

LEGISLATIVE PROPOSALS TO INCREASE ACCESS TO CAPITAL

June 26, 2018 (Senate Banking, Housing, and Urban Affairs Committee)

SENATOR DOUG JONES: “I want to go back to a bill that Senator Kennedy talked about briefly and one that Senator Cotton and I have introduced concerning the Small Business Audit Correction Act and I think it’s pretty clear that everyone on both sides of the aisle in Congress always take investor protection very serious and we should never take it lightly but I also recognize that sometimes rules can kind of spread and have meanings that catch up small businesses when they weren’t intended. I think our bill is a perfect example of trying to give some relief to small businesses, small firms which are privately held, non-custodial broker dealers who do not handle client funds and that are in good standing and is going to exempt those firms from the rigorous PCAOB audits and so first all, I would like to ask Mr. Keating: It sometimes could seem like a small issue, but can you just give us a sense of what regulatory costs like that can mean for a small firm, especially in a non-custodial type business?”

RAYMOND KEATING, Chief Economist, Small Business & Entrepreneurship Council: “I think in general, you’re right, it can seem small, but when you look at this type of requirement and you look at other regulations, this is one of the things that we have to fight on a constant basis because it’s not just the additional cost of this regulation, but it’s on top of everything else along the way. So when you look at small firms, again, they don’t have the legal department down the hall to handle these types of things, you’re right they often serve as a surprise because that legal department isn’t down the hall. So there are a whole bunch of things here, it’s uncertainty, it’s cost and ultimately it’s what would you be doing with those resources otherwise?”

SENATOR JONES: “And it’s important to note again that these are non-custodial firms, they don’t handle client money so they’re not auditing any kind of client money coming through like that.”

MR. KEATING: “What’s nice about all of these bills that we are talking about that that we support today is they are common sense carveouts that’s why I think they are bipartisan which is, again, a wonderful thing and somebody mentioned before we don’t see a lot of bipartisanship, but they are common sense carveouts that small businesses would certainly appreciate.”

SENATOR JONES: “Mr. Bullard, I would like to follow that up with you though and especially in light of earlier comments to RM Brown about the need for audits and sometimes the problems that we see when we exempt and carve out industries and companies from having those. I recognize those, as a lawyer I’ve seen that all too many times. I also know that the Accounting Institute, the American Institute of CPAs has kind of consistently said that this might not be needed for these firms, but I would like to get your thoughts on this particular bill if you’re familiar with it and what you think about it.”

PROFESSOR MERCER BULLARD, The University of Mississippi School of Law: “This is the exemption for brokers without custody?”

SENATOR JONES: “Yes.”

PROFESSOR BULLARD: “I think that there may be other reasons, there are a lot of reasons why an entity might be subject to public accountant oversight, but if they don’t have custody that resolves the securities law issue and I agree that unless there is some other public policy concern that there is no reason to require that they have a public accountant.”

SENATOR TOM COTTON: “Thank you, Mr. Chairman. Thank you, gentlemen, for your appearance today. I’d like to say a few words about the topic Senator Jones addressed, a bill that we have introduced, the Small Business Audit Correction Act. The bill would correct one of the unintended consequences of Dodd–Frank, specifically the massive increase in audit costs for small, non-custodial broker-dealers.

This is a big problem. In hindsight, I think it’s clear that Congress overshot the mark trying to prevent another Bernie Madoff-style scandal, when it extended Public Company Accounting Oversight Board audit requirements to these small, non-custodial broker-dealers. As a result, public-company audit rules for gigantic firms now apply to firms that don’t hold customer assets and couldn’t even pull off a Madoff scam if they wanted to in the first place.

Now this requirement might seem harmless or obscure, but in fact it’s increased costs for small broker-dealers a lot. One Arkansas broker told me that his audit costs had gone from \$6,000 to \$30,000—and he has only five employees and his offices are much smaller than the room in which we now sit. And that’s not an isolated incident to Arkansas either, I would venture that every member of the Banking Committee has constituents just like mine.

And when you think about it, this is a classic “square peg into a round hole” problem. As one Board-registered audit firm wrote in a letter,

“The Board audit requirement makes sense for public companies like Apple and Broker/Dealers that carry customer funds or securities, like Morgan Stanley, because the investing public and markets are potentially at much greater risk from these companies. Conversely, the PCAOB requirements make no sense for privately-held, small non-custodial firms that do not carry customer funds or securities—companies like mine. Currently, a 3-person small business is held to the same standards as Merrill Lynch; this is not right, fair or reasonable.”

As he wrote, in other words, it’s the big guys, the custodial firms, that should get the PCAOB audit, not the little guys.

Both the SEC and the PCAOB have said they have no data to suggest that this requirement has created a healthier, safer investment environment. In fact, even Board-registered audit firms, whom you’d think would be in favor of it, are speaking out against it. But it shouldn’t be a surprise: They’re losing business as small brokers die out.

That’s why my legislation would make a simple change. It would exempt the small, privately held, non-custodial firms in good standing from this Board requirement and

allow them to file their financial statements according to GAAS standards they used just a few years ago.

It's true regulators like the SEC and FINRA could relieve some of this compliance burden themselves, but they could also reverse that decision later on. I think our small broker-dealers deserve the regulatory certainty that will only come from a change in the law.

I think this is simply common sense, and I know it has widespread support. We've heard from many organizations who have sent letters of support, and as far as I know, there are no organized groups opposed.

So to sum up, I believe these unnecessary regulations are crushing our small broker-dealers and holding back economic growth, particularly in states like Arkansas. If we pass our bill, we can help lighten the load a little and allow more Americans to invest their money with small local broker-dealers, if that is their choice.

I address the question first to you, Mr Keating: Do you feel these small, non-custodial firms, and perhaps more importantly their customers, would benefit from returning to this type of right-sized audit standard?"

MR. KEATING: "Yes, I would agree with you 100%. You laid it out very well and I think this legislation makes sense and I think any kind of scaling to fit the size of the business has to be thought about when we're moving ahead with legislation and when folks like the SEC are moving ahead in terms of the regulatory burdens they put on things. And that speaks to just a larger regulatory issue of we need some institutional reforms in addition to fixes like this, so we don't have to come back and keep doing this. You know, cost benefit analysis, there's a bill in the House (78) where the SEC would be required to do a cost-benefit analysis and look at the impact on small businesses and market liquidity and so on. So, I think this makes perfect sense and I think we need to take the next step and say, "How do we stop the overshooting that you talked about."

SENATOR COTTON: "And Professor Bullard, do you share that opinion?"

PROFESSOR BULLARD: "I share the opinion on the bill, yes."

SENATOR COTTON: "Thank you. My time is nearly expired. I do hope this Committee can markup our legislation and then move it to the floor for committee vote, as well as some of the other meritorious bills we have passed. As our witnesses have made clear today too, I think this is another good example of working together in a bipartisan fashion. I know we don't have unanimous support for this legislation, but that's pretty rare in here, but we do have healthy support from Democrats and Republicans and I want to thank the Chairman and Ranking Member for trying to move ahead with additional important legislation in this Congress."