WEILD&CO.

Hearing on Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens, Part II

Statement of David Weild, Founder, Chairman & CEO of Weild & Co., Inc.,
before the U.S. House of Representatives Financial Services Committee, Capital Markets and Government Sponsored Enterprises Subcommittee, May 13, 2015.

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Contents

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Introduction

Chairman Garrett, Ranking Member Maloney and members of the Subcommittee, thank you for again inviting me to speak at this important hearing. My name is David Weild. I am Chairman & CEO of Weild & Co., which we founded to improve equity capital formation and support for corporate issuers and their investors. As many of you know, I was formerly vice chairman of The NASDAQ Stock Market with responsibility for all of its listed companies, and I ran the equity new issues business of Prudential Securities, back when Prudential Securities was one of the ten largest underwriters of new issues equities in the United States. We've written extensively on capital formation and recently appeared before the G-20, the Securities & Exchange Commission's Advisory Committee on Small & Emerging Companies and have authored work for the Organization of Economic Cooperation and Development ("OECD") entitled, "Making Stock Markets Work to Support Economic Growth."

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The Need for Venture Exchanges

Improving access to equity capital in the United States is, we believe, still a critical need for our economy. Small companies are the job creators of our economy and small companies are started with equity capital – not debt. For all the quantitative easing of the Federal Reserve, banks won't lend to small businesses on the scale necessary until we improve their access to equity capital. For all the good work that this Subcommittee has done – including The JOBS Act and the recently announced SEC Tick Size Pilot - we still have not answered the question that former Democratic Senator Ted Kaufman posed from the floor of the U.S. Senate in 2009, namely, "How can we create a market structure that works for a $25 million IPO — both in the offering and the secondary aftermarket. If we can answer that question, Mr. President, this country will be back in business."[1]

The "Main Street Growth Act," which would establish a new class of stock exchanges catering to the needs of small cap companies, has the potential, with some modifications, to get this country back in business. It has the potential to go down as one of the most important Acts to come out of this, or any, Congress by creating essential infrastructure in support of U.S. economic growth. It has the potential to bring back American entrepreneurial swagger and to reignite the American Dream. It has the potential to create jobs on a scale that will improve labor participation rates and hourly wages and help lift many middle class and lower income people to reach their aspirations of financial well-being.

When corporations access capital they hire people. Those people spend money in the economy on everything from lawyers and accountants to construction and restaurant workers - a "multiplier effect" is created. The benefits become widespread.

The Subcommittee through its work on The JOBS Act and Tick Sizes has done much with the SEC to lay the groundwork to improve equity capital formation. However, the data shows that while small business and IPO activity has improved modestly, it still has a long ways to go. What is needed, is an institutional solution – Venture Exchanges – to an institutionalized problem:

- The economist Robert Litan recently wrote in Foreign Affairs that "In 1978, start-ups—defined in the database as companies less than a year old—accounted for nearly 15 percent of all U.S. firms; by 2011, that figure had slipped to just eight percent. For the first time in three decades, business deaths exceeded business births."[2]
- In our earlier work[3], we concluded that the collapse of aftermarket economic incentives to support small cap companies, brought on by Reg. ATS in 1998, precipitated a collapse in the ecosystem of dealers and in turn the small IPO market. As a result,

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[1] See http://green.lib.udel.edu/webarchives/kaufman.senate.gov/press/press_releases/release/-id=352c7e34-1cad-4ad3-b31c-c267bd492d1a.htm

[2] *Foreign Affairs,* January/February 2015, "Start-Up Slowdown: How the United States Can Regain Its Entrepreneurial Edge" *By Robert Litan*

