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June 3, 2022

The Honorable Pat Toomey
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510

Re: JOBS 4.0 Discussion Draft

Dear Senator Toomey:

On behalf of the Investment Company Institute (ICI),[1] I appreciate the opportunity to comment on the discussion draft of the JOBS Act 4.0 legislative package. We recognize the committee's efforts to build on the bipartisan success of the JOBS Act through legislative proposals that seek to increase economic growth, facilitate capital formation, and enhance participation in the US capital markets by retail investors. Many of the legislative proposals included within the discussion draft are issues that ICI has long supported, and we appreciate the committee's attention to these important topics which affect long-term investors.

Our recommendations are as follows:

I. Section 104 – Reporting Requirements Reduction Act (S. 3819)

ICI and its members – including regulated fund managers that are public companies – have serious reservations about diminishing the frequency of reporting by public companies. We are concerned that any change from quarterly to semi-annual reporting would diminish the amount and timeliness of information available to fund managers, thereby hindering their ability to analyze company performance and make informed investment decisions. We likewise are concerned that semi-annual reporting would impede price discovery and contribute to increased

[1] The Investment Company Institute (ICI) is the leading association representing regulated investment funds. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. Its members include mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in Europe, Asia and other jurisdictions. Its members manage total assets of $29.7 trillion in the United States, serving more than 100 million investors, and an additional $9.3 trillion in assets outside the United States. ICI has offices in Washington, DC, Brussels, London, and Hong Kong and carries out its international work through ICI Global.

volatility in security prices.[2] A change to semi-annual reporting also may increase the cost of equity capital for public companies and thereby diminish their long-term prospects.

Regulated funds are significant investors in equity and fixed-income securities issued by US public companies. Mutual funds, for example, held approximately $12.9 trillion in such securities on December 31, 2021, representing 58 percent of their total net assets. Mutual fund holdings represent approximately 23 percent of all outstanding US equity securities and approximately 20 percent of all outstanding US corporate fixed-income securities. Regular, reliable, and comparable information from public companies is essential to managers' investment decision-making on behalf of the more than 100 million Americans who invest in regulated funds.

II. Section 105 – Restoring Shareholder Transparency Act (S. 3945)

We have strong concerns with the provisions of Section 105 related to Rule 14a-8, the SEC's shareholder proposal rule. As a general principle, we believe that smaller shareholders should be able to submit proxy proposals pursuant to this rule, subject to reasonable conditions meant to ensure that their interests are aligned with those of a company's long-term shareholders generally. Following this principle, we supported the changes to the rule's shareholder eligibility and resubmission standards that the SEC adopted in 2020 under Chairman Clayton, which we regarded as reasonable regulatory line drawing. By contrast, these legislative amendments—particularly the requirement that a shareholder own at least 1 percent of the market value of the company's securities—would go too far by effectively precluding smaller shareholders from submitting proxy proposals.

III. Section 106 – Increasing Access to Adviser Information Act (S. 3965)

We support the goals behind Section 106, which is intended to encourage the provision of research by US broker-dealers to clients such as regulated fund managers. We recommend additional consideration of amendments to address a broader range of investment manager payments for research to US broker-dealers. Such amendments should not be limited to those payments solely subject to EU directives or similar laws from other foreign jurisdictions, including any future changes to those laws. Importantly, such an approach would be clearer and provide comparable treatment of research payments by investment managers related to both EU and US clients, as payments for research could be made directly on behalf of both groups. Under the current provision, complex and burdensome procedures would be needed to accommodate the different treatment of research payments on behalf of US clients.

IV. Section 302 – Access to Small Business Investor Capital Act (S. 3961)

We strongly support Section 302 which would eliminate the requirement that regulated funds report acquired fund fees and expenses (AFFE) in their fee table disclosure for their investments

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[2] *See, e.g.,* Robert C. Pozen and Mark Roe, *Keep Quarterly Reporting* (Sept. 5, 2018), available at https://www.brookings.edu/opinions/keep-quarterly-reporting/ ("With corporate results disseminated less frequently, stock prices would be less accurate as investors struggled to assess the financial effects of material developments without the company's numbers. Small bits of information loom larger in stock price valuations when investors are in the dark as to the actual earnings implications of such bits.").

in business development companies (BDCs). This would allow funds to treat BDCs in the same manner as investments in operating companies for expense presentation purposes.

