

Statement
Of
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Before the Senate Committee on Banking, Housing, and Urban Affairs

On
Spurring Job Growth Through Capital Formation While Protecting
Investors, Part II

Dirksen Senate Office Building

March 6, 2012

Thank you Chairman Johnson and Ranking Member Shelby for holding this hearing and it is an honor to be invited to testify before you. I am sure everyone here at the hearing today can agree that increasing employment in the United States, and bringing back jobs that have left the country, is vitally important to our economy and the well being of America, and Americans. The destructive effect of the most recent financial crisis on American jobs, the United States (U.S.) capital markets, retirement and savings accounts, and families provides us stark lessons in this regard, if we choose to learn from them, rather than repeat them.

Background

- Let me begin by noting my comments today are framed by my past experiences including:
- Having been involved as an executive in starting up a successful venture backed company that created jobs.
- Having served on a Commission formed in my state in the 1980's to explore what could be done to improve the success rates of start up businesses and smaller companies.
- Serving as a trustee for two institutional investors, including on the investment committees. One of those institutions does invest in startup and/or growing companies via investments in venture capital and private equity.
- Serving as the U.S. Securities and Exchange Commission (SEC) Chief Accountant, responsible for advising the SEC Chairman and Commission on matters of disclosure, transparency and auditing affecting all public companies.
- Serving as a Vice President and Chief Financial Officer at a semiconductor and storage systems company. Attracting capital and financing was critical to the company's success as we made major investments and purchases in manufacturing plants and the jobs in them. We spent two years preparing for an Initial Public Offering (IPO), including preparation of filing documents, selection of underwriters, and working with sell side analysts as they wrote research reports in anticipation of the offering. Ultimately, due to the downturn brought on by the Asian Crisis and its contagion effect on the capital markets, the IPO was not completed.
- Spending twenty years of my career with a Big 4 accounting and consulting firm, including spending considerable time in the Emerging Business Services Group that advised and audited emerging and growing businesses. This included working with companies inside two business incubators in Boulder and Denver Colorado for which the Boulder Incubator Board presented me with the Board Partnership Award.

Initial Public Offerings

Public offerings of stock by companies to investors are an important factor in the success of our capital markets. The number of offerings completed, as well as the amount of money raised, tracks the economy in general. This was noted in the Goldman Sachs Global Economics Weekly report February 7, 2007 which stated:

“Several recent reports have fuelled anxiety that Wall Street is losing out... most keenly to London and is doomed to lose its perch as the world’s pre-eminent capital market. Studies have pointed to strict legal and regulatory practices in the US as reasons why issuers are increasingly looking elsewhere for IPOs. These issues are typically contrasted with London’s light touch regulation, more hospitable legal regime and ease of migration.

The regulatory climate does matter, and policy reform might strengthen New York’s competitiveness. Nonetheless, we do not think this is the main problem nor indeed that Wall Street is losing out in a regrettable way. Instead we see the growth of capital markets outside the US as a natural consequence of economic growth and market maturation elsewhere. The US has in fact been losing market share for several decades, and it trails Europe in trading of FX and many derivatives.”

“Legal and regulatory factors probably do matter, and policy reform might strengthen New York’s competitiveness. Nonetheless, we do not see them as the critical drivers behind the shift in financial market intermediation, even in the aggregate. **Quite simply, economic and geographic factors matter more.**”

The reason IPO’s track the economy is that investors invest to earn a return. When the economy is growing, companies can grow. That growth in revenues, profits, cash and investments such as employees fuels the growth in companies’ stock and the returns investors seek. However, when the economy has stalled or is declining, and companies are not growing, investors simply cannot achieve the types of returns they need to justify making an investment. The following chart highlights that. As a result of the downturns in the economy that occurred during much of the 1970’s brought on in part by withdrawal from Viet Nam, the recession brought on by inflation at the beginning of the 1980’s, the dot com bubble and corporate scandals, and the most recent great recession, investors became concerned about returns that could be earned in the markets and IPO’s declined. As the economy and employment have recovered after each of these downturns, so has the IPO market.

Chart 1

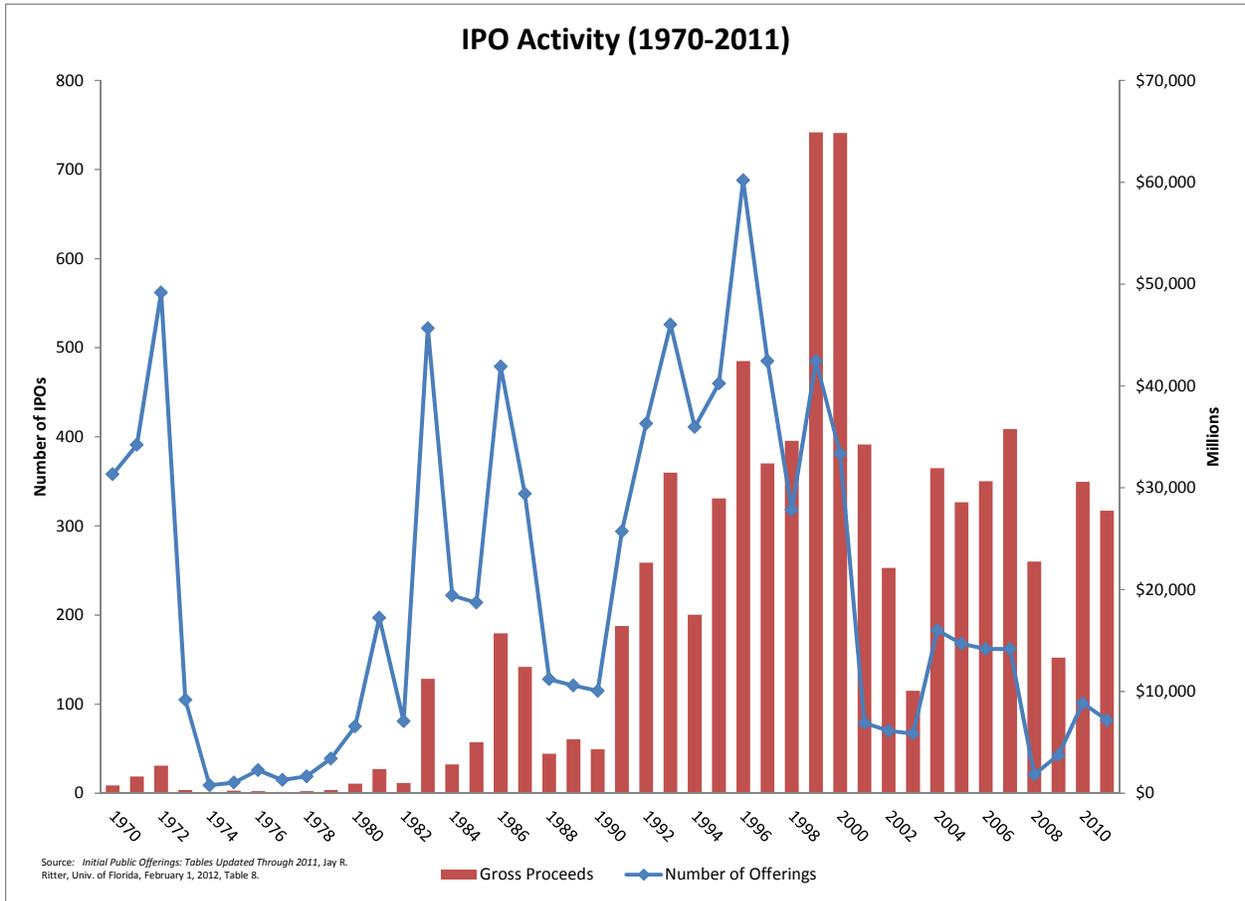
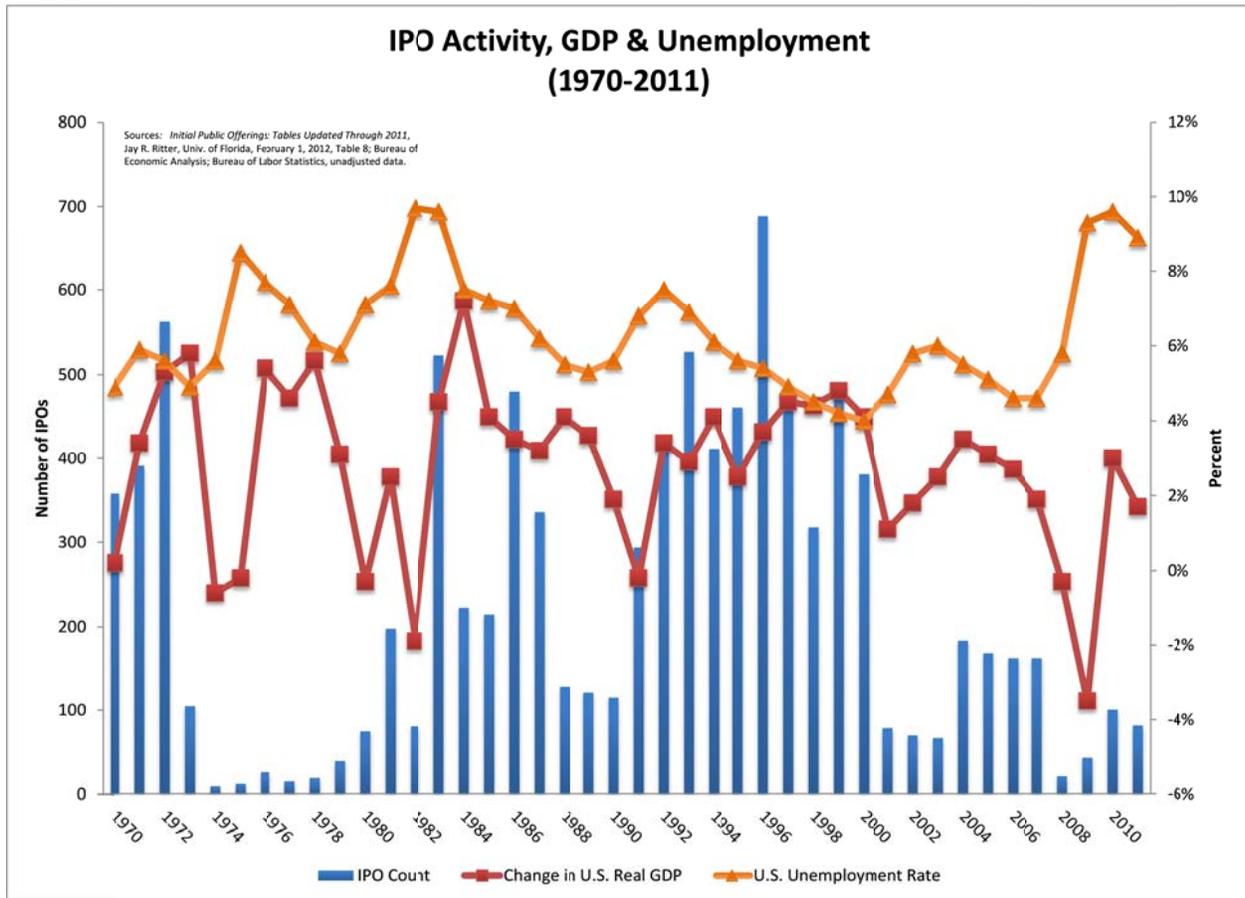