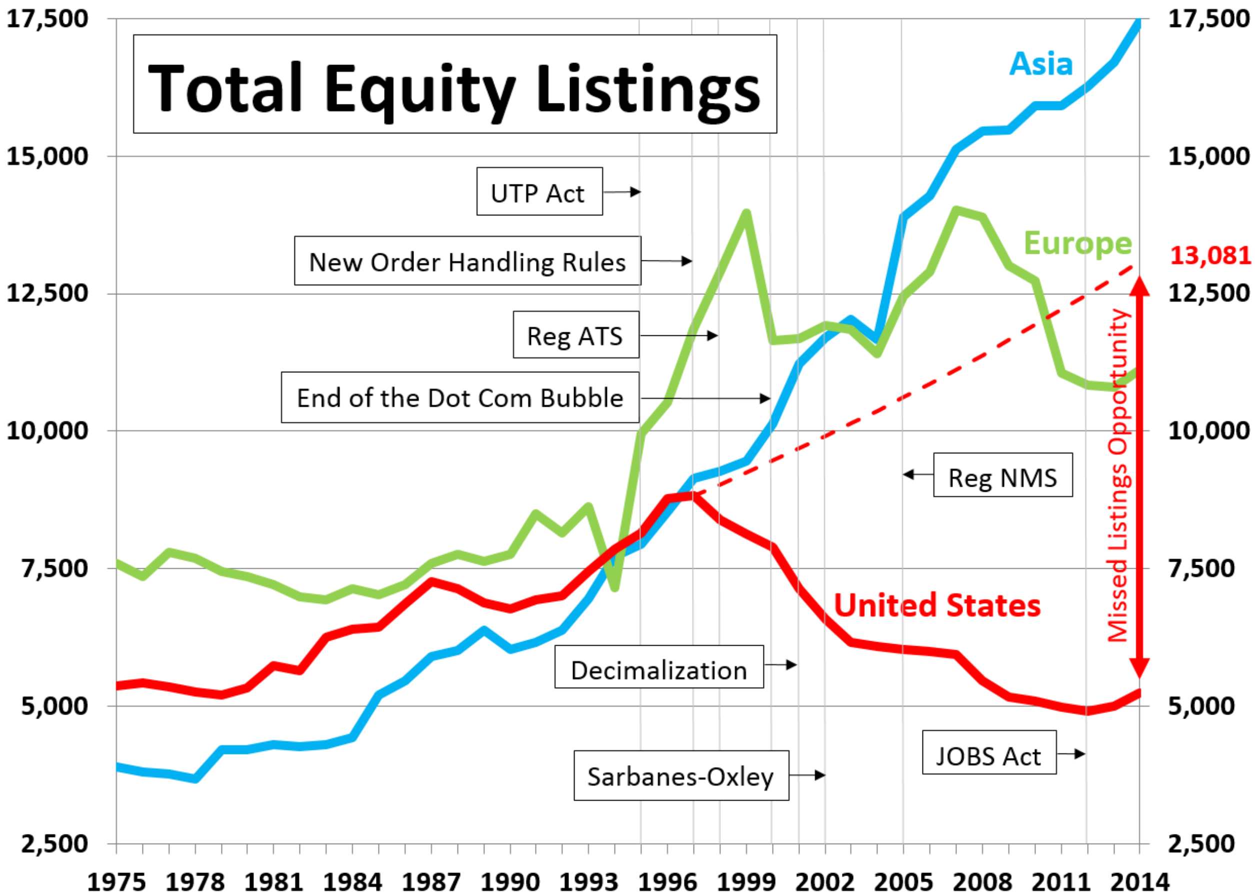
[3] See "Market structure is causing the IPO crisis – and more" by Weild & Kim (Grant Thornton – 2010) and "The U.S. Need for Venture Exchanges" by Weild & Kim (Weild & Co. – 2015).

- The U.S. has averaged only 150 IPOs per year since 2000 versus what was 500 IPOs a year prior to the Dot Com Bubble and should be 950 IPOs a year on today's larger economy.
- The number of small IPO book running managers collapsed from 164 book runners in 1994 to only 31 for all of 2014. Of the 164 book running investment banks in existence in 1994, only 34 of these firms are in existence today.

The Main Street Growth Act (Recommendations)

U.S. stock markets have become one-size-fits-all stock markets optimized to trade large cap stocks. The structure and rules have been a disaster for small cap companies, entrepreneurship and job creation. The "Main Street Growth Act" would change this by establishing a second stock market structure – one allowing its sponsors broad discretion in addressing the needs of small-cap companies, their investors, and the ecosystem of value providers – broker-dealers, research providers and market makers - needed to support them. This is a noble and important Act for the American people and deserves the attention and support of both parties.

The United States once had a very successful venture exchange that gave us companies like Intel, Microsoft, Staples and Starbucks. That venture exchange was called the National Association of Securities Dealers Automated Quotation System or the original "NASDAQ." The "Main Street Growth Act" proposes to allow "Venture Exchanges" to write rules that would be exempt from many of the very changes that caused NASDAQ to quote stocks in penny increments and cater to High-Frequency Traders. This Act establishes a clean canvas on which Venture Exchanges would be able to "paint" solutions designed to meet the needs of small cap growth companies and their investors.



Sources: Weild & Co., World Federation of Exchanges, CFA Institute

My primary concern is that the Act does not go far enough: Many currently public companies are struggling against the current market structure. With that in mind, we offer the following improvements for inclusion in the current Act:

1) **Venture Exchanges should be opened up to all currently reporting (SEC registered) U.S. companies that are under $2 billion in equity market value <u>or</u> have less than $1 billion in revenue and are public for 5 years or less.** Many public companies are struggling to find research coverage and real market making support under the current one-size fits all stock market regime. Not allowing already public companies to have a choice in listing (trading) venue is not fair to those companies and their investors. A venture exchange could help already public companies attract new investors, attract research coverage, improve share prices and lower the cost of growth capital.
2) **Create an orderly transition for companies to graduate from a Venture Exchange – Companies should be permitted to stay on a venture exchange until they have exceeded some higher threshold (say $2.5 billion) for twelve consecutive months.** Stocks frequently trade above and below thresholds – especially in bull markets. Higher prices must be sustainable and there must be a seasoning or "grace" period to allow companies to prepare for a transition and to prepare shareholders for that transition.
3) **Explicitly permit broker-dealer member-owned venture exchanges.** The profitability of the ecosystem of broker-dealers will determine the success of venture exchanges. Stock exchange profitability is much less important than dealer profitability because it is the dealers, and not the exchanges, that support small-cap stocks. In our research, we spoke to participants in the London AIM market, the Toronto TSX Venture Exchange and the Frankfurt Neuer Markt. These markets experienced problems when stock exchange profitability was put ahead of the needs of the dealer system. For this reason, we believe that the most successful model will be one that embraces member-owned exchanges.
4) **Finally, we recommend that listing thresholds be adjusted annually for inflation.**

Benefits to Consumers, Investors and the Poor

Consumers, Investors and the Poor are all indirectly harmed by low-cost, one-size-fits-all stock markets. This is what we refer to as the "*Low-Cost Paradox"* of small-cap markets: Large cap markets are naturally liquid. They don't depend on intermediaries. In this case, low-cost trading benefits consumers. However, small-cap markets are naturally illiquid. Without intermediaries to provide research, marketing, and capital commitment to support liquidity, small-cap markets deteriorate. The lack of sufficient aftermarket economic incentives causes broker-dealers to pull out from these markets. As a result, the capacity to take companies public declines, and share prices decline (through lack of support) harming investors as institutional investors shift capital allocations away from small cap illiquid stocks to large cap naturally liquid stocks.

