NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.
750 First Street N.E., Suite 1140
Washington, D.C. 20002
202/737-0900
Fax: 202/783-3571
www.nasaa.org

NASAA

March 2, 2016

The Honorable Jeb Hensarling
Chairman
House Committee on Financial Services
Washington, D.C. 20515

The Honorable Maxine Waters
Ranking Member
House Committee on Financial Services
Washington, D.C. 20515

Re: March 2, 2016 Full Committee Markup (H.R. 4638 and H.R. 3798)

Dear Chairman Hensarling and Ranking Member Waters:

On behalf of the North American Securities Administrators Association (NASAA),[1] I am writing to express our concern with two bills that the Financial Services Committee is scheduled to consider on March 2, 2016. I appreciate your consideration of NASAA's views.

(1) H.R. 4638, The Main Street Growth Act of 2016

The Main Street Growth Act would amend the Securities Exchange Act to provide a framework for a national securities exchange to elect to be treated as a "venture exchange," which the bill would define as a "market place or facilities for bringing together purchasers and sellers of venture securities." The venture exchange established under the bill, as currently envisioned, would function in parallel with traditional public markets for companies under $2 billion in value. The bill would also create a new class of security, or "venture security," that would be listed and traded only on venture exchanges. Such venture securities would be exempt from a significant number of regulatory requirements, and presumably subject to significantly diminished listing standards.[2]

The securities listed on the venture exchange established by H.R. 4638 could include securities not presently listed on a national exchange, and transacted only on an over-the-counter (OTC) basis, as well as securities listed on a national securities exchange as an "emerging growth company." One of the most notable common features of these types of securities, however, is that they are prone to illiquidity. In an effort to manufacture additional liquidity for such securities, H.R. 4638 would exempt them when listed on a venture exchange from various reporting and disclosure requirements, and would establish new trading rules specifically for securities on venture exchanges, including rules that would allow higher tic-sizes.

[1] The oldest international organization devoted to investor protection, the North American Securities Administrators, Inc. was organized in 1919. Its 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 grass-roots investor protection and efficient capital formation.

[2] Under H.R. 4638, securities listed on a venture exchange would be exempt from SEC Reg. ATS and NMS, Decimalization, Sarbanes-Oxley, and State Blue Sky laws.

NASAA has previously questioned the need for legislation to establish a new venture exchange.[3] Current law allows for the creation of new exchanges, including exchanges targeted to smaller companies. Today, there are many national exchanges registered with the SEC and that operate with varied listing requirements. In addition to traditional national exchanges, various alternative marketplaces exist, such as the OTCQX, OTCQB, and OTC Pink. In fact, OTC Markets refers to the OTCQB as "The Venture Marketplace." It is not clear why, or if, new legislation or regulatory relief would be necessary to foster the creation of such an exchange.

Further, it is far from certain that any venture exchange will be created, or succeed, with the enactment of H.R. 4638. Venture exchanges have existed in the past and have fared poorly. Over the past 80 years, more than 20 regional stock exchanges have gone out of business or merged with other exchanges to stay afloat. While state securities regulators do not oppose the establishment of a new venture exchange provided there are sufficient safeguards for investors, serious questions remain about the challenges to making such exchanges a successful proposition in the U.S. Moreover, to the extent any securities traded on such an exchange would receive federal covered status, the exchange must have rigorous listing standards in order to provide protections ordinarily afforded under state Blue Sky laws.

- **Retail investors will be a primary source of capital for a venture exchange, and this raises investor protection concerns.**

A venture exchange will likely be significantly reliant on retail investors to support a market for the securities this exchange would trade. Many institutional investors do not invest in the smaller and more speculative issues like those that would likely be listed on a venture exchange.[4] In the absence of institutional capital, the venture exchange would rely heavily on capital from individual investors – including passive and "self-directed" retail investors, to capitalize the venture exchange. A potential venture exchange's reliance on retail investor customers could also present investor protection concerns. Indeed, while it is unclear how venture exchanges would augment the many tools available to provide capital to businesses, it is readily evident that establishing such exchanges could pose a risk to investors and the capital they invest in those markets. The central features of the proposed "venture exchanges" – newer, untested companies, reduced disclosure, limited liquidity, and comparatively high rates of failure or bankruptcy and investment loss – sharply contrast with the robust disclosure and transparency regime that define America's modern and efficient capital markets.

