AFR Americans for Financial Reform

June 7, 2018

Dear Representative:

On behalf of Americans for Financial Reform, we are writing to urge you to vote against five of the bills under consideration at today's markup.[1] HR 3861 would eliminate key informational and advisory powers of the Federal Insurance Office (FIO), which plays an important monitoring function for the systemically critical insurance industry. HR 5877 would create a "venture exchange" that would exempt risky private companies from investor protections under state blue sky laws, and could expose ordinary retail investors to major losses on the next Theranos or other early stage company failure. HR 5756 would significantly reduce shareholders ability to influence the policies of companies they own. HR 5054 and the Budd discussion draft would unjustifiably reduce disclosures for public companies. The Committee should reject all five.

The bills are discussed in numerical order below.

HR 3861

Ten years ago, the failure of the insurance company AIG triggered the largest public bailout of a private company in U.S. history. During the financial crisis, other life insurers received tens of billions of dollars in public loans and capital injections due to losses in their annuity business and other businesses heavily exposed to financial markets.[2] The failure of multiple monoline bond insurers was also an important contributor to the 2008 crisis.

The Dodd-Frank Act did not touch our state based system of insurance regulation, leaving the authorities of state insurance regulators completely intact. However, in light of the problems revealed in the financial crisis, and the difficulty experienced by state regulators in monitoring the risks of global insurance giants with hundreds of billions of dollars in assets and numerous subsidiaries, the Dodd-Frank Act did add several new elements to insurance regulation. One of these was a new Federal Insurance Office (FIO) within the Treasury Department. FIO plays a monitoring and advisory role. To perform its monitoring function, FIO is empowered to collect data on the insurance industry nationally, including by collecting data from insurance companies above a certain size. FIO is also empowered to advise the Treasury Secretary on insurance policy issues and to represent the U.S. in negotiations on international insurance agreements where

[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 AFR members is available at http://ourfinancialsecurity.org/about/our-coalition/

[2] The Hartford and Lincoln National received over $4 billion in TARP capital and various insurance companies borrowed over $30 billion in liquidity funding from Federal Reserve programs. This is in addition to the $182 billion bailout of AIG. See Table 4 in Niehaus, Greg, "U.S. Life Insurers Responses to the Financial Crisis: A Review of the Research", *The Journal of Financial Perspectives: Insurance,* Volume 4, Issue 1, Ernst & Young. https://go.ey.com/2xPnGRP

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appropriate. FIO exercises its international negotiation powers in consultation with state regulators.

HR 3861 would severely weaken, indeed almost eliminate, FIO's powers and render it incapable of performing an effective monitoring or advisory function. The bill would remove FIO's ability to independently gather data and information from large insurance companies, remove FIO's advisory powers, and end its ability to represent the United States in international negotiations where a unified position is needed. These changes are uncalled for and would eliminate key abilities to provide unified monitoring of the insurance industry on issues ranging from financial system risk to consumer protection and racial discrimination in insurance contracts. HR 3861 should be rejected.

HR 5054

HR 5054 would exempt newly public companies with revenues under $1 billion and existing public companies with revenues under $250 million from requirements to issue financial disclosures in a machine-readable format. The exemption for existing public companies would expire after five years.

In the 21st century there is no excuse for public companies not to issue financial disclosures in a format that can be easily downloaded and analyzed via computer. Purely paper disclosures are much less useful and cannot be easily analyzed and compared to other financial data. The American Institute of CPAs recently found that small public companies generally pay $10,000 or less for machine readable XBRL filings.[3] This should be an easily affordable cost within the context of accounting costs for publically tradeable companies, and is greatly outweighed by the benefits of increased transparency for investors and securities analysts alike.

HR 5054 is opposed by the Council of Institutional Investors, Morningstar, and others. It should be rejected.

HR 5756

HR 5756 would dramatically raise the threshold for shareholder votes required to resubmit a previously submitted shareholder proposal. The bill would increase the threshold from 3 percent to 6 percent if a proposal has been made once within the preceding five years, from 6 percent to 15 percent if it has been made twice; and from 10 percent to 30 percent if it has been made three times within the preceding five years.

Shareholder proposals often do not gain support until they are resubmitted multiple times over a period of years. Such resubmissions allow investors to gain familiarity with the proposal. Board diversity proposals are an example of a type of shareholder proposal that at first received single-

[3] See AICPA, Research Shows XBRL Filing Costs Lower than Expected (2015), available at https://www.aicpa.org/content/dam/aicpa/interestareas/frc/accountingfinancialreporting/xbrl/downloadabledocuments/xbrl-costs-for-small-companies.pdf.

digit support but in recent years has gained strong investor support and has frequently been enacted. HR 5756 would make it much harder to resubmit proposals. In addition, HR 5756 would make it easier for insiders who hold increased voting rights in dual-class shareholding companies to effectively veto the resubmission of shareholder proposals.

The Council of Institutional Investors, the New York State Comptroller, and many other entities concerned with investor rights oppose HR 5756. We urge you to oppose it.

HR 5877

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. Shares traded on these venture exchanges would be exempted from oversight by state securities regulators.

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.[4] 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.[5] 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 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

[4] 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
[5] 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

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.

Adding to the general concerns about venture exchanges, HR 5877 would grant companies traded on venture exchanges a broad and far-reaching exemption from state securities registration requirements and supervision by state securities regulators under blue sky laws. This is an extremely risky and unjustified step when dealing with new, untested companies that have limited disclosure and high risk of failure and that are not adequately overseen by the Securities and Exchange Commission. Regardless of one's view of venture exchanges in general this would be a grave error. HR 5877 should be rejected.

Budd Discussion Draft (SEC R_002)

This discussion draft would permit "well known seasoned issuers" (WKSI) companies to engage in sales activities for new offerings before a prospectus for the offering has been filed with the SEC. If underwriters and dealers are permitted to communicate about an offering on behalf of an issuer before a registration is filed, they will be able to secure indications of interest, essentially pre-selling the security, before any documentation is available. By making the prospectus documentation irrelevant to sales this bill would undermine the transparency and fairness of our capital markets.

It is true that WKSI companies tend to be large companies that already have a track record. However, new offerings they make may still raise issues and require that investors be provided with clear and accurate information prior to purchase. It is unclear why new offerings by large public companies should receive an exemption from securities laws intended to protect investors and indeed such an exemption for well-known public companies would tend to disadvantage small companies and initial public offerings. We therefore oppose this legislation.

If you have questions, please contact AFR's Policy Director, Marcus Stanley, at marcus@ourfinancialsecurity.org or 202-466-3672. Thank you for your attention to this letter.

Sincerely,

Americans for Financial Reform