Stock markets should not be looked at through the lens of other consumer-oriented businesses. They are unlike other products and services because the proper functioning of small-cap stock markets is essential to support access to capital, job creation, economic growth and the very competition from which consumers will benefit broadly throughout the economy.

How do consumers, investors and the poor indirectly benefit from by higher economic incentives? Bear with me, because this many be counterintuitive:

Consumers Benefit

Consumers benefit as more companies are able to access equity capital. More new companies means more competition and innovation. More competition and innovation means consumers benefit. Thus, the apparently simple, unarguable benefit of low cost trading has paradoxically harmed the consumer by causing a collapse in the capital formation infrastructure of our economy.

Venture Exchanges, by improving access to equity capital, will support the scientists, engineers and entrepreneurs who will find cures to cancer, global warming and the other great challenges we face.

Investors Benefit

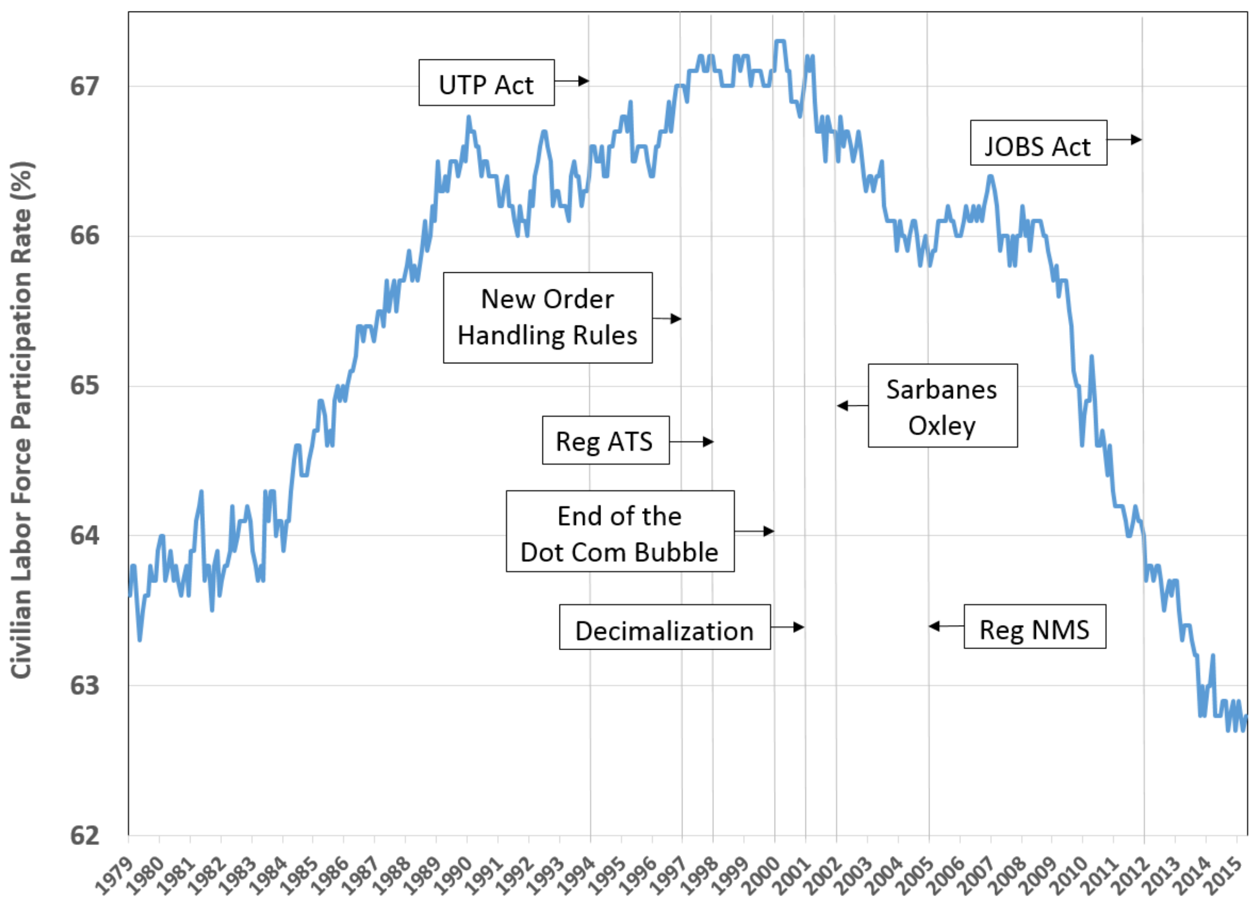
Long-term investment returns are dependent on long-term economic growth. The trajectory of long-term economic growth can be tilted upward by improving the rate at which start-ups are created and by improving the rate at which companies go public to free up more equity capital for investors to reinvest and start new companies – thereby creating a so-called "Virtuous circle."

