AFR Americans for Financial Reform

May 23, 2023

The Honorable Patrick McHenry
Chairman
House Committee on Financial Services
2129 Rayburn HOB
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
House Committee on Financial Services
4340 O'Neill HOB
Washington, DC 20515

Dear Chairman McHenry and Ranking Member Waters:

Americans for Financial Reform (AFR) write to share our perspective regarding the four capital markets bills that the House Financial Services Committee ("HFSC") is scheduled to consider as part of its markup on May 24th, 2023.

As Congress made clear at the time of their adoption, the purpose of the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act") was to provide the investing public with critical information about securities offerings and the companies conducting securities offerings.[1] The securities laws are premised on the idea that all investors should have equal access to essential information about companies, so that they may make informed investment decisions. Congress and the Securities and Exchange Commission ("SEC") have repeatedly affirmed that access to this information is essential to promoting a fair and efficient marketplace, as well as protecting investors.

Unfortunately, for a variety of reasons, in recent years, policymakers have taken steps to shift policy away from the disclosure-based public framework of federal securities laws.[2] Each new exemption expands the ability of companies to raise funds from the public without complying with the public company disclosure framework and providing disclosures that are critical to investment decisions."

Today, instead of going public, many large companies are opting to remain private. To the profound detriment of most investors, the exception has come to literally swallow the rule, with the amount of capital raised in the "exempt" markets dwarfing the amount raised in public markets, and the number of U.S. public companies having declined by over 50 percent during two decades.[3]

The dramatic expansion in the size of private markets requires that Congress conduct a comprehensive review of the nature and purpose of the exempt offering framework, and ensure that it serves not only

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[1] Often referred to as the "truth in securities" law, the Securities Act of 1933 has two basic objectives: to require that investors receive financial and other significant information concerning securities being offered for public sale; and prohibit deceit, misrepresentations, and other fraud in the sale of securities. The Securities Exchange Act of 1934 created the Securities Exchange Commission and identifies and prohibits certain types of conduct in the markets and provides the Commission with disciplinary powers over regulated entities and persons associated with them.

[2] https://www.sec.gov/education/capitalraising/exemptofferings

[3] See discussion in Release, as well as Doidge, Craig and Kahle, Kathleen M. and Karolyi, George Andrew and Stulz, Rene M., Eclipse of the Public Corporation or Eclipse of the Public Markets? (January 1, 2018).

the needs of issuers, but investors. The bills being proposed today, if enacted, will reinforce this fundamentally harmful and issuer-centric policy agenda at the expense of investors and the fairness of the capital markets.

With these principles in mind, we appreciate your consideration of the views and concerns raised below.

1. **H.R. 3063, the Retirement Fairness for Charities and Educational Institutions Act**

H.R. 3063 would amend various federal securities laws to allow 403(b) retirement savings plans access to collective investment trusts ("CITs") and unregistered insurance company separate accounts.

Although H.R. 3063 has been mischaracterized by some as an innocuous technical fix intended to create "parity" between 403(b)s and 401(k)s, because of the material differences between how these plans are managed, there will be significant differences in how CITs and annuities will affect these retirement plans. Currently, securities laws require mutual funds and variable annuities that are sold to 403(b) plans to register with the SEC. By registering, they disclose essential information, including their key features, risks, and costs. SEC staff review these disclosures to ensure that they provide full and fair disclosures and comply with rules relating to the proper form and content of registration statements.

This bill would allow unregistered securities, including unregistered mutual funds and unregistered variable annuities, to be sold by unregistered brokers to 403(b) plans and plan participants. This includes both ERISA and non-ERISA 403(b)s.

This would allow brokers of unregistered securities to bypass providing disclosures to investors to enable informed decision making. Additionally, the financial professionals selling these products would not be subject to any broker-dealer regulation, including SEC Regulation Best Interest, advertising rules, recordkeeping requirements, and supervisory responsibilities, nor would they be subject to examination by the SEC and FINRA.

Importantly, while some 403(b) plans are subject to fiduciary protections under ERISA, many are not, and thus lack an ERISA-mandated plan administrator with a fiduciary obligation to make sure the plan is run solely in the interest of its participants. As non-ERISA 403(b)s are commonly offered to public school teachers, the practical effect of H.R. 3063 would be to remove meaningful safeguards for teachers saving for retirement. The bill would allow and encourage the sale of products that have detrimental features by financial professionals who have no obligation to comply with broker-dealer consumer protections.[4]

We urge the Committee to reject H.R. 3063.

2. **H.R. 2622, a bill to amend the Investment Advisers Act of 1940 to codify certain Securities and Exchange Commission no-action letters that exclude brokers and dealers compensated for certain research services from the definition of investment adviser, and for other purposes.**

H.R. 2622 would codify an SEC "no-action" letter that temporarily permits broker-dealers who operate in Europe and are subject to its MiFID II rules to avoid registering with the SEC as investment advisers. MiFID II provides that brokers operating in the European Union cannot provide both trade execution and investment research services. To achieve this aim, the bill would create a new registration exemption under the Investment Advisers Act of 1940.