Chart 2



During the 1990's, the U.S. economy experienced high growth rates, which has not since been matched. The above charts illustrate how the IPO market reached an unprecedented level during the 1990's not achieved before or after. Some argue that is because the U.S. regulations protecting investors are overly onerous. Often they cite Sarbanes-Oxley and its Section 404(b) requirement for companies, mandating an audit of their internal controls as an unjustified cost. But the facts simply don't bear this out, and those arguments have a lot in common with the too common refrain - "the sky is falling." Those making this argument also cite the London AIM market as an example of a "lightly" regulated market the U.S. should attempt to emulate.

However, a close examination of the issue does not support these individuals. First of all, the U.S. IPO market had very significant declines in the 1970's, 1980's, and as the last century came to a close. Some of those declines occurred before current regulator financial reporting requirements were adopted, and certainly before Sarbanes-Oxley was adopted in 2002. In addition, if one looks at the following charts for the AIM market, one can see that market also experienced deep declines in its IPO market. And its recovery has significantly trailed those in

the U.S. as the U.S. economy has outperformed that in Britain. One can only ask, why would a reasoned and thoughtful person want to copy that?

Chart 3

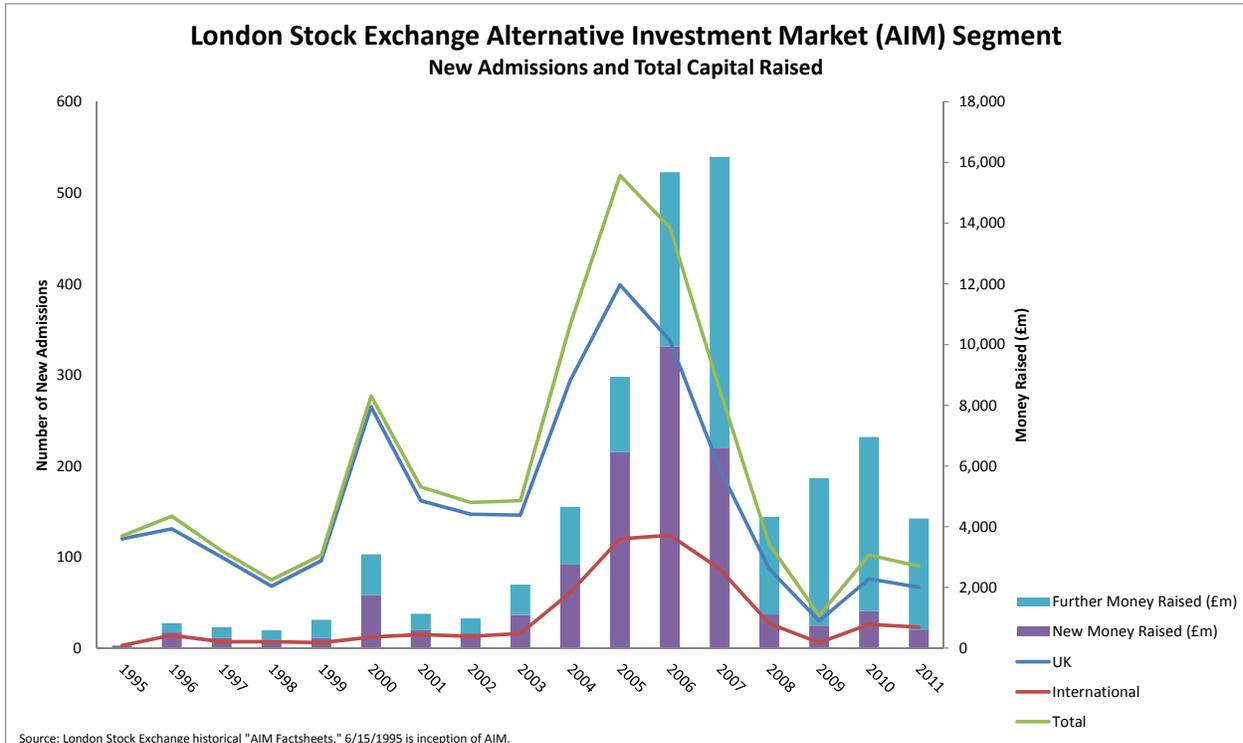