We agree with this treatment because of the nature of a BDC's fundamental investment objectives, manner of operating, and associated expenses. A BDC is a closed-end investment company that Congress established for the purpose of making capital more readily available to certain types of companies. Under the Investment Company Act of 1940, a BDC must invest at least 70 percent of its assets in "eligible portfolio company," and certain other, securities. BDCs compete with various sources of capital, including private equity funds, hedge funds, and investment banks to provide financing to these companies.

Because of the nature of their business, BDCs typically have high expense ratios relative to traditional open-end and closed-end funds (CEFs). For example, BDCs typically finance a substantial portion of their investment portfolio through borrowing and the interest paid is included in the expense ratio. In addition, the expense ratio is based on net assets (i.e., the borrowed funds are a liability and are excluded from the asset base on which the expense ratio is calculated). For these reasons, a BDC's expenses are more like an operating company's expenses, and we agree with excluding BDCs from being treated as an "acquired fund" for purposes of the required fee table presentation.

In addition, Section 302 would have the benefit of causing the fee table expense presentation for funds investing in BDCs to better align with the expenses reported in a fund's financial statements and shareholder reports. AFFE are not expenses under generally accepted accounting principles and are not reflected as expenses in the fund's statement of operations. As a result, the expense ratio included in the fund's financial highlights table and the shareholder report expense example do not reflect AFFE.

V. Section 304 – Increasing Investor Opportunities Act (S. 3948)

We strongly support Section 304 of the Act with one modification, as set forth in **Appendix A**, to clarify that all CEFs, including those that publicly offer their shares to retail investors, may invest in private funds more fully.

Section 304 intends to expand opportunities for Main Street investors to access private investments through closed-end funds (CEFs), while maintaining the important protections for investors that only regulated funds provide pursuant to the Investment Company Act. Section 304 would also strengthen the CEF structure by eliminating a loophole that activist investors have used to extract short-term profits at the expense of retail investors.

CEFs are important retirement savings and investment vehicles that can provide steady, diversified streams of income to retail investors. They also serve as long-term sources of capital for small companies. CEFs have a robust regulatory framework similar to mutual funds with, among other things, requirements that minimize conflicts of interest, ensure the proper safeguarding of assets, and provide for comprehensive public disclosures. In addition, investment advisers to CEFs separately must register with the Securities and Exchange Commission (SEC) and adhere to strong fiduciary obligations and additional disclosure requirements. Further, the SEC has inspection authority over, and is tasked with monitoring and enforcing, CEFs' compliance with applicable laws and regulations.

While similar to mutual funds, CEFs have more flexibility to invest in less liquid assets, providing retail investors more opportunities to diversify their investments. With their strong regulatory structure, CEFs can provide retail investors with appropriate access to less liquid investments without the need for each investor to meet minimum sophisticated investor thresholds. These investments, which retail investors typically could not access on their own, provide enhanced opportunities to gain exposure to uncorrelated assets that provide protection in times of public market stress and to outperform other asset classes.

Despite their strong protections, the SEC staff currently restricts a CEF from investing more than 15 percent of its assets in private funds, unless the CEF sells its shares to accredited investors who make minimum initial investments of at least $25,000. In addition, through SEC staff direction, national securities exchanges must require any CEF seeking to list to confirm that the CEF will not invest in private funds before permitting the CEF to list and trade. These positions are contrary to any existing law, regulation, or national securities exchange's initial or continued listing standards.

This section intends to enable CEFs to invest in private funds more fully and enable such CEFs to list on national securities exchanges. The current laws, regulations, and listing standards, which do not restrict a CEF's ability to invest in less liquid assets (*e.g*., private funds), are appropriate because, unlike mutual funds, CEFs, by definition, are not required to offer shareholder redemption rights.[3] Therefore, CEFs do not need to hold liquid investments to meet redemptions.[4]

Concerns about investments in private funds are addressed when a regulated fund is inserted between retail investors and private funds, which fundamentally differs from retail investors investing directly in private funds. Regulated funds and their investment advisers are subject to strict substantive requirements that the SEC administers. For example, a registered investment adviser to a regulated fund must conduct due diligence on the fund's investments, including an assessment of underlying private fund valuation mechanisms to ensure that the regulated fund can meet its own valuation requirements.