[4] Consumer Federation of America letter Re: May 24th Markup of House Financial Services Committee Bills (May 17, 2023).

The practical effect of H.R. 2622 would be to codify and thus permanently extend a policy of regulatory relief that was ostensibly put into place on a "temporary" basis by the SEC Staff in 2017.[5] That policy, articulated in the "no-action" letter, has since allowed for the "bundling" for sales purposes of two otherwise distinct services without subjecting research providers to the Investment Advisers Act.

In our view, the SEC's no-action relief policy creates challenges for regulators and skews incentives in ways that don't serve investors. Broker-dealers have historically bundled order execution services with research in exchange for higher execution commissions, also known as "soft commissions." Research bundling has also been shown to reduce transparency in pricing for different services, and it has the potential to lead to conflicts of interest between investment managers and end investors.[6] Moreover, the present lack of competition for trading services doesn't just harm investors. Broker-compelled bundling also inhibits competition in both the research and trade execution businesses.[7]

We urge the Committee to reject H.R. 2622.

3. H.R. 1553, the Helping Angels Lead Our Startups (HALOS) Act

H.R. 1553 would require the SEC to amend Rule 506 of Regulation D to specify that prohibitions on general solicitation and advertising in Rule 506(b) offerings do not apply to sales promotion events (also called "demo days," "venture fairs," or "pitch days") that are sponsored by various types entities named in the statute - including governmental entities, colleges or universities, nonprofit organizations, angel investor groups, trade associations, venture forums, or venture capital associations. The bill would also limit the type and amount of information that may be communicated prior to and at such events.

The HALOS Act has been introduced consecutively since the 113th Congress, and for roughly nine years has failed to become law.[8] Beyond the simple fact that the policy changes the bill contemplates are of little obvious value, H.R. 1553 includes alarming restrictions that seek to prevent the SEC from taking corrective or remedial steps to protect investors should the need for additional protections become apparent. By their own terms, the inclusion of such an egregious statutory limitation on the SEC's ability to act in furtherance of its primary mission of protecting investors is grounds for opposing H.R. 1553.[9]

We urge the Committee to reject the HALOS Act.

4. H.R. 2627, the Increasing Investor Opportunities Act

H.R. 2627 would amend the Investment Company Act of 1940 to prohibit limitations on closed-end companies investing in private funds. Should the legislation be enacted, it would remove the SEC's policy of permitting a closed-end fund to invest only up to 15 percent of its assets in private securities, where such closed-end funds are being sold to non-accredited investors.

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[5] Press Release: SEC Announces Extension of Temporary Measure to Facilitate Cross-Border Implementation of the European Union's MiFID II's Research Provisions (Nov. 19, 2019)

[6] For example, evidence suggests the practice of bundling of research and execution services tends to distort best execution practices because it encourages securities firms to force investors to accept inferior execution quality in order to obtain research. *See* Impacts of Conflicts of Interest in the Financial Services Industry, The RAND Corporation (Feb. 2015)

[7] *See* Joint letter from Healthy Markets Association, CFA Institute, and Council of Institutional Investors to U.S. Securities and Exchange Commission re Research Payment Practices and Expiration of SIFMA No-Action Letter re MiFID II Implementation (Mar. 23, 2023)

[8] *See, e.g.*, H.R. 4915, 113th Cong.

[9] These restrictions were not included in prior versions of the HALOS Act.

Although the SEC has not finalized a rule with the limitation, closed-end funds with more than 15% of their assets in private funds have limited their offerings to accredited investors at the "urging" of SEC staff. This 15% threshold is rooted in the imperative of investor protection.[10] For example, closed-end funds do not offer daily redemptions and are not held to the same liquidity standards as open-end funds.[11]

We are not aware of any valid basis for allowing closed-end funds sold to retail investors to invest their entire portfolio in risky and illiquid private offerings. In addition, we question the extent to which investing in such funds could reasonably be construed to be suitable for most retail investors, much less consistent with the requirements of either SEC Regulation Best Interest or the Advisers Act.

We urge the Committee to reject H.R. 2627.

Again, thank you for the opportunity to comment on the bills that will be considered this week by the HFSC. Please don't hesitate to contact Andrew Park at andrew@ourfinancialsecurity.org should you have any questions.

Sincerely,

Americans for Financial Reform

[10] See, e.g., Speech: PLI Investment Management Institute by Dalia Blass, Director of the SEC's Division of Investment Management (Jul. 28, 2020). Accessible at https://www.sec.gov/news/speech/blass-speech-pli-investment-management-institute

[11] Ibid.