June 14, 2016

The Honorable Jeb Hensarling
Chairman
Financial Services Committee
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Maxine Waters
Ranking Member
Financial Services Committee
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Hensarling, Ranking Member Waters, and Members of the Committee:

This week the Committee is scheduled to mark up a series of bills that double down on the belief that you can promote healthy, sustainable capital formation by weakening protections for the providers of capital. The Committee continues to promote this approach despite a total lack of evidence that it is effective in increasing the amount of capital raised, as opposed to simply shifting capital raising into progressively less well-regulated areas of the markets. Among the ten capital markets bills being marked up this week, all but two would significantly weaken regulatory oversight, reduce transparency, and generally undermine the regulatory framework that helped make America's financial markets the deepest, most vibrant markets in the world.

We are therefore writing on behalf of CFA and Americans for Financial Reform to urge you **to oppose the following eight bills** scheduled for mark-up:

- H.R. 4850, the "Micro Offering Improvement Act"
- H.R. 4852, the "Private Placement Improvement Act"
- H.R. 4854, the "Supporting America's Innovators Act"
- H.R. 4855, the "Fix Crowdfunding Act"
- H.R. 5311, the "Corporate Governance Reform and Transparency Act"
- H.R. 5421, the ''National Securities Exchange Regulatory Parity Act''
- H.R. 5424, the "Investment Advisers Modernization Act"
- H.R. 5429, the "SEC Regulatory Accountability Act"

Vote NO on H.R. 4850, the "Micro Offering Improvement Act"

This legislation would create a yet another unnecessary and unwarranted exemption from the Securities Act of 1933 to enable the sale of micro-cap offerings (those involving sales of securities valued at $500,000 or less in a single year) without appropriate regulatory protections. While the legislation would limit the total number of investors in such offerings, it includes no requirement that those investors have the financial sophistication to understand the potential risks of the offering or the financial wherewithal to withstand any losses. Instead, it requires only that they have a "pre-existing relationship" with an officer, director or major shareholder of the issuer, a condition that provides no meaningful protections. The bill:

- doesn't require issuers to notify regulators of the offering,
- doesn't require them to provide even the minimal disclosures required under Reg D,

- doesn't impose any limits on the amount individuals can invest, and
- doesn't include any restrictions on secondary sales.

While the amendment in a nature of a substitute does make some improvements to the original legislation – by actually limiting it to micro offerings, for example, and adding a bad actor provision – these changes are completely inadequate to address the legislation's fundamental short-comings. In particular, since the bill preempts state authority over what are likely to be predominantly local offerings, there is unlikely to be any regulatory oversight exerted to enforce the bad actor provision or to otherwise prevent fraudulent and abusive practices. Certainly, the SEC doesn't have the resources to provide that oversight for offerings of this type. Because this legislation would very quickly and predictably become an avenue enabling questionable offerings to avoid regulatory scrutiny and countless retail investors to suffer devastating losses, we urge you to vote no on this legislation.

Vote NO on H.R. 4852, the ''Private Placement Improvement Act of 2016''

When Congress removed the ban on general solicitation in private offerings under Rule 506 of Regulation D, it both increased the risk of fraud in a market already plagued by misconduct and eliminated the primary red flag regulators had relied on to identify possibly fraudulent offerings. Acting in accordance with recommendations from investor advocates and state securities regulators, as well as the unanimous recommendation of the SEC's Investor Advisory Committee, the Commission has proposed a modest set of reforms designed to both improve compliance with existing rules and provide regulators with better information about this large, important and often opaque market. For example, the proposed rules would: require Form D, which includes basic information about the offering, to be filed in advance of any general solicitation; would require an additional filing at the termination of the offering containing information on the total amount of capital raised; and would stiffen the penalties for failing to file Form D. These filings are necessary both to provide regulators with basic information on the market and to alert them to potentially problematic offerings. In addition, the proposed rules would ensure that private funds, which are now free to advertise, follow guidelines designed to ensure their advertisements are not misleading. This legislation would prevent the SEC from finalizing those rule proposals even where it finds the actions are necessary to protect investors, to promote market integrity, and encourage capital formation. Because it would prevent the SEC from taking appropriate actions to provide needed oversight of the Reg D market, perpetuate widespread non-compliance with the existing filing requirements, and undermine informed policymaking, we urge you to vote no on this legislation.