- **Appropriate listing standards will be essential to a successful venture exchange.**

[3]See: Written Statement of William Beatty, NASAA President and Washington Securities Division Director, delivered to the Subcommittee on Securities, Insurance and Investment of the Senate Committee on Banking, Housing and Urban Affairs. "Venture Exchanges and Small-Cap Companies." March 10, 2015. Accessible at http://www.nasaa.org/34863/venture-exchanges-and-small-cap-companies

[4] There may be a variety of reasons that institutional investors tend not to invest in smaller issues such as those likely to be listed on a venture exchange. Some obstacles, such as potential illiquidity and lack of research coverage, may be attenuated by a venture exchange with robust listing standards. Other obstacles seem likely to persist, particularly as they relate to the size of the issues themselves. For example, the low market capitalization of the issues listed on a venture exchange may make it difficult for institutional investors to invest in them profitably, or to buy them in the ordinary course of their business activities without pushing the stock price up appreciably.

In order to be successful, a U.S. venture exchange will need to be capable of attracting and sustaining interest from issuers, retail investors, brokers, analysts, and other market participants. It will also need to attract at least *some* institutional capital. Sustained interest will require robust listing and disclosure standards to facilitate brokers recommending investments in a venture exchange. When recommending investments to retail clients, brokers rely on disclosures to meet their suitability responsibilities. A venture exchange without reliable disclosure requirements and governance requirements will face additional challenges as brokers could be unable to meet their suitability responsibilities to their clients. Similarly, inadequate listing standards will impose a major barrier to investments of assets from Individual Retirement Accounts (IRAs) and other tax-deferred retirement accounts, which may become subject to an even more stringent fiduciary standard later this year.

In NASAA's view, H.R. 4638's lack of listing standards present a significant challenge. At the very least the legislation should be amended to require listing standards such as specifying minimum standards for quarterly reporting; auditing; accounting; due diligence; management and corporate governance. As a general principle, the listing standards of a successful venture exchange should be as rigorous as they can be without compromising the ability of the exchange to scale its requirements to reasonably reduce costs and attract companies to list on the exchange. Finding the appropriate balance is challenging but absolutely crucial in establishing a venture exchange. In addition, there should be a mechanism to remove companies that fall below the listing standards.[5]

- **Congress should account for the lessons learned from other venture exchange efforts.**

Congress would be well-advised to closely scrutinize previous efforts to establish venture exchanges in the U.S. and elsewhere. There is theoretical potential for a venture exchange to play a useful function in our capital markets, but there are also many valid questions about why, how, and whether such exchanges might succeed in the United States. Congress should study these questions more closely prior to passing legislation establishing such an exchange. In particular, Congress should examine reasons for the demise of the American Stock Exchange Emerging Company Marketplace (ECM), as well as the lessons learned from NASDAQ's efforts to establish a new venture exchange in 2011. Congress should also examine the international experience with venture exchanges, including notably Canada's TSX Venture Exchange, and the Alternative Investment Market ("AIM") in the United Kingdom. As former SEC Commissioner Luis Aguilar has noted, there is considerable evidence that these and other international venture exchanges are continuously plagued by low liquidity, and at times high volatility.[6] In NASAA's view, Congress should strive to understand the underlying causes of such problems prior to establishing similar exchanges in the United States.

[5] Shell or non-operating companies, for example, are often a mechanism for fraud. Indeed, since 2012, the SEC has suspended trading of more than 800 microcap stocks.

[6] Remarks of Commissioner Luis Aguilar. Meeting of the SEC Advisory Committee on Small and Emerging Companies. Wednesday, March 4, 2015. Accessible at http://www.sec.gov/info/smallbus/acsec/acsec-transcript-030415.txt

Unfortunately, the House Financial Services Committee has held only one hearing on the topic of venture exchanges in recent years – a subcommittee hearing in early 2015 – and only one of the four bills that were the focus of that hearing related to a venture exchange.[7] The Committee has done little to further explore the many challenges to establishing a venture exchange. While additional study could be helpful and even decisive in assuring the long term prospects of a venture exchange effort, the Committee is proceeding in the opposite direction; advancing legislation that was only introduced on February 26, and only posted to the Committee's website several days before the markup.