The Poor Benefit

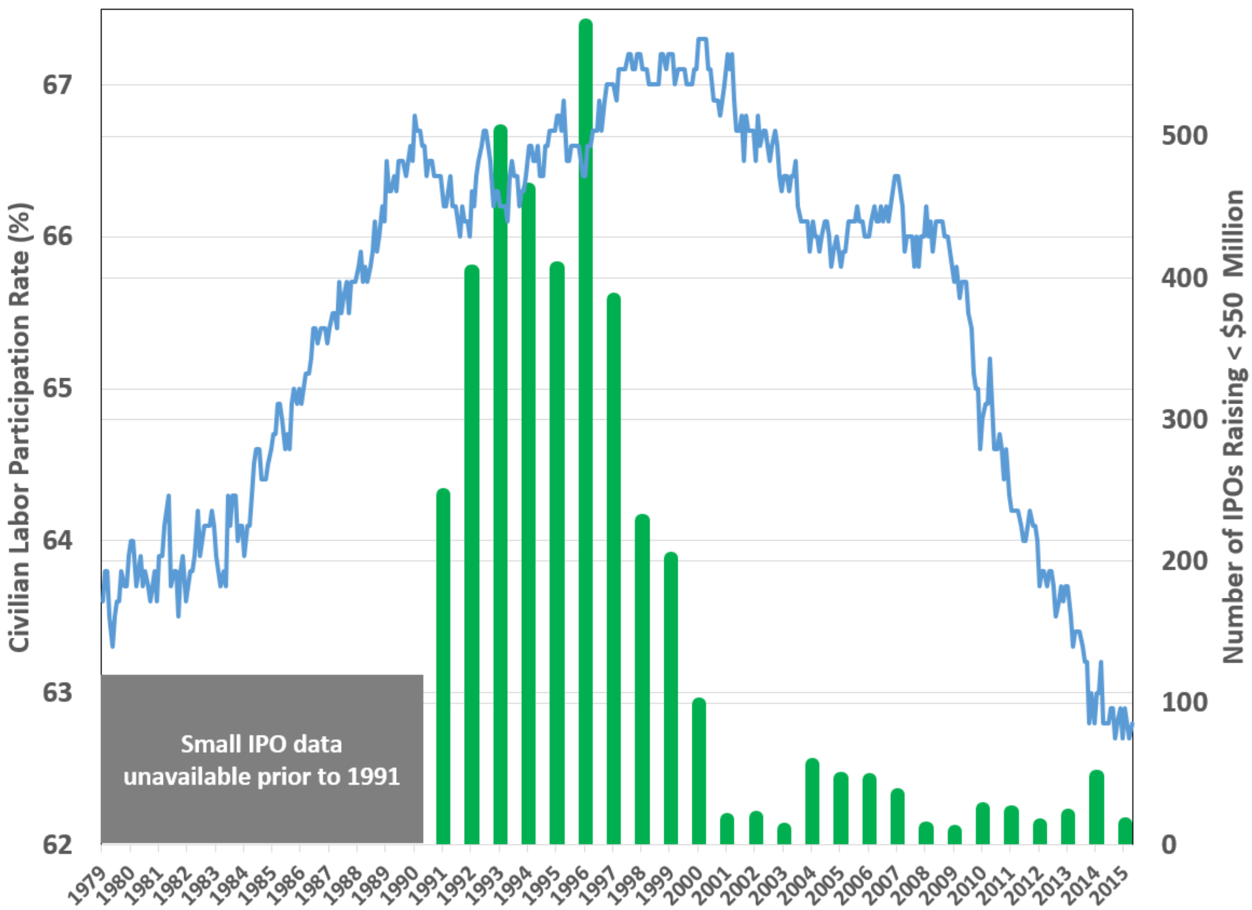
It is very clear that labor participation rates for 16 to 19 year olds, and 25 to 54 year olds – workers in their prime – have been declining since roughly the time that the bottom fell out of the small IPO market. It is also clear that workers of retirement age – 65 and older – are holding onto their jobs longer. The two trends combined – young workers working less and old workers working more – is a sign of a job market and economy under stress. I have said this to members of the Black Caucus and I will repeat it here – African Americans according to the Pew Institute, have an average net worth of somewhat more than $11,000 as of 2013. They are not day-trading stocks, as they simply do not have enough money to be invested in the stock market. Thus, they derive no personal benefit from low-cost trading. But poor people do need jobs. They need higher wages. And these are things that venture exchanges and the "Main Street Growth Act" can bring, in time.

Overall U.S. labor participation rates are now below where they were in 1979.

Labor participation rates stalled when aftermarket incentives were collapsed by Reg. ATS in 1998 and the bottom dropped out of the small IPO market. We believe the two (labor participation rates and the loss of the small IPO) are to some degree related.



Source: US Bureau of Labor Statistics. Seasonally adjusted.