Further, CEFs are treated as sophisticated investors and are permitted to freely invest in other types of privately offered investments that retail investors would typically not have access to. For example, regulated funds can invest in institutional debt, privately offered municipal securities, and reverse repurchase agreements—privately offered investments that a retail investor could not invest in directly. Private funds should not be distinguished from these other privately offered investments, and the ability to gain exposure to such assets through a regulated fund, like a CEF, is an important benefit to retail investors.

Enabling CEFs to invest in private funds more fully will provide retail investors with greater exposure to investment opportunities they otherwise could not attain. Using vehicles such as

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[3] Section 5(a) of the Investment Company Act of 1940 defines an open-end fund (*e.g.,* a mutual fund) as "a management company which is offering for sale or has outstanding any *redeemable security* of which it is the issuer" (emphasis added). It defines a CEF as "a management company other than an open-end [fund]."

[4] After the initial public offering, investors typically buy and sell CEF shares in the secondary market (*e.g.*, on a national securities exchange).

CEFs, Congress can permit retail investors more investment choice, offering broader exposure to more types of assets while ensuring appropriate investor protections. Permitting such funds to trade on national securities exchanges could attract further interest and provide enhanced liquidity to CEF investors. These changes can encourage the expansion of publicly offered and heavily regulated funds that can inject capital into the markets.

In addition, notwithstanding their many benefits in providing retail investors access to more diverse pool of assets, in recent years the number of CEFs has steadily declined. One reason for these declines stems from activist investors who have inappropriately targeted CEFs.[5]

- Since year-end 2007, the number of CEFs has decreased nearly 31% (from 664 funds at year-end 2007 to 461 funds at year-end 2021).[6]
- On average, 35 exchange-listed CEFs launched each year between 2002 and 2011 compared with an average of 14 launches each year between 2012 and 2021.[7]

Predatory activists use private funds to acquire a CEF's shares on the secondary market, often targeting CEFs trading at a significant discount to the fund's net asset value.[8] These activists accumulate large positions in the fund and then seek to force a tender offer, convert the fund to an open-end fund, or liquidate the fund in order to realize gains for themselves, and to the detriment of the CEFs long-term shareholders who purchased fund shares for exposure to the fund's investment strategy. With this strategy, the activists are able to realize the difference between the discounted market purchase price and the higher tender or redemption price to the detriment of the CEF and its shareholders.

Congress enacted statutory limits to address abuses that can arise when one investment company ("acquiring fund") invests in a regulated fund ("acquired fund"), including the pyramiding of

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[5] *See* James Duvall, "The Closed-End Fund Market, 2021." ICI Research Perspective 28, no. 5 (May 2022) ("2021 ICI Research Perspective") at Figure 2 (showing that activist shareholder action involvement in CEFs has increased over the past 24 years), *available at* https://www.ici.org/system/files/2022-05/per28-05.pdf. The number of filings between 2017 to 2021 was spread across 114 distinct funds, and 91 percent of these filings were submitted by just 5 activist investors. *Id*.

[6] *See* Quarterly Closed-End Fund Data, Fourth Quarter 2021, *available at* https://www.ici.org/research/stats/closedend/cef_q4_21. At year-end 2021, 461 CEFs had total assets of $309 billion.

[7] *See* 2021 ICI Research Perspective at Figure 8. *See also Recommendations Regarding the Availability of Closed-End Fund Takeover Defenses* (March 2020) ("2020 ICI Report") at Figure A.4, *available at* www.ici.org/pdf/20_ltr_cef.pdf.

