costly SEC regulations. Funds would be permitted to have up to 500 investors and $50 million in assets (Up from 250 investors and $10 million currently). This bill would expand the pool of potential investors and capital available for early-stage angel investments and help provide funding for the next generation of innovative American businesses.

Equal Opportunity for All Investors Act (S. 3921)

An accredited investor is an individual who is permitted to trade securities that may not be registered with the SEC. Securities in early-stage, nonpublic companies, have a significant potential for growth, but are also considered to be higher-risk. The accredited investor definition is intended to limit investors from participating in this market.

Traditionally, the accredited investor threshold has been determined through asset and income tests, which have resulted in both an under- and over-inclusive outcomes. The definition leaves out sophisticated and savvy investors who may not meet financial thresholds while including a wealthy person with no experience in financial markets.

In August 2020, the SEC finalized a rule expanding the definition of "accredited investor" to include more individual investors, such as those with professional qualifications in the financial industry. S. 3921 would further expand the definition of accredited by allowing an individual to become accredited regardless of income status, and also allowing any individual to invest up to 10 percent of their income in a Reg D offering. The bill would also allow for self-certification of accredited status under Rule 506(c) which would improve the likelihood that businesses conduct "general solicitation" offerings that were permitted by the JOBS Act.

Small Business Audit Correction Act (Sec. 301 of JOBS Act 4.0)

The legislation would exempt privately held noncustodial brokerage firms from a requirement to have a Public Company Accounting Oversight Board (PCAOB)-registered firm conduct their annual audit. Small broker-dealers are often important sources of capital for startups or small businesses around the country, and there is no compelling reason to subject them to an audit process that is more fitting of a large company.

Amend Form S-3 to eliminate baby-shelf restrictions and allow all issuers to use Form S-3 (Accelerating Access to Capital Act, H.R. 4529, 115th Congress)

Forms S-3 and F-3—commonly referred to as "shelf registration" forms—are the most simplified registration forms that a company can file with the SEC, and typically bring significant cost savings for those companies that are eligible to use one or the other. However, EGCs and many small issuers are prohibited from using these forms which leads to increased reporting and compliance costs that do not promote investor protection. The SEC's Annual Government-Business Forum on Small Business Capital Formation has recommended over the past several years that all issuers become eligible for use of Forms S-3 and F-3. The Accelerating Access to Capital Act would permit all companies to use a shelf registration statement without a limit on the amount they can raise, which would significantly improve the capital formation process for small public companies.

The Expanding Access to Capital for Rural Job Creators Act (S. 3503/H.R. 5128)

The legislation would expand the focus of the Office of the Advocate for Small Business Capital Formation at the SEC to include ways to increase capital access for rural small businesses. The legislation would help ensure that rural areas receive due consideration during any future SEC rulemaking process.

Gig Worker Equity Compensation Act (S. 3931/H.R. 2990)

The legislation would expand the pool of workers who can receive equity compensation under the SEC's Rule 701 to include independent contractors and "gig" economy workers. Rule 701 exempts certain sales of securities made to compensate employees, consultants, and advisors.

On November 24, 2020, the SEC proposed temporary rules that would permit an issuer to provide equity compensation in certain "platform workers" who provide services available through the issuer's technology-based platform or system. This proposed rule was a step in the right direction, given it recognized the challenges for the gig economy, but was never finalized. The Chamber looks forward to working with members on both the House and Senate version of these bills in the next Congress.

A 2016 report from the Economic Innovation Group found that half of all post-recession business creation in the U.S. occurred across only 20 counties, and that many rural areas have not seen expected economic growth since the 2008 financial crisis. This bill is an incremental but important step that would focus the SEC on the needs of businesses in rural communities.

Congress should direct the SEC small business advocate to develop recommendations for how to help minority-owned businesses raise capital

Black entrepreneurs are nearly three times more likely than White entrepreneurs to have business growth and profitability negatively impacted by a lack of financial capital. Congress should initiate a formal process through the SEC to develop recommendations for changes in existing law and regulations that would improve access to capital for minority-owned businesses. This process could be conducted through the SEC's Office of the Advocate for Small Business Capital Formation by prioritizing outreach to minority-owned businesses to understand their financial needs and by working with financial companies to understand what public policy barriers stand in the way of providing capital.