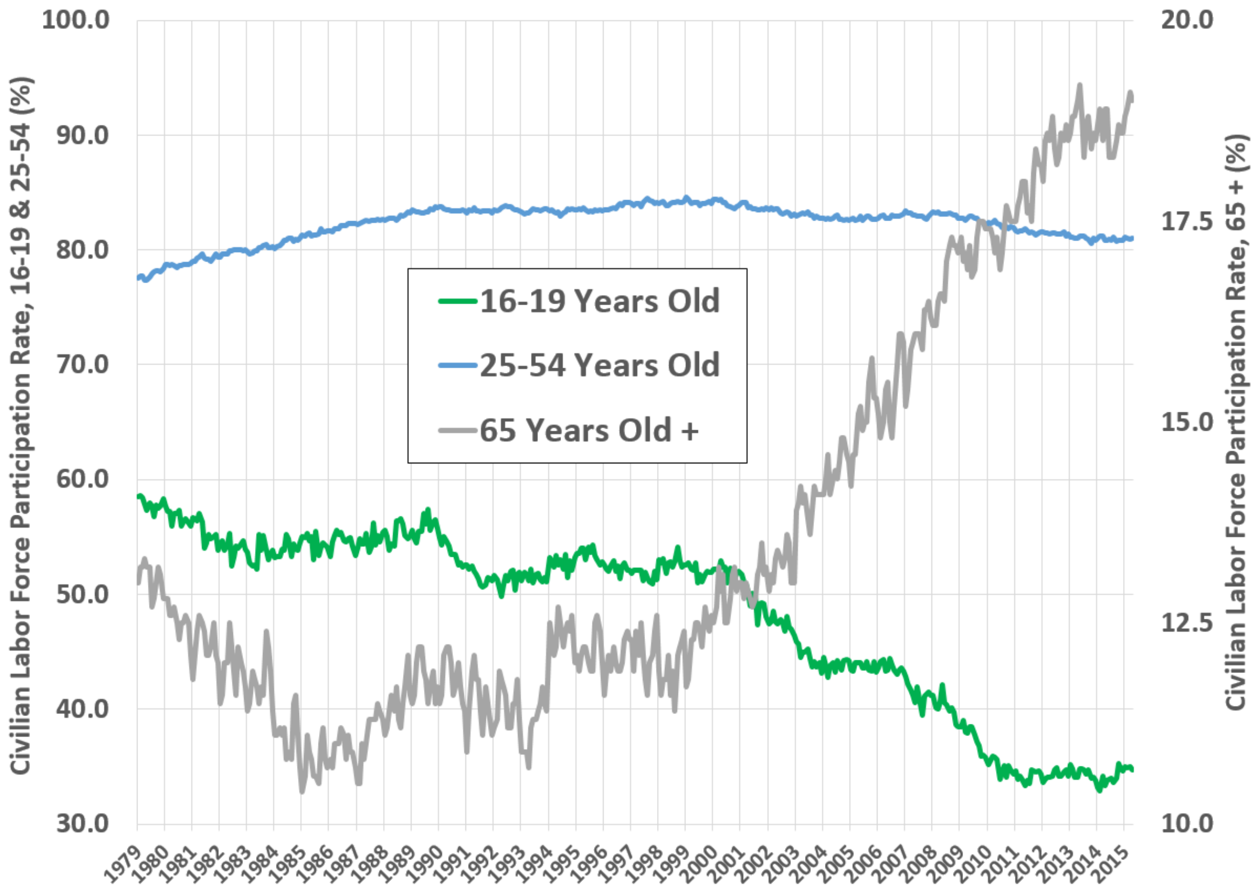


Sources: Labor data from US Bureau of Labor Statistics, seasonally adjusted. Transaction data from Weild & Co. and Dealogic, corporate IPOs only, excluding closed-end funds, REITs, SPACs and other financial vehicles.

Labor participation rates for young people (16-19) and people in their prime (25-54) have declined significantly since the late '90s.

The only segment of the population seeing a steady increase in labor participation rates is workers over retirement age (65+) – A sign, we believe, that older workers can't afford to retire.

Venture exchanges through the "Main Street Growth Act" will help reverse these disturbing trends.



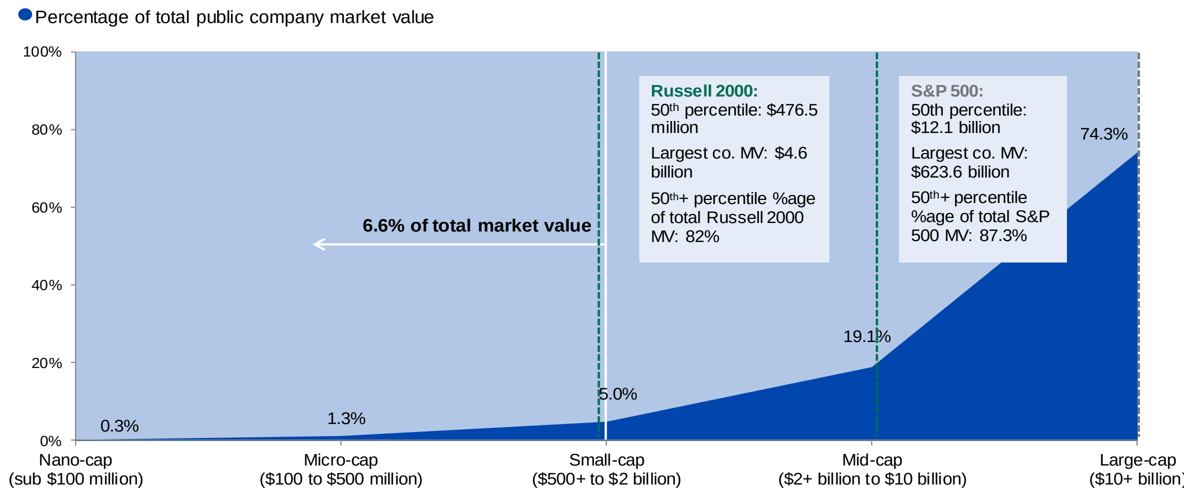
Source: US Bureau of Labor Statistics. Data for 16-19 year olds and 25-54 year olds is seasonally adjusted.