- **Venture exchanges have the potential to be very risky for certain investors.**

Finally, and perhaps most importantly, no matter how effective the regulatory scheme for a venture exchange, securities that trade on such proposed exchanges will be significantly riskier investments than securities issued by public companies traded on a major national exchange. Congress should act with this in mind, and should thoroughly examine all of the issues NASAA and other commenters have raised in regard to venture exchanges prior to advancing H.R. 4638 or any similar legislation.

(2) H.R. 3798, the Due Process Restoration Act of 2015

The Due Process Restoration Act seeks to broadly undermine the efficacy of the present federal securities law enforcement framework by providing all respondents in Securities and Exchange Commission (SEC) enforcement cases with the ability to have their case removed to a federal district court and out of the SEC's administrative enforcement authority. The bill would establish a right to remove proceedings from an SEC administrative hearing to federal district court for all respondents named in an SEC administrative action. The right to remove would apply not only to unregulated respondents, but to directly regulated entities, such as brokerage firms, investment advisers, investment companies, and persons associated with such entities. The bill would create a similar right of removal for persons who are subject to an SEC cease and desist order. Finally, for cases that remain within the purview of an SEC Administrative Law Judge, H.R. 3798 would raise the burden of proof to a higher "clear and convincing evidence" standard.[8]

The likely impact of H.R. 3798 would be to cripple aspects of the SEC's ability to protect investors and police U.S. financial markets. The authority to pursue remedies for alleged violations of federal securities laws in an administrative proceeding is an important tool in the SEC's arsenal and furthers the agency's mission to protect investors.

The SEC has possessed authority to seek civil monetary penalties in enforcement actions since Congress enacted the Securities Remedies and Penny Stock Reform Act of 1990.[9] In 2010,

[7] House Financial Services Subcommittee on Capital Markets Hearing entitled "Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens" April 29, 2015. Printed Hearing 114-18. Accessible at http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=398911

[8] The SEC has traditionally applied a "preponderance of the evidence" standard to administrative enforcement actions.

[9] Initially, the SEC's authority to seek such penalties in administrative proceeding was limited to regulated entities or persons associated with a regulated entity – brokerage firms, investment advisers and investment companies. In order to obtain monetary penalties against other persons, the SEC was required to pursue a civil action before a federal district court.

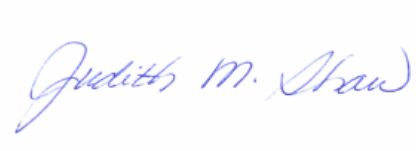
as part of the Dodd-Frank Act, Congress granted the SEC broader authority to impose civil monetary penalties in administrative proceedings. Section 929P of Dodd-Frank, amended Section 8A of the Securities Act, Section 21B(a) of the Securities Exchange Act, Section 9(d)(1) of the Investment Company Act, and Section 203(i)(1) of the Investment Advisers Act permit the imposition of civil monetary penalties in administrative proceedings, in addition to the cease-and-desist orders previously available to the SEC.

The likely impact of H.R. 3798 on the ability of the SEC to effectively police financial wrongdoing would be significant and would likely reduce the overall number of enforcement actions pursued by the SEC. Further, because SEC enforcement actions brought as administrative proceedings often conclude more rapidly than those brought in federal district court, and because they consume fewer federal resources than enforcement actions brought in the federal courts, the bill would serve to make future SEC enforcement actions significantly costlier to the SEC and the government.

NASAA does not see any valid basis for tying the hands of the SEC or any other securities law enforcement agency in the manner contemplated by H.R. 3798. We urge the Committee to reject this flawed legislation.

Thank you again for considering NASAA's views on H.R. 4638 and H.R. 3798. Please do not hesitate to contact me or Michael Canning, NASAA's Director of Policy, at (202) 737-0900, if we may be of any additional assistance.

Sincerely,



Judith M. Shaw
NASAA President and Maine Securities Administrator