Small Business Mergers Acquisitions, Sales, and Brokerage Simplification Act (S. 3391 / H.R. 935)

The legislation would simplify SEC registration requirements and provide a safe harbor for certain financial professionals who assist small and mid-size businesses that are looking to transfer corporate ownership. Importantly, the legislation also includes strong investor protections such as requiring the disclosure of relevant information to clients as well as the owners of eligible privately held companies. The bill does not impede in any way on the ability of the SEC to crack down on bad actors, or to prohibit past securities law violators from taking advantage of the exemption.

Secondary Market Trading Reforms

Main Street Growth Act (S. 3097/H.R. 5795)

While the JOBS Act did a great deal to help EGCs raise capital in primary offerings, it did comparatively little to address the secondary market trading in these companies. The Main Street Growth Act provides the legal framework for the establishment of venture exchanges, which would remedy this issue by providing a tailored trading platform for EGCs and stocks with distressed liquidity. Companies that choose to list on a venture exchange would have their shares traded on a single venue, thereby concentrating liquidity and exempting these shares from rules that are more appropriate for deeply liquid and highly valued stocks. Venture exchanges would also be afforded the flexibility to develop intelligent "tick sizes" that could help incentivize market makers to trade in the shares of companies listed on the exchange. Importantly, both the creation of the venture exchange and the decision to list on such an exchange should be completely optional—companies should be allowed to choose whether not to list on a venture exchange.

The Chamber also welcomes S. 3947, the Intelligent Tick Study Act, as part of JOBS Act 4.0 This legislation would require the SEC produce a study and recommendations related to the widening of "tick sizes" for small issuers in order to improve liquidity and trading efficiency for investors.

Restoring Due Process

Right of removal to an Article III court/S. 3930, Administrative Enforcement Fairness Act of 2022

Since passage of the Dodd-Frank Act, the SEC has been permitted to bring a greater number of enforcement cases before through administrative proceedings as opposed to Article III courts. Administrative proceedings lack the fundamental due process and Constitutional protections of the Federal court system and not subject to the Federal Rules of Evidence or the Federal Rules of Civil Procedure.

The Chamber has supported for several the right of respondents in SEC cases to have their cases heard before a Federal court. We have supported legislation in the House (Due Process Restoration Act, and appreciate the inclusion of S. 3930 in JOBS Act 4.0) Businesses and investors must have confidence that the SEC operates in a fair manner when bringing enforcement actions—this legislation will help provide that confidence by reinforcing the due process rights of respondents.

Stress Test Reforms

Alleviating Stress Test Burdens To Help Investors Act (Sec. 407 of JOBS Act 4.0)

The Chamber has long argued against the misguided application of bank-centric regulation and supervision of nonbank companies. The professional staff of the Securities and Exchange Commission has concurred. In 2016, the SEC Chief Economist described how the application of stress tests to asset managers was premised on a "false parallel." This legislation would remove that misguided regulation and reduce unnecessary regulatory cost.

Conclusion

Thank you again for the opportunity to testify on these critical issues and legislative proposals. The Chamber looks forward to working with both Republicans and Democrats on capital formation and progrowth initiatives in the coming months.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CORTEZ MASTO FROM GILBERT ANDREW GARCIA

Q.1. *Federal Tax Incentives Incent DEI Investments*—How have Federal investments such as the New Markets Tax Credit and the Opportunity Zones tax credit provided incentives to investors to consider businesses and communities that are frequently overlooked by the investment market?

A.1. Senator, I am not familiar with these credits and am unable to comment.

Q.2. Do you have information on Opportunity Zones investment in Nevada? If so, please provide it.

A.2. No, I do not have any information on Opportunity Zones investment in Nevada.

Q.3. *Franchise Businesses*—Last year, I published a report raising concerns about some franchise business practices.[1] My report found numerous deceptive practices that harmed immigrants and veterans.

What actions do you recommend franchise corporations, Congress, the Federal Trade Commission, the Small Business Administration, and State governments take to increase investor protections for franchise owners?

A.3. I am not familiar with franchise corporation business practices; however, more transparency is always beneficial.

Q.4. *Discrimination in Opportunity*—Do you think some women and people of color have decided to mask their identities when trying to access capital and business opportunities?

A.4. Yes. Regrettably, many women and people of color mask their identities in various ways while attempting to access capital and business opportunities. Some alter, change, or use a generic, vanilla name in order to hide their minority/gender status. Others often refuse to apply for an MWBE certification to prevent being "boxed in" or labeled out of concern that an MWBE certification will limit their growth.

