

July 10, 2018

Dear Representative,

On behalf of Americans for Financial Reform, we are writing to urge you to vote in opposition to HR 5877 (the “Main Street Growth Act”) and HR 4537 (the “International Insurance Standards Act”) which are being considered on the House floor under suspension of the rules today.<sup>1</sup> HR 5877 would create a new system of “venture exchanges” that would trade shares in early-stage non-public companies. Venture exchanges are a bad idea that would pose significant dangers to retail investors and reduce incentives for companies to enter the public markets. They are also unnecessary since the U.S. venture capital system is already extremely successful in channeling investment to early stage companies. HR 4537 would subject international agreements addressing systemic risks from the insurance industry to restrictions that are not present in any other areas of international trade or commercial negotiations.

**HR 5877** would allow national securities exchanges to elect to be “venture exchanges” and trade shares in early stage companies, including non-public companies that have not made any public offering or registered with the SEC.

A threshold question concerning venture exchanges is why they are needed. The market for venture capital is already extremely healthy both in the U.S. and globally, reaching new records of approximately \$200 billion annually in venture capital funding, with over half in the U.S.<sup>2</sup> Ownership stakes in early stage non-public companies, including venture-funded companies, are already broadly available through over the counter markets to sophisticated individual investors, institutional investors, asset managers, and pension funds that can perform the complex due diligence needed to assess early startup companies without a track record of financial returns. Even for these kind of investors, the returns from venture investments are highly uncertain and mixed, with venture capital as an asset class generally underperforming the public markets over the long term.<sup>3</sup> Venture capital would seem to be an asset class that does not lend itself to trading by retail investors. In addition, inducing retail investors to trade non-public venture companies through venture exchanges would reduce incentives for companies to enter the public markets.

Increasing liquidity for venture capital investments should not be seen as an end in itself, but should only occur if it serves a real public policy purpose. Greater liquidity might be used as a vehicle for informed venture company insiders to exit and sell their investments before bad news about their company reaches the broader public. It would not, for example, have been beneficial if early stage investments in Theranos had been more liquid and company insiders had been able to sell out before the fraud at the company had been revealed. The U.S. public markets are the broadest, deepest, and most liquid in the world, and the success of public markets is most likely

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<sup>1</sup> Americans for Financial Reform is an unprecedented coalition of more than 200 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith-based and business groups. A list of coalition members is available at <http://ourfinancialsecurity.org/about/our-coalition/>

<sup>2</sup> See KPMG, Venture Pulse: Q1 2018 Global analysis of venture funding, available at: <https://home.kpmg.com/xx/en/home/insights/2018/04/venture-pulse-q1-18-global-analysis-of-venture-funding.html>

<sup>3</sup> Mulcahy, Diane and Weeks, Bill and Bradley, Harold S, “We Have Met the Enemy...and He is Us: Lessons from Twenty Years of the Kauffman Foundation’s Investments in Venture Capital Funds and the Triumph of Hope Over Experience”, Kauffman Foundation, May 2012. Available at SSRN: <https://ssrn.com/abstract=2053258>

to be sustained if companies seeking liquidity are encouraged to go public. Furthermore, venture exchanges risk creating the appearance but not the reality of liquidity, as shares in early stage venture companies with limited information and disclosure are always likely to be thinly traded and vulnerable to pump and dump schemes or liquidity failure under stress. HR 5877 should be rejected.

**HR 4537** would subject international insurance standard or agreements addressing systemic risks posed by international insurance conglomerates to significant new restrictions, including a fast track Congressional veto process that does not exist in any other area of international trade or commercial negotiation.

The large insurance conglomerates that dominate the U.S. and global insurance market today are active far beyond the boundaries of any individual state. State-based insurance regulation is generally appropriate for key areas of insurance company oversight such as policyholder and consumer protection, but the implications of the financial activities of large insurance companies go beyond the purview of any single state regulator. One of the lessons of the 2008 financial crisis was the failure of state-based regulation to address problems at AIG Insurance, which received the largest Federal bailout ever given to a single company. As Professor Dan Schwarcz said during Congressional testimony on the subject, “the benefits of reducing systemic risk are felt almost entirely outside of the boundaries of any individual state. For this reason, systemic risk regulation should generally be conducted at the national and international levels.”<sup>4</sup>

The Dodd-Frank Act recognizes the importance of state-based insurance regulation and state regulators are currently given a very substantial consultative role in international insurance negotiations. HR 4537 increases this role and also puts in place unprecedented Congressional oversight requirements, including a fast track veto process for covered agreements that address risk protections for the financial activities of large insurance companies. It is ironic that Congress does not demand substantial powers of oversight or veto when it comes to international trade agreements that directly affect consumer safety, worker rights, and environmental protections, but does ask for such powers when it comes to overruling financial regulatory safeguards for multinational insurance companies. HR 4537 should be rejected.

Thank you for your attention. For more information please contact AFR’s Policy Director, Marcus Stanley, at [marcus@ourfinancialsecurity.org](mailto:marcus@ourfinancialsecurity.org) or 202-466-3672.

Sincerely,

Americans for Financial Reform

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<sup>4</sup> Testimony of Professor Daniel Schwarcz, Housing and Insurance Subcommittee hearing entitled, “The Federal Government’s Role in the Insurance Industry.” October 24, 2017.