AMERICANS
FOR FINANCIAL REFORM
ACCOUNTABILITY • FAIRNESS • SECURITY

Americans for Financial Reform
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February 3, 2016

Dear Representative,

On behalf of Americans for Financial Reform (AFR), we are writing to express our strong opposition to HR 1675, the "Encouraging Employee Ownership Act of 2015".[1]

This legislation contains five provisions, four of which would significantly harm the ability of the Securities and Exchange Commission (SEC) to protect investors. At a time when markets are turbulent and investment products are growing ever more complicated, Congress should not act to make financial markets even more dangerous for investors.

Title II of the bill, entitled "Fair Access to Investment Research," would exempt broker-dealers from rules designed to prevent conflicts of interest in analyst reports on new financial products, including 'Exchange Traded Funds' (ETFs) and Business Development Companies (BDCs). These rules are designed to protect investors from situations where broker-dealers issue manipulative and biased 'research reports' designed to push flawed products in which the broker-dealer has a financial interest. Such misleading analyst reports played a significant role in the dot-com stock market bubble of the 1990s and have been shown repeatedly to be a significant threat to investors.

While some modification of these rules may be appropriate in particular cases, the statutory safe harbor granted in Title II is so sweeping that it would prevent both the SEC and the Financial Industry Regulatory Authority (FINRA) from effective oversight of conflicts of interest in the marketing of these complex financial products. Broker-dealers should not be permitted to pose as objective analysts of products in cases where they have a financial interest in investors' purchasing such products. In testifying on this legislation, University of Mississippi Law School Professor Mercer Bullard stated that, "The Act essentially destroys the foundation of Rule 139 [the key SEC rule protecting against conflicts of interest in this area] by undercutting the Rule's most fundamental principles."[2]

[1] Americans for Financial Reform is a 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 member groups is available at http://ourfinancialsecurity.org/about/our-coalition/

[2] Bullard, Mercer, "Testimony of Mercer Bullard Before the Subcommittee on Capital Markets of the Committee on Financial Services Re Legislative Proposals to Enhance Capital Formation And Reduce Regulatory Burdens, Part II", May 13, 2015; available at http://financialservices.house.gov/uploadedfiles/hhrg-114-ba16-wstate-mbullard-20150513.pdf

Title III of the bill, entitled "Small Business Mergers, Acquisitions, and Brokerage Simplification," would eliminate SEC broker-dealer registration requirements for merger and acquisition brokers. While a much narrower version of this legislation could be acceptable, this legislation poses risks to investors and to the fair conduct of our financial markets. It lacks needed investor protections, such as provisions to prevent bad actors from taking advantage of exemptions from registration to evade enforcement of securities laws.[3] It also applies the exemption from registration for M&A broker exemption far too broadly, to any acquisition of a company with gross revenues of $250 million or less. This goes far beyond transactions involving the purchase of local small businesses and would permit numerous deals involving companies of significant size to avoid broker-dealer oversight. Finally, the lack of an effective provision to prevent transfer to a shell company means that the broker could effectively also take control of the transferred company in a private-equity type transaction.

The potential application to private equity is concerning, as the exemption from broker-dealer registration would restrict the SEC in policing this complex area and interfere with ongoing SEC investigation of potential abuses in private equity involving unregistered broker-dealer activities.[4] This legislation is also unnecessary, as the SEC has already taken administrative action to exempt merger and acquisition brokers from broker-dealer registration, while preserving its capacity to enforce needed investor protections.[5]

We would also point out that numerous registered broker-dealers who comply fully with SEC broker-dealer conduct requirements are active in arranging deals to sell companies, and this overly broad legislation would expose them to competition from unregulated entities that would not have to comply with important investor protection requirements such as suitability standards. We believe this is inappropriate.

Title IV of the bill, entitled "Small Company Disclosure Simplification," would exempt over 60% of publicly traded companies from requirements to file machine-readable financial statements. By banning the SEC from requiring most companies in the market to file computer-readable financial data, this legislation would strike a serious blow against progress in bringing financial reporting into the 21st century. The legislation also directly contradicts recommendations from SEC staff and the SEC's Investor Advisory Committee which call on the agency to move to an open data disclosure system in order to benefit investors, issuers, and the public.[6]

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[3] North American Securities Administrators Association, "NASAA Letter to Senators Manchin and Vitter Re S 1923", September 8, 2014

[4] Buccacio, Katherine, "Republicans Look to Ease PE Regulatory Burden", Private Equity Manager, January 13, 2015; Morgenson, Gretchen, "Private Equity's Free Pass", New York Times, September 27, 2014.

[5] Securities and Exchange Commission, "No-Action Letter Re M&A Brokers", January 31, 2014 [Revised February 4, 2014].

[6] Securities and Exchange Commission, "21st Century Disclosure Initiative, Toward Greater Transparency: Modernizing the Securities and Exchange Commission's Disclosure System", January 2009; Securities and Exchange Commission Investor Advisory Committee, "Recommendations of the Investor as Owner Subcommittee Regarding the SEC and the Need for the Cost Effective Retrieval of Information by Investors", July 25, 2013.

Should Congress wish to address issues in the SEC's implementation of open data requirements, the answer is not to exempt the bulk of the market from any requirement to provide machine-readable data to investors. Instead, Congress should take steps that assist the SEC and the issuer community in moving data disclosure forward into the modern era of computerized, machine-readable information. Such steps could significantly improve financial sector transparency.

Title V of the bill, entitled "Streamlining Excessive and Costly Regulations Review," would impose extensive new statutory requirements on the SEC to review its body of existing regulations. This legislation is unnecessary, and would create major new administrative burdens on the SEC that would harm the agency's ability to protect investors and the market.

The review of existing regulations is a reasonable agency goal, for example when the intent is to determine whether regulations continue to be effective in protecting investors. And the SEC frequently issues exemptions and no-action letters based on requests from market participants to revisit the utility of past regulations. No legislation is needed to permit such reviews or actions.

In addition, the Regulatory Flexibility Act currently imposes a statutory requirement on the SEC to periodically review all rules that affect a substantial number of small entities. Furthermore the SEC complies with Executive Order 13563, which requires a retrospective review of all rules that "may be outmoded, ineffective, insufficient, or excessively burdensome" and to modify or repeal them as appropriate.

This legislation would add to these existing agency actions a statutory requirement for a review and full Commission vote on every existing significant rule every ten years under full Administrative Procedure Act requirements. This would place a crippling administrative burden on the SEC. The legislation would also require such full-scale reviews and Commission votes even for regulations that had been passed recently, within the ten year window. Thus the SEC would be required to review rules that had been passed quite recently and may not even have been fully implemented.

We urge you to reject HR 1675, which undermines investor protections in multiple ways, and preserve the SEC's ability to properly oversee our financial markets to ensure that they are transparent and fair to investors.

Thank you for the opportunity to express our views on this legislation. Should you have additional questions on this issue, please contact Marcus Stanley, AFR's Policy Director, at marcus@ourfinancialsecurity.org or 202-466-3672.

Sincerely,

Americans for Financial Reform