Also, many certification processes are extremely time consuming, highly intrusive personally and incredibly bureaucratic. It would be great if we had one Federal certification process that would have reciprocity with State and local agencies.

Q.5. Do you have any insight into how prevalent these practices to avoid discrimination are?

A.5. I only have anecdotal experience that it is widespread.

Q.6. State business laws has not historically accounted for gendered discrimination. Instead, it tends to rely on gender-neutral fiduciary principles. Do you agree with Ann Lipton's paper at Tulane University, alleging that gender-neutral fiduciary principles can result in substantial inequity?[2]

A.6. I am unfamiliar with Ann Lipton's paper.

[1] "Strategies To Improve the Franchise Model: Preventing Unfair and Deceptive Franchise Practices". April 2021. *https://www.cortezmasto.senate.gov/imo/media/doc/Franchise%20Report%20from%20the%20Office%20of%20Senator%20Cortez%20Masto.pdf*

[2] *https://papers.ssrn.com/sol3/papers.cfm?abstract—id=3882274*

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARNOCK FROM GILBERT ANDREW GARCIA

Q.1. In your testimony, you referenced a study that analyzed the percentage of assets that were managed by diverse-owned firms within the U.S. based asset management field, which found that only 1.1 percent of the $71.4 trillion in assets were managed by diverse-owned firms. I find that number shockingly low and demonstrates that while there may be efforts to hire diverse candidates at junior level positions, a majority of the power in the industry still severely lacks diversity. Do you believe programs like Seizing Every Opportunity (SEO) help with this issue, specifically when it comes to pushing diverse candidates into more senior roles? Why do you believe barriers continue to exist between diverse candidates and more senior roles?

A.1. SEO has singlehandedly changed the face of Wall Street. As you may know Senator, I am an SEO alum (1983) and am the longest serving member of the Board of Directors (1988). Despite our great work, it has been extremely difficult for minorities, including our alums, to reach the upper levels management. Large financial institutions have no incentive to increase transparency nor to make Diversity & Inclusion a core value, a measurable statistic to track, nor a key component to senior management compensation. Barriers exist because of outright ignorance and overt racism. Furthermore, barriers exist to achieve and justify desired end results. Our firm has experienced many degrees of racism.

Q.2. There are many studies that show firm diversity is not only the right thing to do, but also good for business. For example, a Boston Consulting Group study found that “diverse management teams have 19 percent higher revenues due to innovation.”[1] If there are such clear benefits to firm diversity, why do we see such a lack of progress? What can Congress do to address this issue?

A.2. Please see my above answer for some of the reasons.

As I mentioned in my testimony, we could accelerate transparency, increase opportunities for people of color, begin closing the wealth gap in our country, while providing better returns to the investing public. This could all be accomplished if the SEC would openly discuss and successfully vote on the AMAC Committee’s (and Diversity & Inclusion Sub-Committee’s) recommendations.

We spent over 2 years interviewing expert witnesses, reviewing research papers and developing a clear track record and roadmap for the Commissioners to consider. We were careful to work with SEC legal staff to prevent any challenges from developing that would prohibit the implementation of our final recommendations. We also made sure we stayed within the SEC’s purview by highlighting that the recommendations were both material and, in the public’s best interest. We urge the Congress to insist that the SEC adopt all recommendations or at least shine transparency as to why they object to their implementation.

Q.3. Do you believe shareholders are widely aware of the financial advantages of diversity? If not, would further educating the public

[1] *https://www.bcg.com/publications/2018/how-diverse-leadership-teams-boost-innovation*

and investors on this issue encourage more firms to prioritize diversity?

A.3. No, I do not believe shareholders are widely aware of the financial advantages of diversity.

Educating the public would be helpful but it would be an extremely slow process before any meaningful results would be felt. The Country cannot wait!

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SCOTT FROM THOMAS QUAADMAN

Q.1. As you know, strong, competitive, and accessible capital markets are essential for a healthy U.S. economy. They make it easier for companies to spur innovation, hire new workers, and invest in their communities.

Just over 30 years ago, less than one-third of American families owned any stocks. Today, over half of U.S. families are actively participating in and accessing U.S. capital markets. These markets are one of the most powerful and transformative drivers of economic growth, job creation, and wealth accumulation. They are the gold standard and envy of the world.

What are your recommendations for lawmakers to build upon the progress achieved in recent decades to further broaden retail investment opportunities and facilitate capital formation?