Vote NO on H.R. 4854, the "Supporting America's Innovators Act"

This legislation would increase fivefold, from 100 to 500, the number of investors a venture capital fund can have while still qualifying for the exemption from the registration requirements under the Investment Company Act of 1940. This has the potential to significantly expand the number of funds that qualify for the exemption from the registration requirements, simultaneously freeing them from the obligation to comply with other substantive requirements designed to protect investors and promote effective regulatory oversight. Although sales of these unregistered funds would generally be limited to accredited investors, the definition of accredited investor fails to ensure that investors in these funds have the financial sophistication to understand potential risks, market power sufficient to demand access to information, or even the financial wherewithal to withstand potential losses. Because this legislation would expand the

exemption for venture capital funds without imposing any additional protections for investors, we urge you to vote no on this legislation.

Vote NO on H.R. 4855, the "Fix Crowdfunding Act"

Roughly a month after federal crowdfunding rules took effect, this Committee is being asked to vote on legislation to "fix" crowdfunding. Moreover, several of the proposed "fixes" would greatly increase the risks to crowdfunding investors by: increasing the amount they could invest in these highly speculative, early-stage start-up companies; reducing liability and thus the incentive funding portals have to ensure issuer compliance with the law; and inappropriately opening the door for issuers to use nonbinding solicitations of interest under the crowdfunding rules to attract investors for other types of offerings where such solicitations are not permitted. The provision to allow single purpose funds to invest in crowdfunding may offer potential benefits to investors, but only if appropriate safeguards are put in place – safeguards that are not included in this legislation. Ironically, it would only achieve any benefits by directly repudiating the principle on which crowdfunding is based, reliance on the "wisdom of the crowd." Rather than trying prematurely to apply a patchwork of fixes to a fundamentally flawed idea, and making things worse in the process, Congress and the Commission should take time to study how the crowdfunding market evolves in order to determine what changes are needed to address any concerns that may arise. We therefore urge you to vote no on this legislation.

Vote NO on H.R.5311, the "Corporate Governance Reform and Transparency Act"

Although this legislation is packaged as a bill to regulate proxy advisory firms, its effect would be to undermine their independence, thereby undermining their value to the investors who use their services. It would, for example, require proxy advisory firms to give companies whose proxy proposals they are supposed to independently analyze an opportunity to comment before any recommendation to investors is finalized. Moreover, it would give companies a right to bring an action in federal court to seek "equitable relief," including money damages, where they believe the proxy advisory firm has failed to provide sufficient opportunity for comment or been insufficiently responsive in responding to company complaints. We certainly agree that proxy advisory firms should be subject to appropriate regulation. Rather than create an entirely new regulatory regime for a handful of firms, however, we believe that is better achieved by regulating these firms as investment advisers, with a fiduciary duty to act in the best interests of the investors who rely on their services and an obligation to minimize and appropriately manage conflicts of interest. We therefore urge you to vote no on this misguided and misdirected legislation.

Vote NO on H.R. 5421, the ''National Securities Exchange Regulatory Parity Act''

Congress has exempted certain "covered securities" from state-level protections against fraud and abuse, but only where these securities meet listing standards imposed by leading national exchanges. The intent was to provide uniform national treatment for stocks of established companies that trade in national markets, while retaining state oversight of smaller, more local offerings. This legislation represents a backdoor attempt to broadly preempt state

oversight of even many smaller, more local offerings. It would do so by sweeping aside the requirement that companies meet listing standards comparable to those of leading national exchanges in order to be deemed "covered securities." Instead, it would condition the definition solely on listing on *any* exchange approved by the SEC. This proposal is particularly troubling in the context of recent discussions regarding possible creation of a new venture capital exchange, with listing standards specifically designed for the types of smaller offerings appropriately subject to state review. If this approach were adopted, investors could be left without the protections afforded by state oversight, without the protections afforded by high listing standards, and without any reasonable hope that the SEC will be able to provide effective oversight at the federal level. We therefore urge you to vote no on this deceptively dangerous bill.

