



May 17, 2016

Dear Representative,

On behalf of Americans for Financial Reform, we are writing to express our opposition to the “Investment Advisors Modernization Act of 2016”.¹ Far from modernizing the regulation of investment advisors, this legislation would 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. The laundry list of regulatory exemptions in this bill would enable the exploitation of investors, possibly including outright fraud. It would also reduce the information available to regulators to address systemic risk.

Prior to the passage of the Dodd-Frank Act in 2010, advisors to private funds such as private equity and hedge funds were exempt from core oversight requirements under the Investment Advisers Act of 1940. The Dodd-Frank Act required these fund advisors to provide information to the Securities and Exchange Commission (SEC) concerning the funds they manage and also to comply with various recordkeeping, reporting, and audit requirements designed to protect fund investors. These requirements are helping to take private funds out of the shadows of the financial system.

The results of the Dodd-Frank changes have clearly demonstrated that Congressional concerns regarding regulatory exemptions for private funds were well-placed. Initial SEC examinations found serious investor protection issues at over half of private equity funds examined, an astounding rate of malfeasance.² Many of these issues involved draining resources from portfolio companies through fees without compensating or properly informing investors, and misallocating expenses to investors that should instead have been paid by the advisor. In response to these findings the SEC has thus far brought a half dozen enforcement actions against private equity funds that have recovered tens of millions of dollars for investors.³

¹ 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/>

² Speech by Chief Bruce Karpati, SEC Enforcement Division's Asset Management Unit, 23 January 2013, <http://www.sec.gov/News/Speech/Detail/Speech/1365171492120#.VPDIPE10zew>; and Speech by Director Andrew J. Bowden, Office of Compliance Inspections and Examinations, 6 May 2014, <http://www.sec.gov/News/Speech/Detail/Speech/1370541735361#.VPDkw010zew>.

³ In the Matter of Blackstone Management Partners L.L.C., et al., Release No. IA-4219 (Oct. 7, 2015), <https://www.sec.gov/litigation/admin/2015/ia-4219.pdf>; In the Matter of Kohlberg Kravis Roberts & Co. L.P., Release No. IA-4131 (Jun. 29, 2015), <https://www.sec.gov/litigation/admin/2015/ia-4131.pdf>; In the Matter of Clean Energy Capital, LLC, Release No. IA- 3785 (Feb. 25, 2014), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540849548#.VPDkp010zew>; In the Matter of Guggenheim Partners Investment Management, LLC, Release No. IA-4163 (Aug. 10, 2015),

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.⁴ In fact, a coalition of 13 state Treasurers, Comptrollers, and public pension funds recently sent a letter to the SEC calling for better enforcement and disclosure of fee practices by private equity funds.⁵

In the area of systemic risk, the new transparency mandated by the Dodd-Frank Act is also paying dividends. The recent report by the Financial Stability Oversight Council (FSOC) on systemic risks in the fund space 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.⁶ The FSOC recommended further study and more data gathering on this issue, which would not have been uncovered without the information provided on the Form PF reports mandated by Dodd-Frank. Yet the “Investment Advisors Modernization Act” seeks to remove key elements of Form PF reporting requirements for numerous private fund advisors.

The “Investment Advisors Modernization Act” would act to return private funds to the shadows of the financial system, and would dramatically restrict the SEC’s capacity to effectively protect investors from possible exploitation by fund advisors.

Section 2 of the bill would exclude major elements of the internal records of private equity funds from any requirements to maintain books and records for SEC inspection. This exclusion would cover key communications relating to due diligence on prospective investments, meaning that the SEC could not effectively audit to determine if the advisor had acted in the best interests of the client in making investments, as well as a broad range of internal firm communications, which are often crucial evidence in determining if a firm has behaved responsibly and honestly. Section 2 would also create major new loopholes in SEC rules designed to ensure that representations of fund performance in advertising materials are not false, misleading, or inaccurate – surely a core protection that the public deserves to have.

Section 3 of the bill would reduce transparency into private equity funds for both investors and regulators, enabling numerous possible forms of investor exploitation. The section would create

<https://www.sec.gov/litigation/admin/2015/ia-4163.pdf>; In the Matter of Alpha Titans, LLC, Release No. IA-4073 (Apr. 29, 2015), <https://www.sec.gov/litigation/admin/2015/34-74828.pdf>; In the Matter of Lincolnshire Management, Inc, Release No. IA-3927 (Sept. 22, 2014)

<http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543006673#.VPDkj010zew>

⁴ Appelbaum, Eileen, and Rosemary L. Batt. Private Equity at Work: When Wall Street Manages Main Street. New York: Russell Sage Foundation, 2014, Chapter 8, p. 239.

⁵ Letter from 13 state Treasurers and Comptrollers to SEC Chair Mary Jo White RE: Standardized Private Equity Fee Disclosure, 21 July 2015, http://comptroller.nyc.gov/wp-content/uploads/documents/SEC_SignOnPDF.pdf

⁶ Financial Stability Oversight Council, Update On Review Of Asset Management Products And Activities, 18 April 2016, <https://www.treasury.gov/press-center/press-releases/Pages/jl0431.aspx>.

major new exemptions from requirements that funds have an annual independent audit of their client funds and securities holdings – a precaution that could be crucial in preventing a fund from claiming to own securities when it actually does not, as Bernie Madoff did. Section 3 also creates significant new exemptions to current requirements that funds provide investors with plain-English narrative reports (“brochures”) that detail fees and compensation, investment strategies, risk of loss, any misconduct, and other financial information, and it would cut back from quarterly to annual the frequency of required reporting on insider securities transactions, an important item of information in determining whether insider trading has taken place.

This Section also eliminates key systemic risk information for regulators by dramatically reducing the number of funds who must report complete information on their leverage and holdings on Form PF, a confidential form used by regulators to track risks to the financial system. The bill would exempt all private equity fund advisors from complete reporting on this form, all hedge fund advisors with assets under management below \$1.5 billion, as well as liquidity fund advisors below \$1 billion. This is especially dangerous given that, as noted above, the information collected on Form PF has been and is being used by the FSOC to identify potential areas of systemic risk, and work to prevent them.

Section 4 of the bill would ban the SEC from applying anti-fraud protections to sales literature distributed to the general public by private funds under the new general solicitation provisions of the JOBS Act. The JOBS Act now allows private equity and hedge funds to engage in general advertising to the public, so long as funds take steps to ensure that all purchasers are “accredited investors,” a category that can include many retirees who have savings but are relatively unsophisticated in investment practices.⁷ Incredibly, this section would ban the SEC from applying even basic protections against fraudulent and misleading advertising to such general solicitation.

By eliminating a wide range of protections against investor abuse and even outright fraud, the “Investment Advisors Modernization Act” would empower private fund advisors to exploit investors in numerous ways. We urge you to reject this legislation.

Thank you for your consideration. For more information please contact AFR’s Policy Director, Marcus Stanley at marcus@ourfinancialsecurity.org or 202-466-3672.

Sincerely,

Americans for Financial Reform

Following are the partners of Americans for Financial Reform.

⁷ An accredited investor must have a net worth of \$1 million excluding the primary residence, or a current income of \$300,000 (for a couple) or \$200,000 for an individual.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- AARP
- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Center for Effective Government
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Green America
- Greenlining Institute

- Good Business International
- Government Accountability Project
- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Home Defenders League
- Information Press
- Institute for Agriculture and Trade Policy
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lawyers' Committee for Civil Rights Under Law
- Main Street Alliance
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Urban League
- Next Step
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen

- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

List of State and Local Partners

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio

- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN

- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- New Economy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG

- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Phoenix AZ
- UNET