A.1. The Chamber deeply appreciates Congress' work to address barriers to economic growth. In 2012, Jumpstart Our Businesses (JOBS) became law. Congress was concerned that a lack of capital access would have negative short and long-term consequences for our economy, and that job creation would suffer as a result. The U.S. economy is again at a precarious moment, necessitating Congress to prioritize progrowth legislation that would help create jobs and maintain the competitive edge of the United States in global capital markets.

These markets are key for economic stability and mobility for Americans, and the Chamber agrees that the power of these markets can be unleashed to drive opportunity for those who have traditionally been underrepresented.

To help address these challenges, the Chamber has a series of recommendations that lawmakers and policymakers can follow. In 2018, the Chamber released a report with extensive recommendations to Congress—many on a bipartisan basis—that would help more companies go and stay public. [1] Additionally, we recently sent a letter to the Securities and Exchange Commission (SEC) detailing how the agency could complement Congress's efforts to examine these issues. [2] As provided in written testimony, the Chamber has also identified a number of commonsense reforms to securities litigation that would help strengthen the integrity and reliability of U.S. capital markets. [3]

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[1] *https://www.centerforcapitalmarkets.com/wp-content/uploads/2018/04/IPO-Report-EXPANDING-THE-ON-RAMP.pdf*

[2] *https://www.uschamber.com/co/start/strategy/types-of-franchise-businesses*

[3] *https://www.centerforcapitalmarkets.com/wp-content/uploads/2023/01/20221209-Testimony-CapitalMarketsDiversity-SenateBanking-PDF-Final-1.pdf?#*

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CORTEZ MASTO FROM THOMAS QUAADMAN

Q.1. *Federal Tax Incentives Incent DEI Investments*—How have Federal investments such as the New Markets Tax Credit and the Opportunity Zones tax credit provided incentives to investors to consider businesses and communities that are frequently overlooked by the investment market?

A.1. The New Markets Tax Credit and Opportunity Zones both lower the cost of investing in certain areas. They do so by lowering the effective tax rate investors pay on the returns they earn for investing in those areas. A lower tax rate lowers the cost of the investment and thereby raises the after-tax return. Higher returns will lead to more investment than would have occurred without the tax incentives in the areas that qualify for them. The New Markets Tax Credit and Opportunity Zones, by their design, lower taxes for investment in diverse communities, leading to more investment in those places. While it is highly likely more investment is flowing to these areas because of the incentives, the size of the effect is up for debate. It can be measured through an economic analysis. Congress can conduct such an analysis to determine how much these incentives are increasing investment in targeted areas.

Q.2. Do you have information on Opportunity Zones investment in Nevada? If so, please provide it.

A.2. The Economic Innovation Group has been and continues to be one of the best resources for data on Opportunity Zones.

Q.3. *Franchise Businesses*—Last year, I published a report raising concerns about some franchise business practices.[1] My report found numerous deceptive practices that harmed immigrants and veterans.

What actions do you recommend franchise corporations, Congress, and the Federal Trade Commission, the Small Business Administration, and State governments take to increase investor protections for franchise owners?

A.3. The U.S. Chamber of Commerce appreciates the work of Senator Cortez Masto's staff to produce such a report and would be pleased to engage with the Senator and staff to discuss the issues identified. We have created resources to help entrepreneurs understand the franchise model and make informed choices.[2] [3]

Q.4. *Discrimination in Opportunity*—Do you think some women and people of color have decided to mask their identities when trying to access capital and business opportunities?

A.4. Lack of access to capital is a significant problem for many entrepreneurs but is especially acute for entrepreneurs of color and women. Following the model of the successful 2012 JOBS Act, Congress should initiate a formal process through the SEC to develop recommendations for changes in existing law and regulations that

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[1] Strategies To Improve the Franchise Model: Prevent Unfair and Deceptive Franchise Practices. April 2021. *https://www.cortezmasto.senate.gov/imo/media/doc/Franchise%20Report%20from%20the%20Office%20of%20Senator%20Cortez%20Masto.pdf*

[2] *https://www.uschamber.com/co/start/strategy/how-to-choose-a-franchise*

[3] *https://www.uschamber.com/co/start/strategy/types-of-franchise-businesses*

would improve access to capital for Black-owned businesses, particularly.

To provide Black and other underrepresented communities with greater exposure to potential funding opportunities, local, State, and national business associations should create "pitch" competitions that provide Black and other underrepresented communities with opportunities to solicit private investment.