A vibrant capital market is the engine of a healthy economy that creates jobs. We estimate that, if not for the scarcity in public offerings, 3.1 million to 9.4 million additional U.S. jobs might have been created by companies after going public. If we assume a multiplier effect where higher IPO activity accounts for a like-kind number of jobs created in the private market (a conservative effect of only one for one), the range of 3.1 million to 9.4 million jobs created jumps to between 6.2 million and 18.8 million.

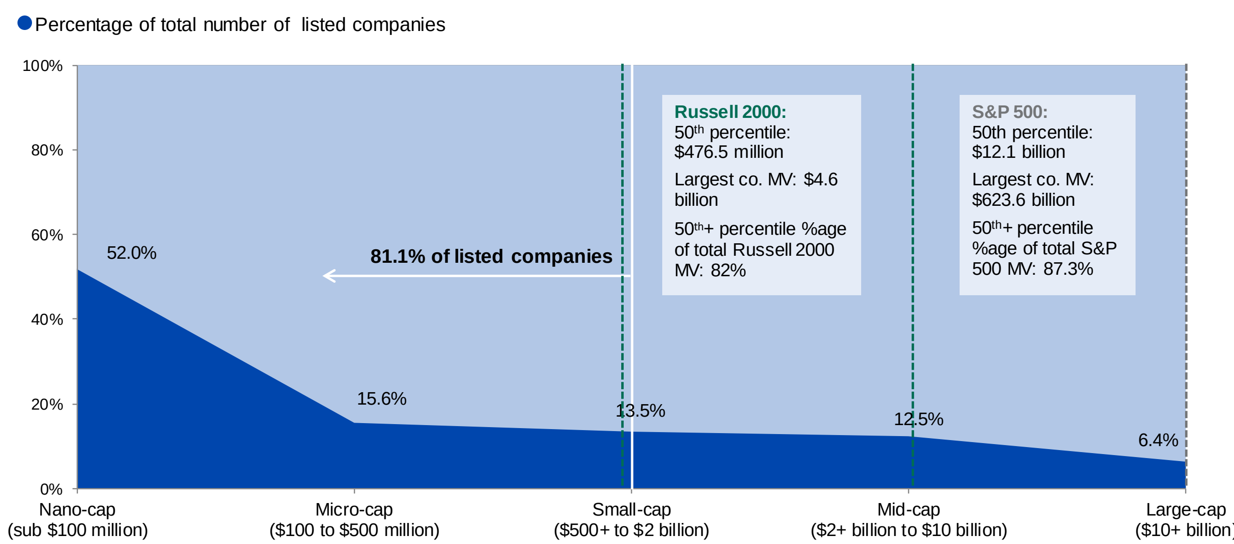
A major contributor to employment

In fact, the so-called multiplier effect may be much larger than we estimate above. Enrico Moretti, Professor of Economics at Berkeley, has estimated that as many as five local service sector jobs — ranging from doctors and teachers to wait staff and sales clerks — are created for every one technology and biotechnology sector job produced. These are the very industries that once sought out public offerings as their preferred strategy to raise capital (and exit). This five-to- one ratio of job formation has served to increase the number of employment opportunities at all skill levels and, ultimately, the U.S. standard of living.

Sub $2 billion market value public companies represent a small percentage of total stock market market value yet drive most job growth (directly or indirectly).



Sources: IssuWorks and Capital IQ
Includes NASDAQ, NYSE (including AMEX) and OTC listings. Corporate issuers only, excluding holding companies, funds, MLPs, SPACs, REITs and other trusts.