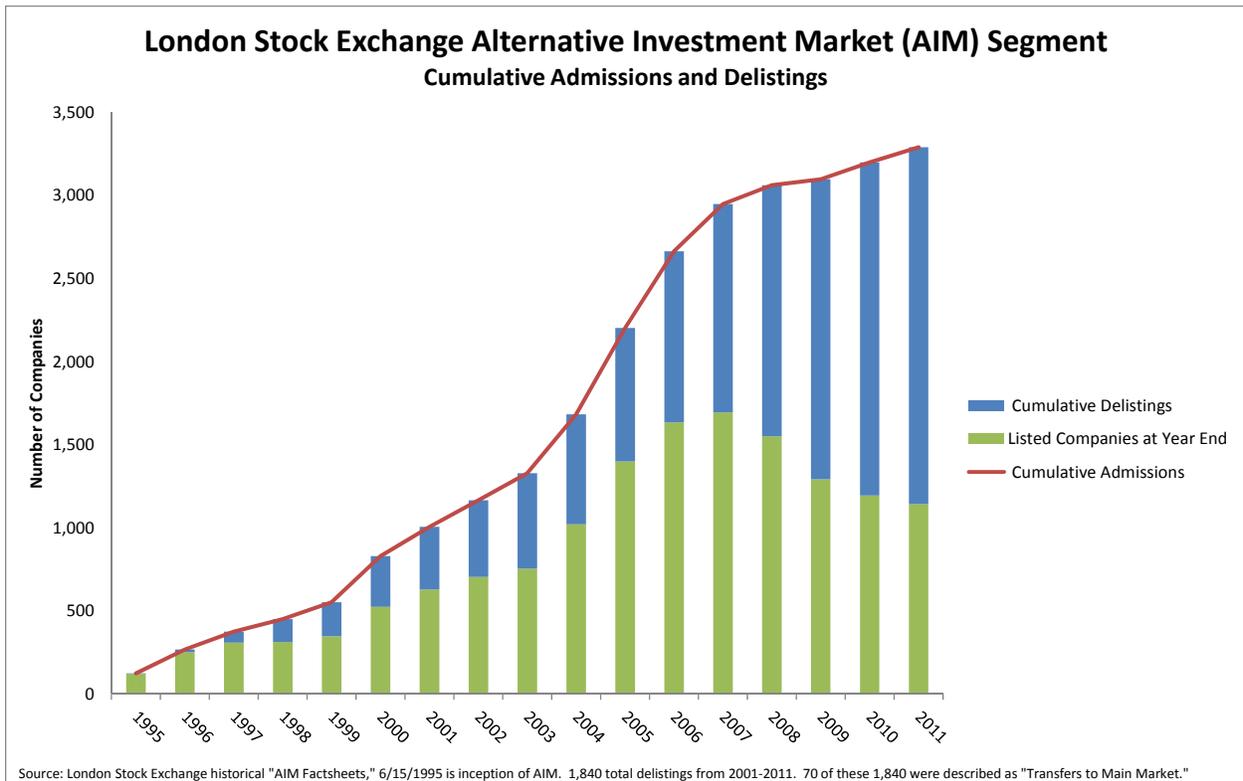
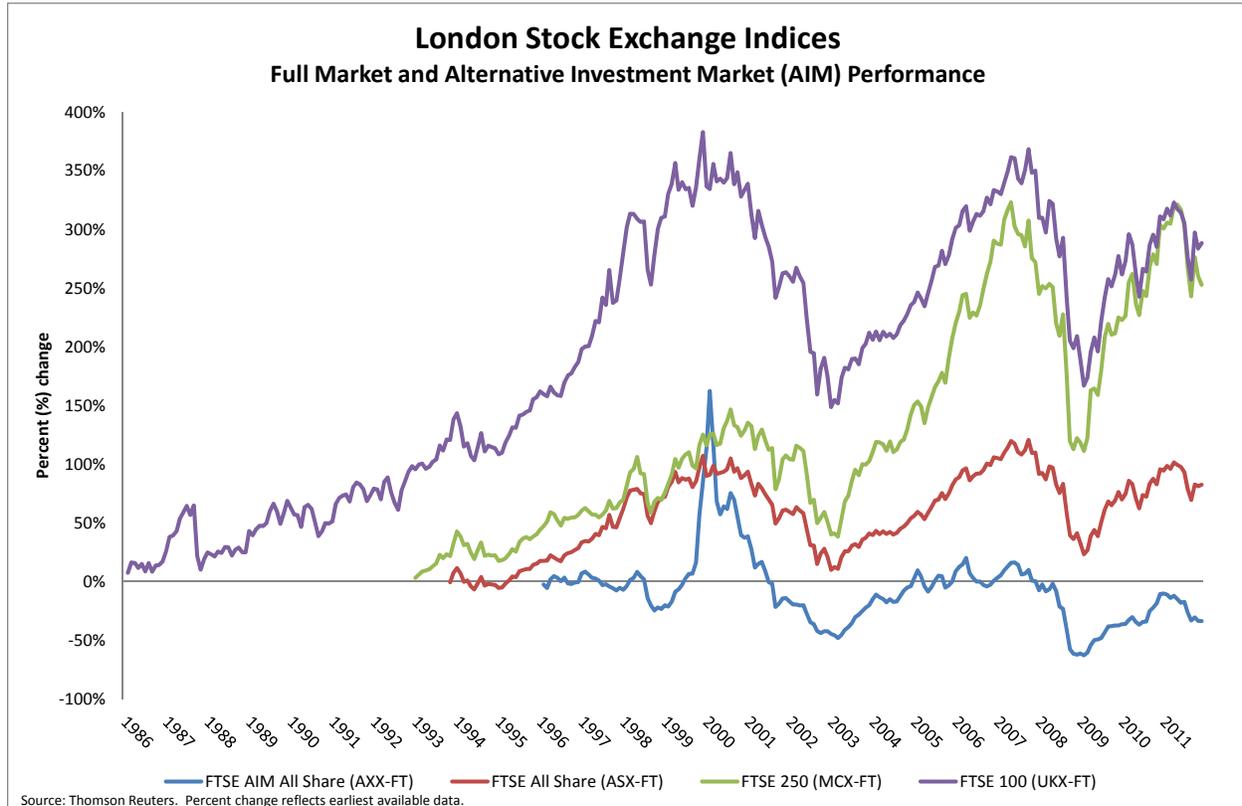


Chart 4



A number of years ago, a former SEC Commissioner caused a ruckus when he made reference to the AIM market as being somewhat akin to a Las Vegas Casino. He had a point. As noted in the following chart, this lightly regulated market was started in the 1995/96 time frame. If one had invested in the AIM market index at the time with a \$1,000, one would no longer have the \$1,000, as the market has generated a negative return for investors. It is no surprise then that The Daily Telegraph in the U.K. recently stated that: “Recent research for *The Daily Telegraph* has also shown that at least 80 leading money managers do not have confidence in the current regulation of natural resource companies on AIM.” (See Exhibit 1).

Chart 5

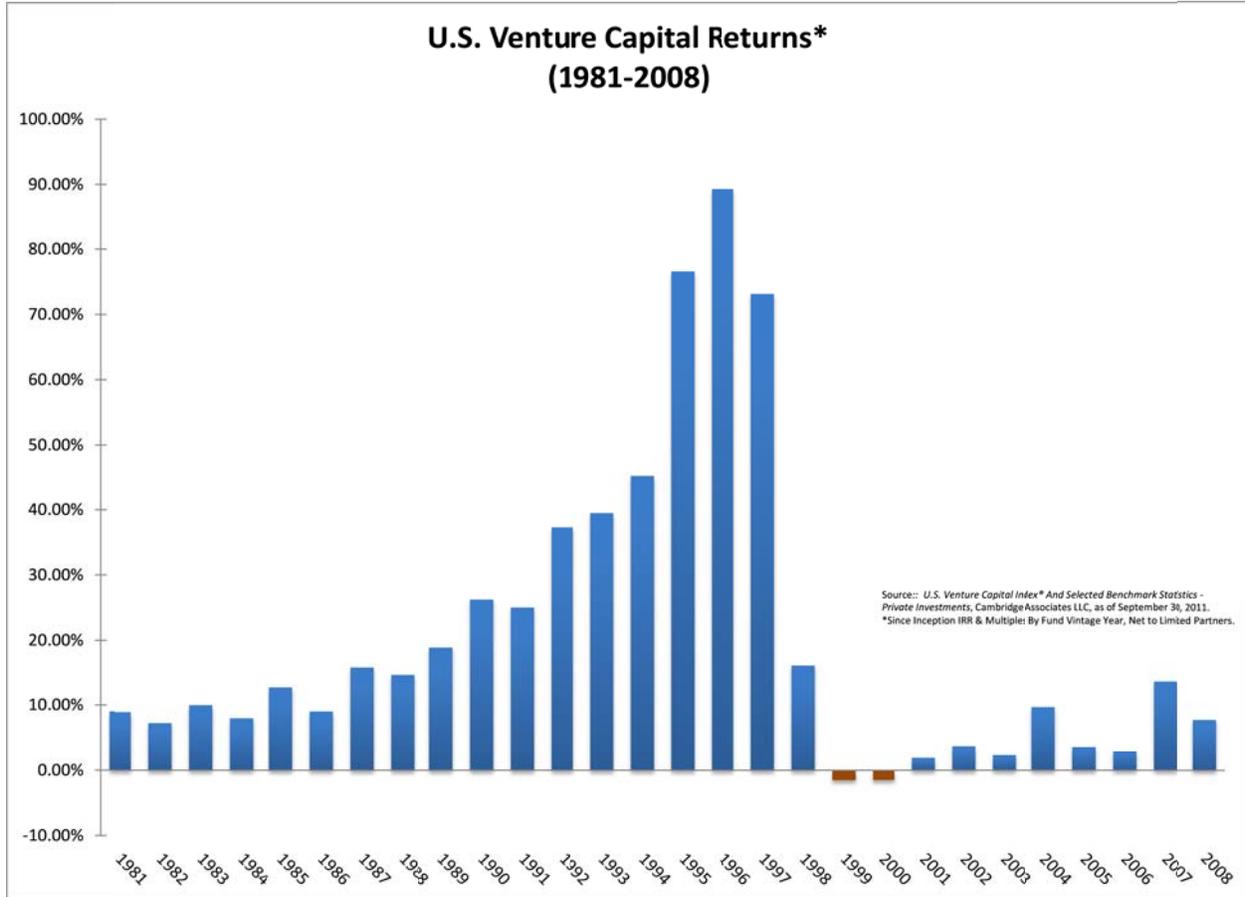


Despite a market that has risen from the despair of 2009, investors remain cautious about giving their money to companies. The aggregate returns they have earned since 1999 have been somewhat meager when compared to the 1980's and 1990's. Baby boomers have seen their 401-K's turned into 201-K's by the scandals and dot com bubble at the beginning of the last decade with the most recent financial crisis burning them badly. Both the Nasdaq and Dow Jones Indexes remain well below their highs. And just a couple of weeks ago, an article in the Wall Street Journal noted that in 37 of the past 40 weeks, investors had pulled cash out of investments in small cap companies.