Q.5. Do you have any insight into how prevalent these practices to avoid discrimination are?

A.5. Access to capital can be a catalyst for economic mobility. However, a recent study found that if the number of firms owned by people of color were proportional to their labor force participation, the U.S. would add more than 1.1 million businesses, supporting an estimated 9 million additional jobs and adding nearly $300 billion in workers' income. [4] However, time and again, studies show that opportunities to access capital are not equal in the United States.

For example, research indicates that Black-owned entrepreneurs are half as likely to get financing as their White-owned competitors, [5] and that Black business owners have been shown to be more likely to rely on alternative forms of credit for their financing needs. [6]

The U.S. Chamber of Commerce is committed to addressing systemic racism in America and removing barriers that make it more difficult to move up the economic ladder. In December of 2021, the Chamber released a report [7] that included 11 recommendations—including endorsements for existing bipartisan legislation—that would help drive economic equality and create solutions that could serve as building blocks of success through improved access to capital for entrepreneurs of color.

Q.6. State business law has not historically accounted for gendered discrimination. Instead, it tends to rely on gender-neutral fiduciary principles. Do you agree with Ann Lipton's paper at Tulane University, alleging that gender-neutral fiduciary principles can result in substantial inequity? [8]

A.6. In our 2021 report entitled "Improving Access to Capital for Minority-Owned Businesses", we endorsed several recommendations to help drive economic equality. Those include a bill from Senator Tim Scott to encourage the use of alternative data for underwriting and supporting initiatives at the Securities and Exchange Commission.

The Chamber is committed to working with Congress to identify and right inequity in our economy.

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[4] *http://globalpolicysolutions.org/report/color-entrepreneurship-racial-gap-among-firms-costs-u-s-billions/*

[5] *https://www.federalreserve.gov/publications/2017-september-availability-of-credit-to-small-businesses.htm*

[6] *https://www.cbcfinc.org/wp-content/uploads/2019/05/CPAR-Report-Black-Entrepreneurship-in-America.pdf*

[7] U.S. Chamber of Commerce. "Improving Access to Capital for Minority-Owned Businesses". December 15, 2021. Available at: *https://www.uschamber.com/assets/documents/CCMC-EOIreport-v3.pdf.*

[8] *https://papers.ssrn.com/sol3/papers.cfm?abstract-id=3882274*

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

LETTER FROM NASAA

NASAA

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December 12, 2022

The Honorable Robert Menendez Chairman Subcommittee on Securities, Insurance, and Investment of the U.S. Senate Committee on Banking, Housing, and Urban Affairs 534 Dirksen Senate Office Building Washington, D.C. 20510	The Honorable Tim Scott Ranking Member Subcommittee on Securities, Insurance, and Investment of the U.S. Senate Committee on Banking, Housing, and Urban Affairs 534 Dirksen Senate Office Building Washington, D.C. 20510

Re: Opportunities to Strengthen Our Support for Diverse Entrepreneurs and Investors

Dear Chairman Menendez and Ranking Member Scott:

On behalf of the North American Securities Administrators Association ("NASAA"),[1] I write in support of your efforts to examine how capital markets serve diverse entrepreneurs and investors, and opportunities to strengthen our support to these communities. Your work will help inform the ongoing regulatory policy discussions related to investor protection and responsible capital formation occurring at the state and federal levels of government. As outlined below, we urge Congress to strengthen diversity by **(1)** empowering state regulators to expand access to capital in their states; **(2)** fostering enhanced coordination and collaboration between the states, the U.S. Securities and Exchange Commission ("SEC"), and federal advisory committees such as the SEC's Asset Management Advisory Committee ("SEC AMAC"); and **(3)** passing S. 374, Improving Corporate Governance Through Diversity Act of 2021. Without further deregulating our capital markets and undermining investor protection, Congress can take steps such as these to expand access to capital among communities that historically and presently are underrepresented in our capital markets.