Vote NO on H.R. 5424, the "Investment Advisers Modernization Act"

While this legislation is being presented as necessary to "modernize" the regulation of investment advisors, it would instead roll back the clock to the years before private fund advisors were subject to elementary oversight measures, measures that numerous documented abuses have shown to be necessary for investor protection. For example, initial SEC examinations conducted after the registration regulatory requirements were adopted found serious investor protection issues at over half of private equity funds examined, an astounding rate of malfeasance. The investors victimized by these ethical violations are hardly limited to sophisticated Wall Street players. As of 2013, thirty-five percent of the capital in private equity funds came from pension funds, mostly public pension funds – money set aside to provide a dignified retirement for teachers, firefighters, and police. The legislation would undermine the SEC's ability to take effective action to protect these investors. With its provisions to remove key elements of Form PF reporting requirements for numerous private fund advisors, the legislation would also reduce the information available to regulators to address systemic risk. This despite the fact that a recent report by the Financial Stability Oversight Council found that the ten largest hedge funds had levels of notional leverage that could exceed 20 to 1, mostly due to derivatives-driven strategies that could create financial instability during times of market stress. Because it would act to return private funds to the shadows of the financial system, and dramatically restrict the SEC's capacity to effectively protect investors from possible exploitation by fund advisors, we urge you to vote no on this legislation.

Vote NO on H.R. 5429, the "SEC Regulatory Accountability Act"

This legislation would foist upon the SEC unnecessary and unreasonable regulatory burdens, with no corresponding public benefit. The most prominent new requirement would mandate that the SEC identify every "available alternative" to a proposed regulation or agency action, an impossible standard to meet, and analyze the costs and benefits of each such alternative prior to taking action. The agency would also be required to perform over half a dozen new analyses and to review every single regulation in effect within one year after the passage of this Act, and again every five years thereafter, with an eye to weakening or eliminating such regulations. Any question concerning compliance with any of these new requirements could become material for a lawsuit. In short, this is a regulatory "accountability" act only if you believe that the SEC's primary accountability should be to the securities firms it is supposed to regulate rather than to the investors it is supposed to protect. The bill even fails its own cost-benefit test. Its sponsors have failed to identify a problem in need of a legislative

solution. The SEC already conducts economic analyses of its rules and is held to a very high standard by the courts in conducting that analysis. When the agency fails to meet that standard, industry groups have had no trouble over-turning its rules in court. Moreover, since the court overturned the proxy access rule, the SEC has adopted a new set of guidelines to ensure that its analysis meets the rigorous standard set in that court ruling. Those guidelines have been praised by the Government Accountability Office and by members of the House who have in the past been most critical of the SEC's cost-benefit analysis. This bill's sponsors also appear to have ignored the significant costs of its proposed approach. The Congressional Budget Office estimated, for example, that a previous iteration of this bill would cost $23 million to implement. Because this bill would further slow the already glacial regulatory process at the SEC and further empower Wall Street interests to derail needed regulatory accountability, we urge you to vote no on this legislation.

Conclusion

Markets function most efficiently when they are transparent, well-regulated, and trusted by investors and issuers alike. Each of these bills would, in its own way, threaten the transparency and effective regulatory oversight of our capital markets. As such, they threaten to undermine not only the health and integrity of our capital markets, but the very capital formation process they claim to promote. We therefore urge you to vote no on each of the eight above listed bills.

Respectfully submitted,

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