Again, investors invest to make a reasonable return. But just as such returns have been fleeting for them, they have also been lower for Venture Capitalists (VC's). My experience has shown that VC's are astute at picking the companies and management teams to invest in, that will yield them and the investors in their funds, the highest possible returns. And they bring great insights and expertise to these companies, greatly aiding them in their efforts to grow and become highly successful. Yet despite all this experience, knowledge and expertise, as noted in the following chart, VC's and the investors in their funds have experienced the same impact from the downturns in the economy everyone else has. And that should be no surprise to anyone who understands fundamental, basic economics. It takes a growing economy such as existed in the

U.S. in the 1990's, and exists now in China, India and certain other emerging countries in the world, to generate returns for investors.

Chart 6



Critical Success Factors for an IPO

I have often counseled that not all companies should do an IPO. If you take someone's money, you should do so **ONLY** if you think it is likely, you will be able to yield them a reasonable return on their money. After all, they are owners of the business once they have bought stock and should be treated accordingly. Those who go public thinking that "possession is 9/10ths of the law" when it comes to cash, are in for a very rude awakening.

When I served on a Colorado Commission that explored why so many small companies were failing in Colorado at the time, and how their success rate could be improved, we found that access to capital was not the primary cause of failure. Rather it was a lack of sufficient expertise and management within the company including in such areas as marketing and operations. While access to sufficient capital for any company is important, I have found that those emerging companies with better management teams and proven products, or products with great growth

potential, are able to obtain it. Those are the types of companies VC's and private equity seek out.

My experience has also taught me that many IPO's are not a success. We are all very mindful of the Googles, Apples, HP's, and Microsofts that have become great successes. In fact, the vast majority of the jobs they created have been created after an IPO, not before.

In an American Enterprise Institute Paper titled "Are Small Businesses The Engine of Growth" Veronique de Rugy, the author states:

"It is a common belief among entrepreneurs and policymakers that small businesses are the fountainhead of job creation and the engine of economic growth. However, it has become increasingly apparent that the conventional wisdom obscures many important issues. It is an important consideration because many government spending programs, tax incentives, and regulatory policies that favor the small business sector are justified by the role of small businesses in creating jobs and is the *raison d'être* of an entire government agency: the Small Business Administration (SBA). This paper concludes that there is no reason to base our policies on the idea that small businesses are more deserving of government favor than big companies. **And absent other inefficiencies that would hinder small businesses performances, there is no legitimate argument for their preferential treatment.**"

And in the paper titled "What Do Small Businesses Do?" professors Erik Hurst and Benjamin Wild Pugsley state:

In Section 3 of the paper, we study job creation and innovation at small and/or new firms. First, using a variety of data sets, we show **that most surviving small businesses do not grow by any significant margin. Most firms start small and stay small throughout their entire lifecycle. Also, most surviving small firms do not innovate along any observable margin. We show that very few small firms report spending resources on research and development, getting a patent, or even copywriting or trade marking something related to the business (including the company's name). Furthermore, we show that nearly half of all new businesses report providing an existing good or service to an existing market.** This is not surprising in light of the most common small businesses. A new plumber or a new lawyer who opens up a practice often does so in an area where existing plumbers and existing lawyers already operate."

They go on to conclude:

"Recognizing these characteristics common to many small businesses has immediate policy implications. Often subsidies targeted at increasing innovative risk taking and overcoming financing constraints are focused on small businesses. Our analysis cautions that this treatment may be misguided. We believe that these targets are better reached through lowering the costs of expansion, so they are taken up by the much smaller share of small businesses aspiring to grow and innovate. In fact, the US Small Business

Administration already partners with venture capitalists whose high powered incentives are aligned with finding these small businesses with a desire to be in the tail of the firm size distribution.”

In fact, during the heydays of the IPO market of the 1990’s, many companies went public and took money from investors that never should have. Yet shortly after going public, as Exhibit 2 notes, many failed, causing investors great losses in their retirement and college education savings accounts, and destroyed over a hundred thousand jobs. Many large pension funds have never been able to recover to their pre dot com bust funding levels, leaving Americans wondering where the money will come for their retirement.

At the height of the bubble, leadership of the Business Roundtable invited then SEC Chairman Arthur Levitt and me to dinner. At the dinner, they urged us to prohibit many of these companies from taking investors money. (The SEC did not have that regulatory power as the U.S. appropriately has a disclosure rather than merit based system.) They argued that rather than the investments going to companies who could put it to good use, investing in plants, jobs and research, the money was flowing into young, unproven companies that lacked adequate management, let alone revenues, profits and a substantive business plan. They turned out to be right. The capital was poorly allocated, and many American investors, businesses and workers paid a stiff price.

Not too long after that, I had lunch with a managing director of one of the “Bulge Bracket” investment banks who had done many public offerings. By that time the market had cratered taking trillions of dollars of wealth with it. He said that in fact, Wall Street, the venture capitalists, attorneys and other gatekeepers, had facilitated the IPO of many companies that never should have gone public. He went on to say that whereas before the IPO market bubble got way out of hand, companies had to have attained at least certain levels of revenues for an established period of time, to demonstrate they were viable companies who could earn a reasonable return for their investors. But in the bubble, he said all that was thrown out the window, and any company they could take public they did. When I asked him why, he responded “Because if we didn’t do it, the next guy would!”

Conclusion on Legislation

For any capital market to work effectively, it must provide investors with high quality, timely and complete financial information that is accurate. Conflicts inherent in the markets must preferably be prohibited and at a minimum must be clearly and completely disclosed to all participants. And there must be an enforcement mechanism that ensures a fair and orderly market.

In the past, the U.S. capital markets have had a reputation for appropriate regulatory and enforcement mechanisms, and continues to attract capital, including from foreign investors. But

the scandals of the last decade has damaged our reputation, beginning with the dot com IPO market bubble, to the Wall Street analysts scandal, to mutual fund market timing and trading frauds, to Madoff and other ponzi schemes, along with the once in a lifetime financial crisis brought on by extremely lax regulation by securities and banking regulators, and by people who originated bad loans, collected huge fees for doing so and then sold the worthless paper to investors.

Lax regulation, in some cases the result of acts of Congress, has hammered the investment accounts of retirees and baby boomers that no longer have sufficient time to recover from the losses incurred. Laws that were passed by this committee, including the Gramm Leach Bliley Act, and the Commodities Modernization Act of 2000, which prohibited regulation of derivatives; were driving factors behind too big to fail companies; and resulted in a \$600 trillion dollar unregulated derivatives market, both of which AIG and Lehman engaged in. These laws neither protected investors nor taxpayers, but certainly did allow them to be taken advantage of. It is not sufficient to say legislation will protect investors, it must actually do it.

As I review the legislation before the committee, I find it reduces the level of transparency and amount of information investors will receive. It removes critical investor protections put in place to protect against a repeat of past scandals. It decreases the credibility of the information one will receive. It not only allows market participants such as analysts to once again engage in behavior and activities that were associated with prior market disasters, it treads on the independence of independent standard setters such as the Public Company Accounting Oversight Board (PCAOB) established by this Committee, as well as the Financial Accounting Standards Board (FASB). If ill-conceived amendments regulating the cost benefit analysis the SEC would have to perform, that were adopted in the US House of Representatives, I suspect investors would be well served to understand that handcuffs had been put on the SEC, rather than bad actors.