I. Congress Should Empower State Regulators to Expand Access to Capital, Not Preempt their Authority

For over a century, state securities regulators have been on the frontlines of making our securities markets safer, more efficient, and more inclusive. For example, we have long been

[1] Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA's membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grassroots investor protection and responsible capital formation.

leaders in public-private efforts to expand awareness and understanding of our markets among the next generation of investors and entrepreneurs in the United States.[2]

Today, we continue to work hard to protect and educate investors, promote responsible capital formation, and support inclusion and innovation in our capital markets. Among other activities, we license firms and their agents, investigate violations of the law, file enforcement actions when appropriate, and educate the public about investment fraud. In addition, NASAA's Diversity, Equity, and Inclusion ("DEI") Committee, which presently includes regulators representing 14 states and two Canadian provinces, fosters DEI initiatives within NASAA, at state securities agencies, and within the securities industry.[3] In all that we do, we strive to implement NASAA's DEI Statement, which the full NASAA membership adopted in 2021.[4]

As you know, efforts are underway on Capitol Hill to pass legislation that would restrict the role of regulation, particularly state regulation, in responsible capital formation. In April 2022, lawmakers included 29 of these bills, many of which have been introduced in the current and recent Congresses, in a discussion draft of the JOBS Act 4.0 package.[5]

NASAA supports several of the bills in this package.[6] For example, we support S. 3391, Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act. This legislation would allow certain brokers, called merger and acquisition brokers, to organize sales and purchases of ownership and control of private companies without registering as "broker-dealers" with the SEC and the Financial Industry Regulatory Authority. In fact, as recently as December

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[2] *See, e.g.*, NASAA, Millennial Money Mission (learn more) and Intrastate Crowdfunding Resources (learn more).

[3] NASAA's 2022-2023 DEI Committee includes representation from California, Delaware, Georgia, Kentucky, Maryland, Michigan, Minnesota, Nebraska, New Mexico, New York, Ohio, Texas, Washington, and Wisconsin, as well as Quebec and New Brunswick.

[4] *See* NASAA, North American Securities Administrators Association Approves Statement on Diversity, Equity, and Inclusion (Sept. 20, 2021) ("The new statement articulates NASAA's commitment to promote DEI to further its mission to protect investors, advance responsible capital formation and ensure the integrity and efficiency of the capital markets.").

[5] *See, e.g.*, Banking Republicans Roll Out Capital Formation Legislation to Mark 10th Anniversary of JOBS Act (Apr. 4, 2022).

[6] NASAA opposes the following proposals in the draft JOBS Act 4.0, many of which will weaken, if not outright eliminate, existing state authority to protect investors: **(1)** H.R. 3448, Helping Startups Continue to Grow Act; **(2)** S. 3919, Reporting Requirements Reduction Act of 2022; **(3)** S. 3945, Restoring Shareholder Transparency Act of 2022; **(4)** S. 3965, Increasing Access to Adviser Information Act; **(5)** S. 3097/H.R. 5795, Main Street Growth Act; **(6)** S. 3976, Expanding American Entrepreneurship Act; **(7)** S. 3914/H.R. 4227, Developing and Empowering Our Aspiring Leaders Act of 2022; **(8)** S. 3939/H.R. 5458, Small Entrepreneurs' Empowerment and Development Act; **(9)** S. 3922/H.R. 8998, Unlocking Capital for Small Businesses Act of 2022; **(10)** S. 4292, Small Business Audit Correction Act of 2022; **(11)** S. 3961/H.R. 5598, Access to Small Business Investor Capital Act; **(12)** S. 3931/H.R. 2990, Gig Worker Equity Compensation Act; **(13)** S. 3948/H.R. 4262, Increasing Investor Opportunities Act; **(14)** S. 3967, Improving Crowdfunding Opportunities Act; **(15)** S. 3966, Facilitating Main Street Offerings Act; **(16)** S. 3916, Increasing Opportunities for Retail Investors Act; and **(17)** S. 3930, Administrative Enforcement Fairness Act of 2022. We continue to review several proposals in the package, including S. 3921/H.R. 4776, Equal Opportunity for all Investors Act. We also support several proposals, including S. 3391/H.R. 935, Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act.

1, 2022, we called on Congress to pair and pass S. 3391 with S. 3529, Empowering States to Protect Seniors from Bad Actors Act, which would establish a grant program at the SEC that state securities and insurance regulators could use to enhance their efforts to protect and educate older Americans from financial fraud and other abuses.[7]

Of the 29 bills in the JOBS Act 4.0 package, however, we oppose 17 of them and are especially concerned about four (4) bills. Those four bills, which are outlined in the table below, would strip state governments of important investor protection and capital formation authority to register and regulate certain securities offerings, professionals, and transactions.