[8] Like a mutual fund, a CEF must periodically publish a net asset value reflecting the value of each of its shares based on the value of its portfolio holdings. Unlike a mutual fund, a CEF generally trades on a national securities exchange and its purchase or sales price is determined by market supply and demand. This often results in market prices that are higher or, in many cases, lower than its net asset value. Although well studied, no one has identified the cause for why CEF market prices tend to trade at prices that are lower or at a "discount" to the fund's net asset value. *See, e.g.,* Charles Lee, Andrei Schleifer, and Richard Thaler, "Investor Sentiment and the Closed-End Fund Puzzle," Journal of Finance 46, no. 1 (1991): 75–109 (suggesting that discounts may be due to market perception or investor sentiment).

control and the exercise of undue influence.[9] Congress feared that the acquiring fund may attempt to use its voting position to exert excessive influence over the acquired fund. The statutory limits recognized that regulated fund investors could be harmed if large outside funds caused the regulated fund to be managed to benefit the outside fund (and its investors) rather than in the interest of the regulated fund's shareholders.

While these statutory limits restrict the amounts that funds, including private funds, can invest in regulated funds, the limits restricting fund investments specifically in CEFs do not apply to private fund investments in CEFs. Activists now are avoiding the restrictions and intent of the statutory limits set by Congress to harm CEF long-term shareholders. Many activists use multiple private funds to exceed the CEF limit. Upon acquiring a significant position in the CEF, they will force the liquidity events described above, harming long-term CEF shareholders.

This section would put private funds on a level playing field with regulated funds and would close the loophole many activists use to take advantage of CEF shareholders. By treating private funds consistently with the way they are regulated in their investments in other funds, CEFs will remain a robust, highly regulated, and viable option for retail investors looking to increase access to a potentially diverse portfolio of assets.

VI. Section 407 – Alleviating Stress Test Burdens to Help Investors Act

ICI strongly supports Section 407, which updates Dodd-Frank 165(i)(2) to require only financial companies whose primary financial regulatory agency is a "Federal banking agency or the Federal Housing Finance Agency" to conduct annual stress tests. Registered funds and advisers thus would fall outside the scope of the stress testing requirement, which is appropriate given that stress test requirements designed for banks are not suited for agency businesses like funds and advisers.

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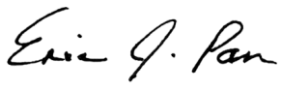
Thank you for your consideration of our views and for the important work that you do. If you have any questions or if we can be helpful in any way, please contact me at Eric.Pan@ici.org or John Emling, ICI Chief Government Affairs Officer, at John.Emling@ici.org. We look forward to working with you and the Committee as this proposal moves forward.

Sincerely,



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[9] *See* Report of the Commission on the Public Policy Implications of Investment Company Growth, in H.R. Rep. No. 2337, at 311-24 (1966).

Appendix A

Section 304. Closed-End Company Authority to Invest in Private Funds

Issue: Section 304 would restrict the Securities and Exchange Commission (SEC) from placing limitations on a closed-end fund's ability to invest in private funds. An SEC staff position currently restricts a closed-end fund from investing more than 15 percent of its assets in private funds, unless the closed-end fund sells its shares to accredited investors who make minimum initial investments of at least $25,000. A closed-end fund could choose to invest in an unlimited amount of private funds if it offers its shares only to accredited investors that make the minimum initial investment. Thus, the SEC staff's position could be viewed *not* as restricting a closed-end fund's ability to invest in private funds but as restricting the *type of investor* to whom such a closed-end fund may sell its investments.

Solution: Limiting the SEC's ability to place restrictions on the offer or sale of a closed-end fund's securities when that fund also invests in, or proposes to invest in, securities issued by private funds would ensure that *all* closed-end funds, including those that are offered to retail investors, are able to invest in private funds more fully.

Proposed Language: Amend § 304(a) as follows:

(a) IN GENERAL.—Section 5 of the Investment Company Act of 1940 (15 U.S.C. 80a–5) is amended by adding at the end the following:
"(d) CLOSED-END COMPANY AUTHORITY TO INVEST IN PRIVATE FUNDS.—

> "(1) IN GENERAL.—The Commission may not ~~limit a closed-end company from investing any or all of the assets of the company in a private fund solely or primarily because of the status of the fund as a private fund~~ restrict the offer to sell or sale of securities issued by a closed-end company solely or primarily because such company invests, or proposes to invest, in securities issued by private funds.
>
> ''(2) APPLICATION.—Notwithstanding section 6(f), this subsection shall apply to a closed-end company that elects to be treated as a business development company pursuant to section 54.''.