The proposed legislation is a dangerous and risky experiment with the U.S. capital markets, and the savings of over 100 million Americans who depend on those markets. The evidence does not support the need for it. In fact, it contradicts it. I do not believe it will add jobs but may certainly result in investor losses. If jobs are created, as the evidence above indicates, it will come from growth in the economy, not this legislation. And finally, there has not been the type of cost benefit study performed with respect to the proposed legislation that Congress itself mandates the SEC must do before adopting such regulations. Senator Shelby has been correct in noting there was insufficient study performed before enactment of Dodd/Frank. There has been even less study of the bills that are the subject of this hearing today.

As a result, I do not support the various bills including the IPO on ramp and crowd funding legislation. I share many of the concerns voiced by others including the Council for Institutional Investors, Consumers Federation, Americans for Financial Reform, AFL-CIO to name a few.

Their concerns are set forth in greater detail in Exhibit 3 which I include for inclusion in the record.

Comments on Particular Bills

I do offer the following specific comments on the legislation for your consideration.

Senate Bill 1933.

Section 2 Definitions

The definitions included in this bill would make it applicable to companies under \$1 billion in revenue, and \$700 million in market capitalization, for up to five years or until they broke those thresholds. While these companies are defined as “emerging”, that is serious a misnomer. As the charts below illustrate, this would scope in over 98% of all IPO’s. And the vast majority of public companies currently filing periodic reports are under these thresholds according to raw data from Audit Analytics.