Sources: IssuWorks and Capital IQ
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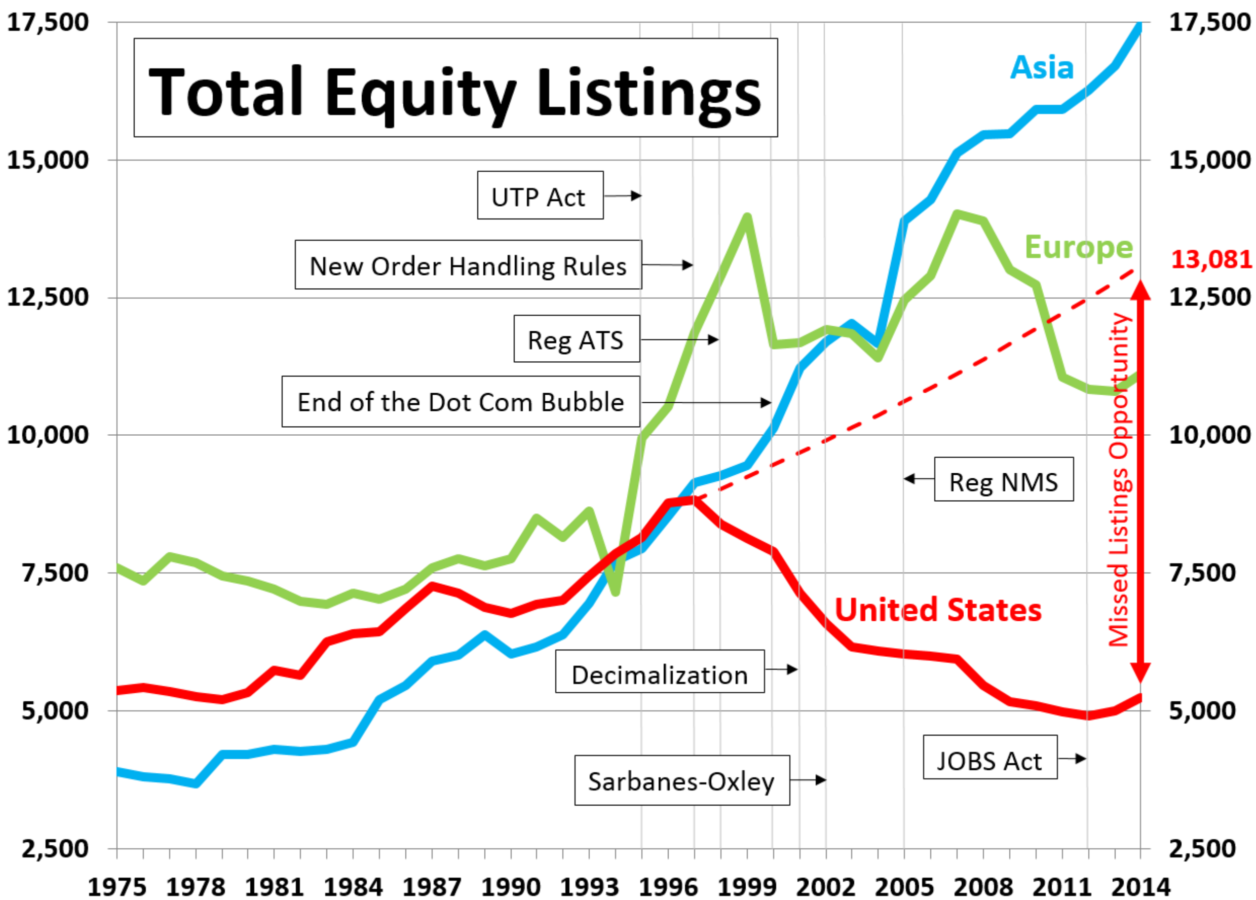
Specific responses to legislative proposals

H.R.____, the "Main Street Growth Act" (Chairman Garrett)

We support this Bill with enhancements as outlined above. This is an essential Bill for its potential to improve capital formation broadly and to create jobs in the United States. Our listed stock markets are in the midst of a long-term and protracted collapse which has been self-inflicted. As seen from data originally compiled by the CFA Institute's Jason Voss, the United States today has fewer publicly listed companies than we did at any point since 1975 (see Figure 1).

Figure 1: U.S. stock market listings have collapsed since 1997
The United States has just over 5,000 listed companies when it should have over 13,000.



Source: Weild & Co., World Federation of Exchanges, CFA Institute

In fact, we have slightly more than 5,000 publicly listed companies, when we should have more than 13,000 public companies, but for the fact that changes to market structure gutted the aftermarket support model in 1997 with the implementation of the Order Handling Rules followed by the shift to electronic markets in 1998 with Regulation ATS (Alternative Trading Systems) and one-size-fits-all penny stock trading in 2001 with "Decimalization."

H.R._____, the "Fair Access to Investment Research Act of 2015."

We abstain from comment on this bill. ETF research is not our area of expertise.

However, we would hasten to point out that ETFs are now a more than $3 trillion AUM industry. As ETFs (and other Index Funds) grow compared to actively managed mutual funds and direct stock ownership, they will close off an increasing percentage of equity capital from corporate America.

We urge Congress to consider requiring that all ETFs create a mechanism to participate in equity new issues so that ETFs can not undermine capital formation and economic growth.

H.R._____, To direct the Securities and Exchange Commission to review all its significant regulations to determine whether such regulations are necessary in the public interest or whether such reguolations shold be amended or rescinded.

We support this bill. As a general principle, we are supportive of most measures in government that require the scheduled, but not-too-frequent and burdensome, review and determination of whether each regulation is no longer necessary in the public interest or is outmoded, inneffective, insufficent or excessively burdensome.

H.R._____, the "Accelerating Access to Capital Act of 2015."

We support this bill. It appears to accelerate the availability of Form S-3 "Shelf Registrations" for public companies. The combination of short-selling and penny tick sizes has made it easier for predatory hedge funds to put pressure on stock prices ahead of an offering. Thus, the flexibility, speed and costs savings afforded by Form S-3 "Shelf Registrations" helps corporate issuers to improve their cost of equity capital.

We would also support the expansion of Form S-3 and other shelf registration approaches to improve access to capital for smaller public companies that are current with their SEC filings.