Anti-State Authority Legislation in the JOBS Act 4.0	
S. 3939, Small Entrepreneurs' Empowerment and Development (SEED) Act	Exempts so-called "micro-cap offerings" – or offerings valued at $500,000 or less in a single year – from core regulatory protections of the Securities Act of 1933, including registration and disclosure protections, and preempts the authority of states to require registration with or notice to the states of these offerings.
S. 3967, Improving Crowdfunding Opportunities Act	Prohibits state governments from requiring securities issuers to report information to the state regarding trades of their securities made through funding portals.
S. 3966, Facilitating Main Street Offerings Act	Undermines responsible capital formation and investor protection by preempting state securities regulation of secondary trading of Regulation A securities issued in Tier 2 offerings.
S. 3922, Unlocking Capital for Small Businesses Act	Exempts "finders" from registration under federal law and prohibits the states from registering "finders," and imposes a broker-dealer-light regulatory regime on private placement brokers.

[7] *See* NASAA Letter to Appropriations Committee Leadership Regarding Securities Policy Riders (Dec. 1, 2022). NASAA remains grateful for Senator Tim Scott's willingness to cosponsor S. 3529. This legislation enjoys bipartisan support in Congress, as well as support from AARP, SIFMA, and other industry and investor advocates.

In our experience, the states are better positioned than the federal government to decide whether it would be helpful to the entrepreneurs, small businesses, and investors in the state to impose these types of regulatory requirements in addition to federal requirements. In many jurisdictions, the state government has imposed one or more of these requirements.[8]

While the reasoning varies, states generally have exercised their authority because they have witnessed firsthand the value that comes from having small businesses and investment professionals engage directly with local regulators in their state, especially regarding small-dollar offerings where the federal government's outreach is limited.[9] The state government's engagement helps entrepreneurs better understand their options for raising capital. It also deters fraud and other misconduct that can harm business owners and investors alike. Last, it facilitates investor access to information necessary to make informed investment decisions, thus enhancing the fairness and efficiency of our capital markets.

Of note, in many cases, the states tailor at least some of their engagement with entrepreneurs, small businesses, and investors to specific communities that historically have been underrepresented in our capital markets such as women entrepreneurs and investors. By tailoring the content or event, the states strive to expand awareness, understanding, and participation in our capital markets by people of all ages and backgrounds located in all corners of the United States and beyond.[10]

In turn, NASAA strongly believes that further restricting the role of the states in responsible capital formation would have a counterproductive effect on our collective efforts to expand awareness and understanding of our capital markets among historically and presently underrepresented communities. As we emphasize and further explain below, Congress should be empowering the states to do more, not less, to promote responsible capital formation in the United States.

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[8] *See, e.g.*, Written Testimony of NASAA President and Maryland Securities Commissioner Melanie Senter Lubin delivered to the U.S. Senate Committee on Banking, Housing, and Urban Affairs (July 28, 2022); Mike Rothman, NASAA President and Minnesota Commissioner of Commerce, The JOBS Act at Five: Examining Its Impact and Ensuring the Competitiveness of the U.S. Capital Markets (Mar. 22, 2017); NASAA, The JOBS Act: an Investor Protection Disaster Waiting to Happen (Mar. 22, 2012).

[9] *See* SEC, Office of the Advocate for Small Business Capital Formation, Annual Report for Fiscal Year 2021 (Dec. 9, 2021); SEC, Small Business Capital Raising Hub. Note that NASAA supports H.R. 7977, Promoting Opportunities for Non-Traditional Capital Formation Act. This bill would require the SEC's Advocate for Small Business Capital Formation (the "Advocate") to provide educational resources and host events to promote capital raising options for traditionally underrepresented small businesses and businesses located in rural areas. In addition, it would require the Advocate to meet at least annually with representatives of state securities regulators to discuss opportunities for collaboration and coordination with respect to these efforts. *See* NASAA Letter to HFSC Leadership Regarding H.R. 7977 (June 10, 2022).

[10] *See, e.g.*, Alabama's She Can (learn more); Georgia's She Leads (learn more); Iowa's SMARTHer Money (learn more); Montana's dedicated resources for capital formation (learn more); New Mexico's Native American Outreach (learn more); Pennsylvania's Investing in Women Initiative (learn more). Georgia created its She Leads outreach specifically to help women understand how they can increase their wealth through investing and entrepreneurship. Other states take the same or similar approach to serving underrepresented communities

II. Congress Should Foster Enhanced Coordination and Collaboration Between Regulators to Promote Diversity in the Asset Management Industry

In addition to preserving the authority of state securities regulators, Congress should be elevating the voices and experiences of state securities regulators by encouraging state participation in all relevant federal working groups. Failure to include them as voting members of federal advisory councils, committees, task forces, and other working groups creates inefficiencies and missed opportunities for all of us to better support diverse entrepreneurs and investors.