Chart 7

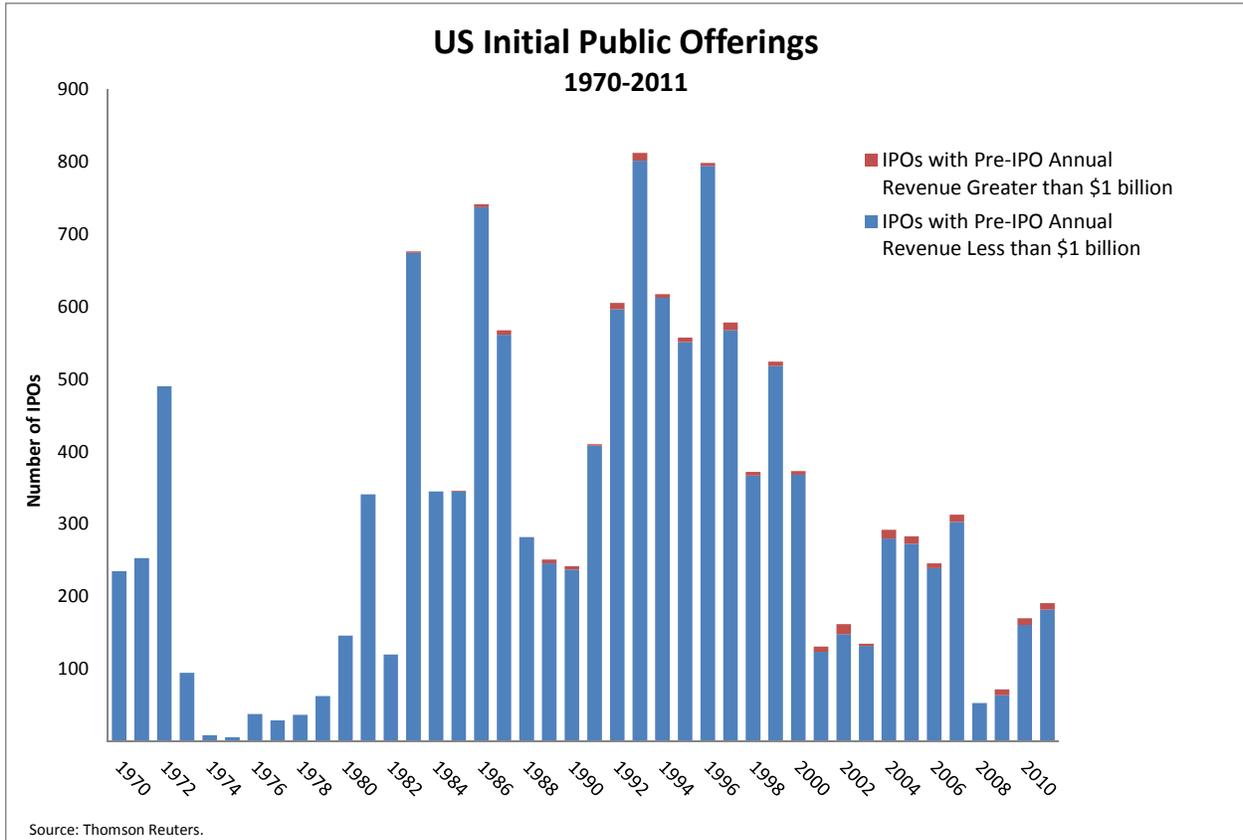


Chart 8

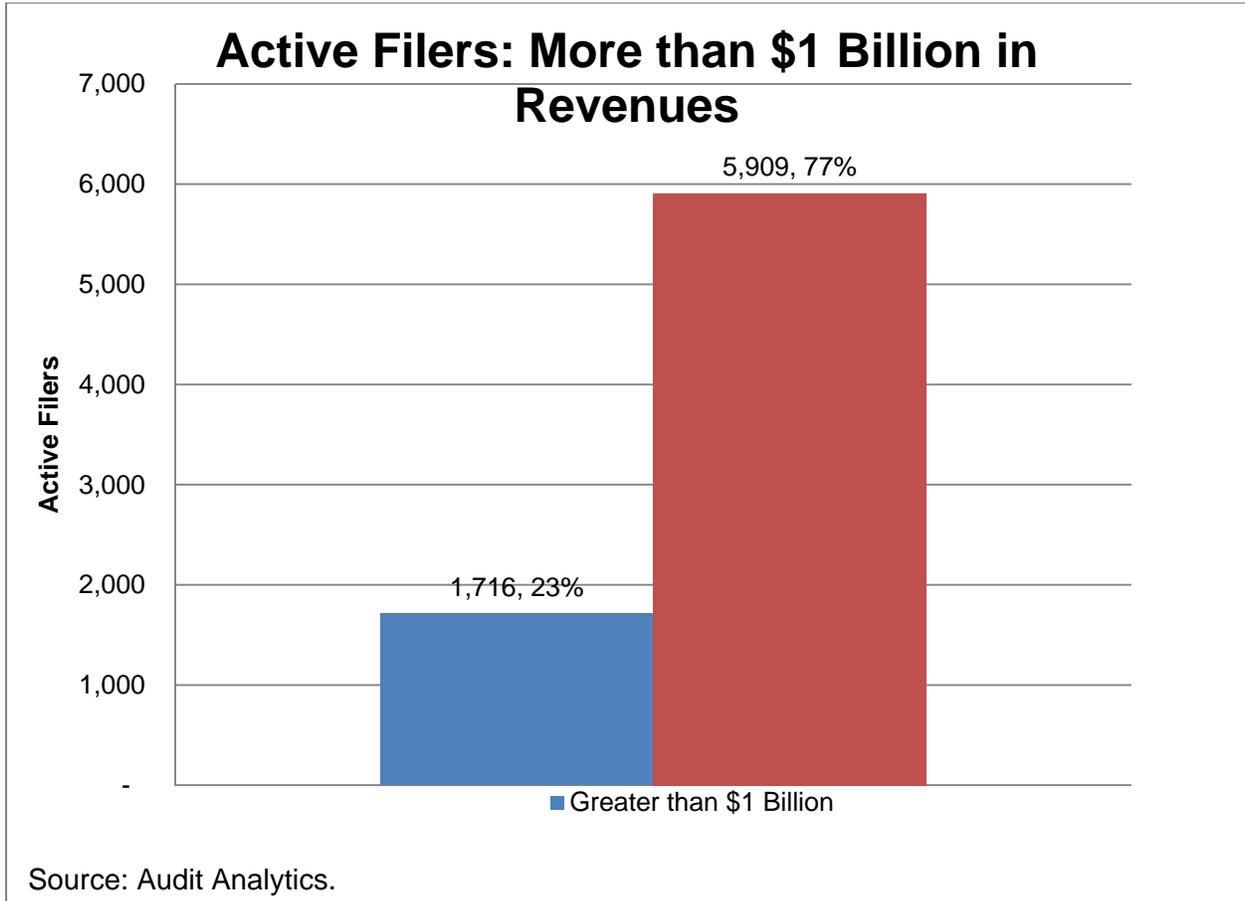
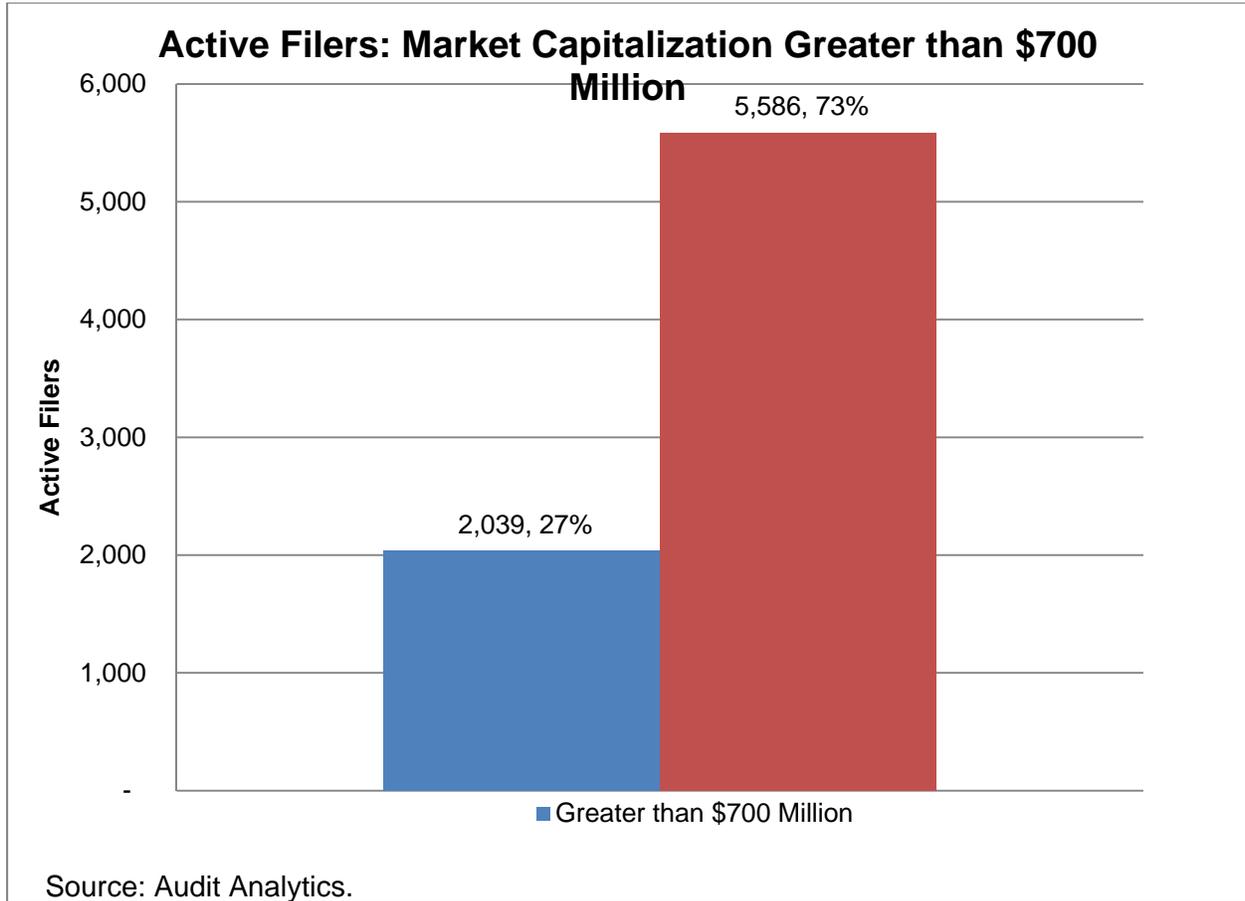


Chart 9



Given the nature of the experiment being run through this proposed legislation, I would strongly urge the threshold be reduced to \$75 million. Experimenting with such a large segment of public companies and IPO's, as the proposed thresholds would, is highly risky and chances putting millions of Americans at risk.

Section 3 Disclosure Obligations

This section would reduce by a third, the amount of credible, audited financial information investors would receive. That information is the lifeblood of the capital markets and necessary for making informed decisions on where capital should be allocated. Yet this vital information is proposed to be seriously restricted by this legislation.

My experience tells me that successful IPO's, are done by companies with sufficient track records to demonstrate they are worthy of an investment. If a company has been established for more than two years, then it should continue, as has been the practice for decades, to present three years of audited financial information to investors. If companies are unable to do this, I

would be seriously concerned if they are ready for the “prime time” of being a public company, and are not likely to generate sufficient returns to warrant an investment.

This section also impinges on the independence of the FASB as it exempts emerging companies from having to adopt new accounting pronouncements. As a result, if the FASB were to adopt a new pronouncement in response to a significant problem such as the off balance sheet special purpose entities of Enron or the off balance sheet reporting at Lehman, emerging companies may well avoid having to implement such standards for a period of time, leaving investors once again in the dark.

As noted at Exhibit 4, Senator Shelby has correctly defended the independence of standard setters such as the FASB. His counsel should be heeded once more and this provision regarding accounting pronouncements should be removed from the legislation.

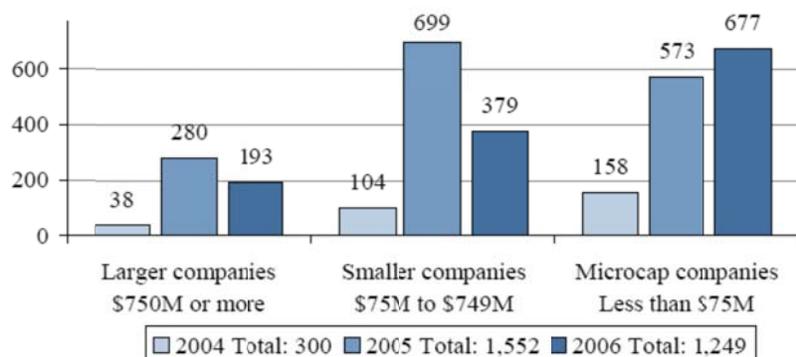
Section 4 Internal Controls Audit

As discussed earlier, Sarbanes Oxley Section 404(b) has not been the reason there has been a decline in the number of IPO's. Companies under \$75 million in market capitalization have never had to implement SOX 404(b) so it cannot be the reason such companies have not gone public. And for those companies that do go public, they have not had to implement SOX 404(b) at the time of the IPO or at the subsequent annual report filed with the SEC. It is only at the time of the second annual report that a public company must complete an audit of its internal controls. This is a reasonable exemption from the requirements of SOX 404(b) that should be retained rather than replaced.

Data has clearly demonstrated that prior to the enactment of SOX, thousands of companies were not complying with the internal control provisions of the Foreign Corrupt Practices Act of 1977. As SOX was implemented, the chart below highlights the numbers of companies that were found not to have complied with the law. SOX 404(b) did bring much greater transparency to the number of companies that had inadequate internal controls, and that as a result, had to correct their financial statements.

Chart 10

Chart 4: Material-weakness disclosures, by company size



Source: Glass Lewis, company filings, Reuters. Note: Company size determined by market capitalization as of filing date. Larger companies include those with \$750M or more in market capitalization. Smaller companies include those with \$75M to \$749M in market capitalization. Microcap companies include those with less than \$75M in market capitalization.

Source: Glass Lewis report, The Materially Weak

As SOX 404(b) was implemented, erroneous financial statements, that in most instances had previously been attested to by the executives, came to light in record numbers. In a February 2007 report by Glass Lewis, where I was the Vice President in charge of the research, found:

“Companies with U.S.-listed securities filed 1,538 financial restatements in 2006, up 13% from what had been a record number in 2005. About one out of every 10 public companies filed a restatement last year, compared with one for every 12 in 2005. Of the latest restatement batch, 118 were by foreign issuers.

If there was any lingering question about whether these figures matter, consider this: The median stock return of companies that filed restatements last year was minus 6%. That was 20 percentage points lower than the return for the Russell 3000 stock index in 2006.”