Conclusion

In our work for the Organization of Economic Cooperation and Development (OECD), we examined IPO markets throughout the world. It became obvious to us that the incentives and disincentives created by governments and regulators are the major determinant of the success (or lack thereof) of small IPO markets (and the aftermarket). The inescapable conclusion is that the collapse of the small IPO market in the United States was caused by ill-conceived and nearsighted public policy and that it can be rectified by improved and farsighted public policy that includes the creation of a regime designed to meet the very different needs of small-cap public companies. Intelligently designed "Venture Exchanges" would create a foundation for a resurgence in entrepreneurship, innovation and job creation. We believe that, once established and after perhaps a decade of operation, Venture Exchanges would lead to the creation directly (by companies accessing and investing capital) and indirectly ("muliplier effect" of jobs being created in the service sector of the economy because of the money spent by these companies and their employees) of 10 million jobs for the U.S. economy.

The ability of the United States to sustain itself as a world leader may rest on our ability to reverse the decades long trend of lower company start-up rates and lower IPO rates. Higher levels of entrepreneurship are the bedrock of a vibrant economy. The creation of Venture Exchanges, and the natural advocacy for entrepreneurship that would emerge from these exchanges, is one of the single most important actions that policy leaders can take to reignite the American Dream and restore America's position as the "Capital market envied by capital markets throughout the world."

About David Weild

David is the Chairman & CEO of Weild & Co., which he recently founded to create technologies and services to improve equity capital formation and aftermarket support. Weild & Co., Inc. owns Weild Capital, LLC. (Formerly IssuWorks Capital), a FINRA-registered broker-dealer.

Experience

David is an internationally recognized expert in how market structure affects capital formation. His work has been cited by academics, regulators and lawmakers in the US and overseas and the IPO Task Force Report to the U.S. Treasury. He was the former vice-chairman and executive vice-president of The NASDAQ Stock Market, with oversight of the more than 4,000 listed companies. Prior to NASDAQ, he spent 14 years at Prudential Securities in a number of senior management roles, including president of ecommerce, head of corporate finance, head of technology investment banking and head of equity capital markets in New York, London and Tokyo. He worked on more than 1,000 IPOs, follow-on offerings and convertible transactions and was an innovator of new issue systems and securities underwriting structures, including the use of Form S-3s to mitigate risk for small capitalization companies raising equity and convertible debt capital. He created the Market Intelligence Desk — or MID — while at NASDAQ to support issuers in their quest to better understand what was impacting trading in their stocks.

Education

David holds an MBA from the Stern School of Business and a BA from Wesleyan University. He has studied on exchange at The Sorbonne, Ecole des Haute Etudes Commerciales and The Stockholm School of Economics.

Industry participation

David has participated in the NYSE's and National Venture Capital Association's Blue Ribbon Regional Task Force to explore ways to help restore a vibrant IPO market and keep innovation flourishing in the United States, and is Chairman of the International Stock Exchange Executives Emeriti (ISEEE) Small Business Financing Crisis Task Force. He has spoken at the G-20 in Istanbul and the OECD (Organisation for Economic Co-operation and Development) with the 35 member nations in attendance, plus the European Commission and the IOSCO (International Organization of Securities Commissions). David testified before the CFTC-SEC Joint Panel on Emerging Regulatory Issues in the wake of the May 2010 flash crash, and has spoken at the SEC a number of times, including the SEC Small Business Forum, the

SEC Advisory Committee on Small and Emerging Companies and the SEC Roundtable on Decimalization. David is often interviewed by the financial news media. He has served as a Director of the National Investor Relations Institute's New York chapter, and he is the Chairman of the Board of Tuesday's Children, the non-profit that serves 9/11 families, and recently expanded its charter to make its long-term programs available to first responders, wounded warriors, families of the fallen and those touched by other acts of political and apolitical terrorism (e.g., Newtown).

Publications

David and Edward Kim have co-authored a number of studies, including *The U.S. Need for Venture Exchanges* published by Weild & Co. in March of 2015, *The trouble with small tick sizes: Larger tick sizes will bring back capital formation, jobs and investor confidence (Grant Thornton)* (with Lisa Newport) in 2012 and *Why are IPOs in the ICU? (Grant Thornton)* in 2008. Released in the fall of 2009, *Market structure is causing the IPO crisis (Grant Thornton)* (updated by *Market structure is causing the IPO crisis — and more* in 2010) and *A wake-up call for America (Grant Thornton)* have been entered into the Congressional Record and the Federal Register. They also authored *Making Stock Markets Work to Support Economic Growth (OECD)* (with Lisa Newport) and the chapter, *Killing the Stock Market That Laid the Golden Eggs (FT Press)* in the recent book on high frequency and predatory practices entitled, *Broken Markets,* by Sal Arnuk & Joseph Saluzzi, published in May 2012.

The *Wall Street Journal* published an Op-ed by David Weild entitled, *How to revive small-cap IPOs* on October 27, 2011. This Op-ed called for the establishment of small-cap (venture) exchanges.

I would like to thank Edward Kim, my partner and co-author, for his many contributions to this work.

About Weild & Co.

Weild & Co. is developing next generation equity distribution and aftermarket support platforms to improve new issue performance and revitalize capital formation. Weild & Co.'s goal is to help investment banks, issuers, and the venture capital and private equity communities drive superior results by reducing the cost and complexity of new issue preparation while improving the distribution and aftermarket support of new issues. The combined effect will keep IPO "windows" open longer, resulting in higher throughput (more new issues).

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