Consumer Federation of America

November 13, 2017

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:

We are writing on behalf of the Consumer Federation of America to urge opposition to four of the capital markets bills scheduled for mark-up tomorrow. Each of the four bills, in its own way and to varying degrees, continues a steady erosion in the health and integrity of our capital markets which will undermine, rather than enhance, capital formation.

- **Vote No on H.R. 4267, the Small Business Credit Availability Act**

H.R. 4265 imprudently would allow Business Development Companies (BDCs) to double the amount of leverage they can take on, from the current 1:1 limit (one dollar of borrowed money for each dollar of investor equity) to 2:1. Doubling their leverage will in turn increase their risk profiles and their likelihood of failure, triggering investor losses. This bill would allow these changes despite evidence that BDC's current leverage limits already significantly understate the actual amount of leverage BDCs take on. This is because the current leverage metric only considers the BDC's leverage at the fund level and does not consider the leverage that's embedded in the fund's individual holdings. According to Wells Fargo 4Q17 BDC Scorecard, for example, "In our view, the raw leverage measure (debt/equity) doesn't tell the whole story as the loans that BDCs hold have various degrees of implicit leverage." Recent market data shows that several BDCs operate with an effective leverage that substantially exceeds both the current and proposed leverage ratios. Before passing any BDC related legislation, Congress should ensure BDC's leverage estimates are accurately disclosed, their risks are fully understood, and that they are not engaging in excessive risk taking. Because this bill would allow BDCs to increase their level of risk, based on an already flawed metric that itself significantly underestimates BDC's level of risk, we urge you to vote no.

- **Vote No on H.R. 4279, the Expanding Investment Opportunities Act**

H.R. 4279 would allow Closed-End Funds (CEFs) to use the securities offering and proxy rules that are available to reporting companies under the Exchange Act, despite the fact that CEFs are investment companies and are subject to an entirely different regulatory registration and reporting regime under the Investment Company Act. The Investment Company Act regime reflects CEFs' activities investing in pools of securities. There is no reasonable justification for allowing CEFs to receive certain benefits that reporting companies receive when CEFs do not contribute directly to the capital formation process. Nor is there any legitimate reason why CEFs should be given favored regulatory status relative to other investment companies, such open-end mutual funds and ETFs. Instead of picking regulatory winners and losers, Congress should help foster a regulatory environment that allows similar investment vehicles to compete on the same terms based on their cost and quality. That regulatory environment already exists within the Investment Company Act regime, and the market has decided that CEFs, as currently structured and sold, are undesirable as compared with other more cost-efficient, better performing, more transparent and liquid funds. Congress shouldn't second-guess the market's decision. Because this bill would inappropriately shoehorn CEFs into a regulatory regime in which they do not belong and unjustifiably provide them favored regulatory status, we urge you to vote no.

- **Vote No on H.R 4015, the Corporate Governance Reform and Transparency Act**

Although H.R. 4015 is presented as a bill to regulate proxy advisory firms in order to better protect investors and the economy, its effect would be to undermine their independence, simultaneously increasing their costs and undermining their value to the investors who use their services. Several of its provisions are specifically designed to give the companies whose proxy proposals the firms are supposed to independently analyze greater input into and influence over their recommendations. It would, for example, require proxy advisory firms to give companies a first look at their draft recommendations and an opportunity to comment on them before any recommendation to investors is finalized. Proxy advisory firms would also be required to employ an ombudsman to take complaints about the accuracy of the voting materials from the companies that are subjects of the recommendations, and provide those companies with an opportunity to include a comment in materials sent to investors if their complaints are not resolved to their satisfaction. Together, these provisions would empower companies to bully proxy advisory firms into watering down their recommendations. 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. 4263, the Regulation A+ Improvement Act**

H.R. 4263 would arbitrarily and prematurely increase by 50 percent the amount that companies can offer and sell under Regulation A+ in a given 12-month period, from $50 million to $75 million. It would make this change despite the fact that the SEC already has unlimited authority to raise the cap as it deems appropriate. Since the Regulation A+ rules were adopted, the Commission has conducted a thorough study of developments in the Regulation A markets.[1] While the study found an "uptick" in Regulation A filings since the rules were adopted, in

[1] Anzhela Knyazeva, "Regulation A+: What Do We Know So Far?" prepared for the Division of Economic and Risk Analysis, Securities and Exchange Commission, November 2016, http://bit.ly/2huFv17.

particular among issuers taking advantage of the higher offering limits for Tier 2 offerings, it also found that a large majority of issuers seek to raise amounts below the tier cap. By carefully analyzing the market – including the success rate for offerings, how proceeds are used, and investor acceptance in light of extremely limited secondary market liquidity – the Commission can make an evidence-based decision regarding the appropriateness of raising the offering cap when it deems that doing so is consistent with its mission of protecting investors and promoting capital formation. Because this legislation arbitrarily increases the offering limit without evidence that doing so is either necessary or beneficial, we urge you to vote no.

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This Committee has an opportunity to carefully study our capital markets, identify factors that are impeding capital formation and undermining the public markets, and act to address those concerns. Instead, it has chosen to continue to rush through ill-considered, poorly thought out bills, such as these, that will further undermine the capital formation process and contribute to the continued decline of our public markets. The end result will be bad for issuers, bad for investors, and bad for the economy as a whole.

Respectfully submitted,

Barbara Roper
Director of Investor Protection

Micah Hauptman
Financial Services Counsel