The report went on to list key findings:

Key Findings

- 1,244 U.S. companies and 112 foreign companies – one of every 10 companies with U.S.-listed securities – filed 1,538 financial restatements to correct errors
- 2,931 U.S. companies, about 23%, filed at least one restatement during the last four years; 683 companies restated two or more times
- Restatements by companies required to comply with SOX 404 declined 14%; restatements by non-SOX 404 companies rose 40%

- Difference in audit fees between SOX 404 and non-SOX 404 companies pales in comparison to cost of corporate accounting frauds and executive compensation
- One third of larger companies and two thirds of microcap companies that restated still claimed to have effective internal controls over financial reporting
- The median one-year stock return of companies that restated last year was 20 percentage points lower than the return of the Russell 3000 stock index in 2006

Companies with deficient internal controls tend to be poorly managed companies that underperform their peers in the markets, and which yield lower returns to investors. Accordingly, information on the quality of internal controls is very important to investors. The chart below highlights this issue, and notes that investors in companies that have poor internal controls and restatements cost investors dearly. However, those who question the costs of SOX 404(b) often disregard such data, caring only about the cost to the company and not the huge economic benefit to investors.

Chart 11

Table 14: One-year stock price performance of companies with restatements and material weaknesses

<i>Group of companies:</i>	Number	Median % total return	Dow % total return	S&P 500 % total return	Russell 3000 % total return	NYSE Composite % total return	Nasdaq Composite % total return	% underperformed Russell 3000
2004 material weaknesses	263	-6.2	3.1	9.0	10.1	12.6	8.6	-16.3
2005 material weaknesses	1,126	-10.9	-0.6	3.0	4.3	7.0	1.4	-15.2
2006 material weaknesses	945	-3.9	16.3	13.6	13.7	17.9	9.5	-17.6
2004 mat. weak. with restatements	133	-9.8	3.1	9.0	10.1	12.6	8.6	-19.9
2005 mat. weak. with restatements	647	-9.2	-0.6	3.0	4.3	7.0	1.4	-13.5
2006 mat. weak. with restatements	537	-3.1	16.3	13.6	13.7	17.9	9.5	-16.7

Source: Glass Lewis, FactSet, company filings. Note: Total returns calculated over calendar years, from Dec. 31 to Dec. 31. Material weaknesses were associated with restatements if the disclosures occurred within one year of each other.

Source: Glass Lewis report, The Materially Weak

The General Accountability Office and SEC have also issued studies and reports on their findings on the benefits of SOX 404(b). One such report captioned “United States General Accounting Office Report to the Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate (**October 2002**) FINANCIAL STATEMENT RESTATEMENTS Trends, Market Impacts, Regulatory Responses, and Remaining Challenges” GAO-03-138 found:

“The 689 publicly traded companies we identified that announced financial statement restatements between January 1997 and March 2002 lost billions of dollars in market capitalization in the days around the initial restatement announcement. For example,

from the trading day before through the trading day after an initial restatement announcement, stock prices of the restating companies that we analyzed fell almost 10 percent on average (market adjusted). We estimate that the restating companies lost about \$100 billion in market capitalization, which is significant for the companies and shareholders involved but represents less than 0.2 percent of the total market capitalization of NYSE, Nasdaq, and Amex. However, these losses had potential ripple effects on overall investor confidence and market trends. Restatements involving revenue recognition led to greater market losses than other types of restatements. For example, although restatements involving revenue recognition accounted for 39 percent of the 689 restatements analyzed, over one-half of the total immediate losses were attributable to revenue recognition-related restatements. Although longer term losses (60 trading days before and after) are more difficult to measure, there is some evidence that restatement announcements appear to have had an even greater negative impact on stock prices over longer periods. The growing number of restatements and mounting questions about certain corporate accounting practices appear to have shaken investors' confidence in our financial reporting system.”

This finding is very consistent with research and findings of the Staff of the SEC while I was Chief Accountant. As a result, I believe the data clearly supports that the benefits of SOX 404(b) to investors significantly outweigh the costs. Congress should conduct a cost benefit test, consistent with what it mandates of the SEC, if it exempts any additional companies from SOX 404(b).

Section 5 Auditing Standards

Section 5 is troubling for two reasons. First, Congress established the PCAOB to regulate auditors of public companies. At the time it did so, it acknowledged that such an entity would be able to do a better job of that than Congress itself.

The PCAOB has a project on its agenda, as the direct result of very troubling findings arising from its inspections of public companies. This project was instituted because auditors have been found to be lacking in independence, professional skepticism and reasonable judgment. The project is in the early stages and a concept release seeking public comment has been released. Yet, at this very early stage Congress is proposing to step in and override the PCAOB, preventing it from adopting rules on mandatory rotation.

Audits are only worth paying for, if they are independent. A dozen years ago, the SEC rewrote the auditor independence rules. But these rules were watered down as a result of undue pressure from Congress as it bowed to the whims of the auditing profession lobby. That turned out to be a disastrous decision as Enron, WorldCom, Adelphia, Xerox and a host of other corporate scandals arose in which it appeared the auditors lacked independence.

Congress is now poised to make the same mistake, yet again. Instead, it should allow the process to run its normal course, obtain the comments from the public, conduct the 4 public hearings it has undertaken, and wait for the outcome of the deliberations.

The second concern with Section 5 is that it requires the SEC to perform a cost benefit analysis of each new rule the PCAOB promulgates. The legislation wording as currently crafted, puts a premium on the cost to the company rather than the benefit to investors and capital markets. And I understand it, any cost benefit study would need to be completed within 60 days of the adoption of a new PCAOB rule. Often that is simply not possible, and so the legislation in essence would exempt emerging companies as defined from new PCAOB rules.

At a minimum, the language should be changed to balance any cost benefit analysis. The SEC should also be given a reasonable period of time to conduct such studies. In addition, while I was Chief Accountant, the industry refused to provide data useful to a cost benefit study. If the industry was once again to refuse to provide necessary data to the SEC or PCAOB, those agencies should be exempted from the cost benefit study requirement provided they can demonstrate any new rule would adequately protect investors and was in investors' best interests.

It is also worth noting that the restrictions that Congress proposes to place on the SEC, the PCAOB and the FASB apply to all companies defined as emerging companies. This would include for example, the population of Chinese companies that in recent years have become an emerging scandal in and of themselves. Investors have and continue to suffer losses in investments of such companies. One must ask, is it really good public policy to roll back regulations as proposed for such companies when the problems grow larger by the day.

I would urge the Committee to consider adding to this section of the legislation, the bi-partisan proposal by Senator Reed and Grassley that would enhance the transparency of the enforcement activities of the PCAOB. As the press and public have rightly pointed out, this would enhance the credibility of the agency and permit investors to understand whether there are serious questions about the quality of audits they are receiving from certain auditors.

Section 6 Availability of Information About Emerging Growth Companies

This is an ill-conceived and poorly thought out section of the bill. As a CFO, I watched as analysts engaged in "marketing" the underwriting of IPO's and public companies to investors. They were anything but independent and their research was misleading. They were in essence, an extension of sales and underwriting arms of the investment banking firms. This led to the Wall Street Analyst Scandal discussed further at Exhibit 5. It also resulted in investors being misled and suffering significant losses on their investments.

Unfortunately this legislation legitimizes this type of behavior. And it fails to recognize the importance of independent research as well as meaningful disclosure of conflicts that do exist. Rather it establishes a process whereby analysts can once again engage in issuing conflicted reports and avoid accountability for their actions.

Below is a chart that reflects the type of reporting this legislation is likely to bring about. As noted, even after the dot com bubble had burst, and just before the largest corporate scandals in this country erupted, analysts were still touting stocks.