As you may recall, state securities regulators play a critical role in the regulation of asset managers. In 2021, there were approximately 17,500 state-registered investment advisers. In general, small investment advisers (less than $25 million of regulatory assets under management ("RAUM")) and mid-sized investment advisers (between $25 million and $100 million of RAUM) are registered with and primarily regulated by one or more state securities administrators. Conversely, large investment advisers (greater than $100 million of RAUM) generally are registered with the SEC and are primarily subject to federal regulation instead of state regulation. In some cases, a small or mid-sized investment adviser may be permitted or required to register with the SEC instead of with one or more states and, in more limited circumstances, a small or mid-sized investment adviser may be registered with the SEC and one or more states.[11] With respect to the investment advisers under their jurisdiction, both the SEC and the state securities regulators require use of the Form ADV (also known as the Uniform Application for Investment Adviser Registration) as an investment adviser registration document. Once investment adviser registration is granted, the Form ADV must be amended at least annually and whenever material changes occur.

Despite the critical role of the states, the SEC AMAC had only one state securities regulator who served on the committee and he served only as a non-voting member. While there appear to be no plans at this time for the SEC to reconstitute the SEC AMAC, the SEC should consider including at minimum one state securities regulator on any such future committee and making her or him a voting member.[12]

Regarding the SEC AMAC's July 2021 Report and Recommendations on Diversity and Inclusion in the Asset Management Industry,[13] NASAA applauds the SEC AMAC for leading in this area and preparing thoughtful, data-driven recommendations. We agree with the spirit of

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[11] Learn more at https://www.nasaa.org/industry-resources/investment-advisers/. *See also* SEC, Investor Adviser Registration.

[12] The SEC AMAC has been inactive since the end of 2021. *See, e.g.,* SEC Chair Gensler, Remarks Before the Asset Management Advisory Committee (Nov. 3, 2021). At present, there appear to be no plans at the SEC to reconstitute the committee. Consistent with congressional mandates to include the states, the SEC includes one state securities regulator as a non-voting member of the SEC's Small Business Capital Formation Advisory Committee and one state securities regulator as a voting member of the SEC's Investor Advisory Committee. Access more information about the SEC's advisory committees.

[13] Access the SEC AMAC's recommendation at sec.gov.

these recommendations and are eager to discuss them with the appropriate SEC staff and/or past or future members of the SEC AMAC, particularly the recommendations related to Form ADV.

III. At the Earliest Opportunity, Congress Should Pass S. 374, Improving Corporate Governance Through Diversity Act

Last, we urge Congress to strengthen diversity in our capital markets by passing S. 374, Improving Corporate Governance Through Diversity Act. As a general matter, NASAA supports efforts to increase broader participation in our capital markets and gender, racial, and ethnic diversity in corporate America. Institutional investors and other stakeholders in our capital markets have pointed to growing research demonstrating links between human capital diversity on the one hand and the financial performance of the corporation on the other hand. Among other enhancements, this legislation would foster more diversity in corporate America by facilitating additional, better disclosure by public companies and requiring the SEC to establish a Diversity Advisory Group. While S. 374 does not call explicitly for the inclusion of a state securities regulator to serve in this advisory group, we applaud lawmakers for directing the SEC to include representatives of state and local governments in this advisory group.[14]

In closing, I want to commend you and your colleagues for working on a bipartisan basis to examine and explore ways to better serve diverse communities. Ultimately, entrepreneurs, small businesses, investors, and taxpayers benefit when we all work together in a positive and effective manner. If NASAA can be of assistance at any point in these discussions, please do not hesitate to contact me or Kristen Hutchens, NASAA's Director of Policy and Government Affairs, and Policy Counsel, at khutchens@nasaa.org.

Sincerely,

Joey Brady
NASAA Executive Director

CC: Members of the U.S. Senate Committee on Banking, Housing, and Urban Affairs
Members of the U.S. House Committee on Financial Services

[14] *See* NASAA Letter to HFSC Leadership Re: April 20, 2021 Full Committee Markup (April 20, 2021) (expressing support for H.R. 1277, Improving Corporate Governance Through Diversity Act).