Chart 12

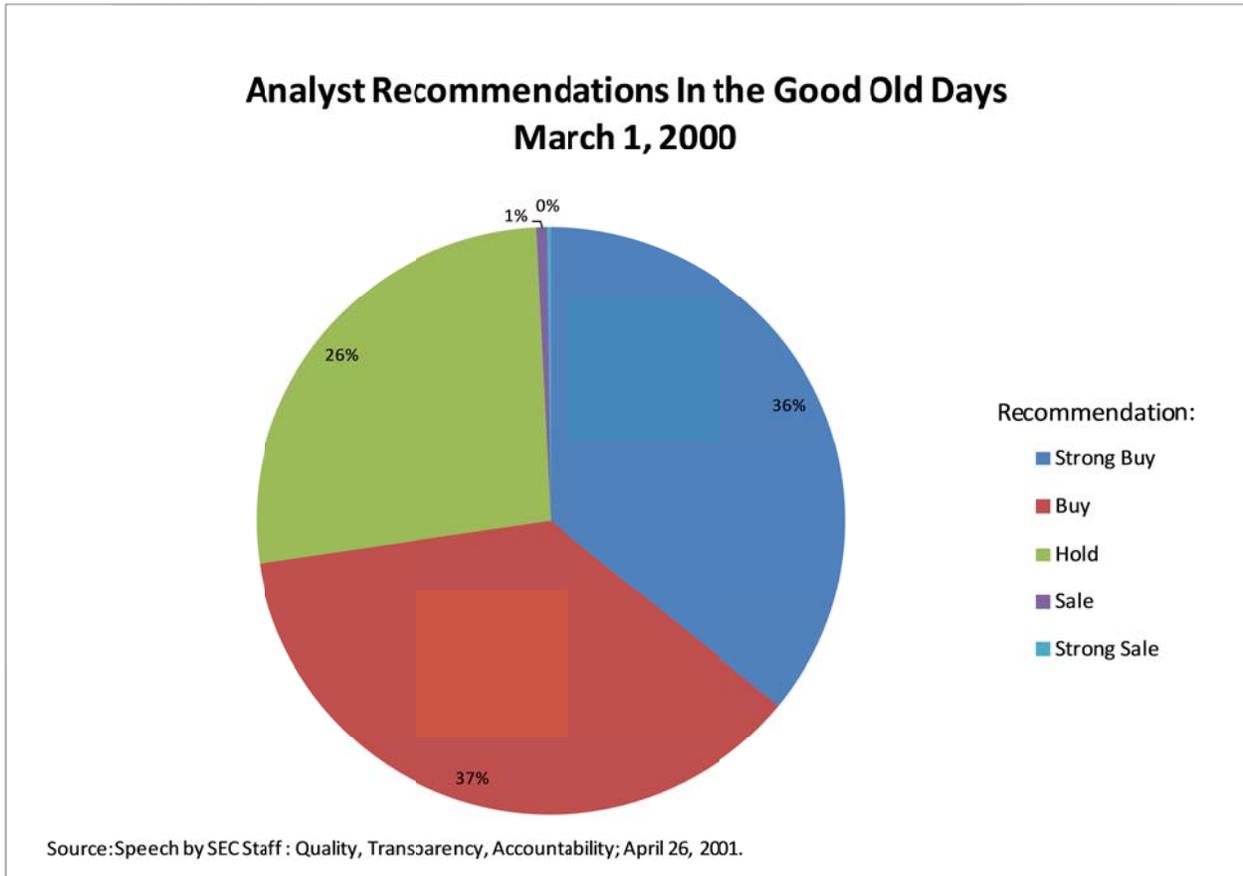
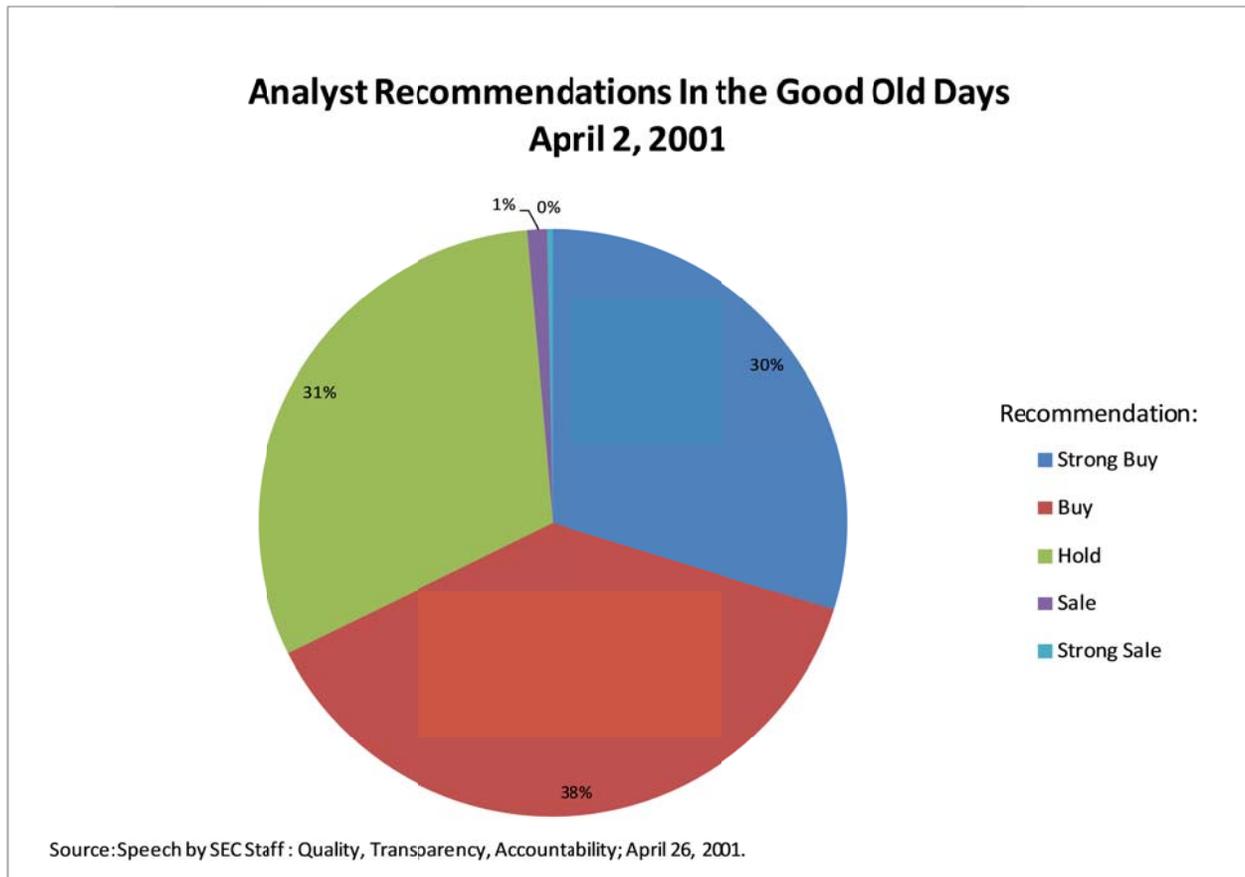


Chart 13



At a minimum, the legislation should adopt the investor protection measures encompassed in the well known Wall Street settlement. This includes provisions that ensure the analyst has to remain independent of the underwriting and investment banking function, and that any conflicts are disclosed in a complete and transparent fashion.

With the Wall Street settlement requirements having lapsed, behavior among Wall Street analysts has quickly returned to what it was before the settlement. No one should be surprised if the outcome and history is repeated once again.

Other

The administration has indicated, and the title of the hearing today would suggest, that the legislation should include investor protections. Currently Senate Bill 1933 and the other bills have fallen way short in this respect. Other commenters and people who have already testified have eloquently pointed that out. I hope the committee will give due consideration to those points. For example, at Exhibit 6, the ICI has voiced its strong opposition to general solicitations noting they are not appropriate for the US capital markets. At Exhibit 7, Professor Jay Brown

has noted some reasoned changes that should be made. And at Exhibit 3, several organizations have made meaningful suggestions very worthy of consideration and acceptance.

In addition to those improvements to the legislation, I would add:

1. Private offerings, which in all likelihood will reduce rather than increase the number of IPO's, should be regulated. Currently, the SEC does not have the resources to engage in meaningful regulation. Accordingly, the state securities regulators should be permitted to regulate offerings and protect investors in their communities when the SEC is unable to.
2. Recent reports have highlighted the level of recidivism that has occurred on Wall Street and gone unchecked. I would urge the Committee to adopt stronger enforcement penalties that ratchet up as recidivism occurs. Penalties such as those included in SOX for auditors are much more appropriate today than existing penalties given changes in the markets.
3. Sanctions should be strengthened for both private and public offerings, when it is found a seller of securities has failed to undertake and ensure the suitability of a security for the investor, or has failed to conduct meaningful and necessary due diligence. All too often we have seen underwritings in which the investment bankers failed to ensure adequate disclosure of key risks and financial data. This is especially true when one relaxes rules governing solicitation.
4. The definition of an accredited investor should be changed. Tying this definition to wealth is inappropriate as we saw with many of the investors in recent Ponzi schemes, such as in the Madoff matter. The seller should be required to obtain a statement from the investor that they not only have a specified level of assets, but also have a reasonable working knowledge to permit them to appropriately analyze the intended investment. If the broker has knowledge that contradicts this, then the investor should not be accredited.

Summary

More jobs and a larger number of qualified IPO's is something we all strive for. But IPO's have to be successful for not only those selling stock, but also for those buying shares. This legislation is currently unbalanced and likely to result in more unsuccessful investments for investors. In the long run, history has judged clearly that such incidents serve to reduce IPO's, cost jobs, and cost investors money sorely needed for retirement and education.