115TH CONGRESS
2d Session
HOUSE OF REPRESENTATIVES
REPORT
115–878

EXPANDING INVESTMENT IN SMALL BUSINESSES ACT

JULY 31, 2018.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. HENSARLING, from the Committee on Financial Services, submitted the following

R E P O R T

[To accompany H.R. 6319]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 6319) to require the Securities and Exchange Commission to carry out a study of the 10 per centum threshold limitation applicable to the definition of a diversified company under the Investment Company Act of 1940, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE AND SUMMARY

On July 10, 2018, Representative Randy Hultgren introduced H.R. 6319, the "Expanding Investment in Small Businesses Act" to requires the U.S. Securities and Exchange Commission (SEC) to study the current diversified fund limit threshold for diversified mutual funds—10 percent of the voting shares in an individual company—and determine whether such threshold limits capital formation. The SEC is to report its findings to Congress and then recommend whether Congress should amend the Investment Company Act of 1940. To conduct this study, the SEC may take public comments, and shall issue a report of its findings to Congress—including any legislative recommendations to increase the 10 percent threshold—within 180 days of enactment.

BACKGROUND AND NEED FOR LEGISLATION

In the April 26, 2018 report released by the Center for Capital Markets Competitiveness at U.S. Chamber of Commerce, the American Securities Association, the Biotechnology Innovation Association, the Equity Dealers of America, SIFMA, TECHNET, NASDAQ

and the National Venture Capital Association noted, "the decline in public companies has created fewer opportunities for American families and businesses, and we present these recommendations to assist more companies in going and staying public."

The goal of H.R. 6321 is to improve the ability of companies, particularly emerging growth companies (EGCS) created by Title I of the Jumpstart Our Business Startups or JOBS Act or smaller issuers, to attract and retain investment capital. Specifically, H.R. 6321 would require the SEC to conduct a study to determine if the diversified fund limit threshold of 10 percent on mutual funds is constraining their ability to take meaningful positions in small-cap companies.

Under Section 5(b)(1) of the Investment Company Act (ICA) of 1940, for a mutual fund to qualify as "diversified," (1) 75 percent of the fund's assets must be in cash, government securities (e.g. bonds, treasury bills, etc.), or in other issuers' securities; (2) no more than 5 percent of the fund's assets may be invested in any one company; and (3) the fund may own no more than 10 percent of an issuer's outstanding securities.

Mutual funds have historically played an important role in helping to provide liquid markets for the shares of newly public companies. Since 1990, the number of total registered mutual funds has grown about ten times, mean fund size has more than doubled, and open-end fund holdings of U.S. corporate equities has reached approximately 24 percent of the entire market. This growth means the investment decisions of mutual funds today are an important aspect of our country's public capital markets.

As the size of mutual funds has increased in recent years, some industry experts have said that the diversified fund limit rules—specifically the cap on a diversified fund's ownership of an issuer's outstanding shares at 10 percent—have limited funds' ability to take meaningful positions in small-cap companies. According to testimony at the Subcommittee on Capital Markets, Securities, and Investment hearing on May 23, 2018, the current 10 percent limit on mutual fund positions limits investment interest in small-cap initial public offerings (IPOs) because, as large funds' assets under management (AUM) grows, the 10 percent limit means that any investment in a small IPO will have a negligible impact on overall fund return. Declining mutual fund interest in small-cap IPOs also materially weakens the trading environment for small-cap stocks and likely deters small firms from joining our public markets.

To address these concerns, this bill would require the SEC to study whether the current diversified fund limit threshold for mutual funds of 10 percent constrains their ability to take meaningful positions in small-cap companies. Specifically, under the bill, the SEC will consider: the size and number of diversified funds that are currently restricted in their ability to own more than 10% of the voting shares in an individual company; if investing preferences of a diversified funds have shifted away from companies with smaller market capitalizations; the expected increase in the availability of capital to small and emerging growth companies if the threshold is increased; the ability of registered funds to manage liquidity risk; and other considerations the SEC considers necessary for the protection of investors.

A modest increasing in this threshold will allow diversified mutual funds to continue to invest in either JOBS Act EGCs or small issuers even as their assets under management continue to grow.

HEARINGS

The Subcommittee on Capital Markets, Securities, and Investment held a hearing examining matters relating to H.R. 6319 on May 23, 2018.

COMMITTEE CONSIDERATION

The Committee on Financial Services met in open session on July 11, 2018, and ordered H.R. 6319 to be reported favorably to the House, without amendment, by voice vote.

COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. The sole vote was on a motion by Chairman Hensarling to report the bill favorably to the House without amendment. The motion was agreed to by voice vote, a quorum being present.

COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the findings and recommendations of the Committee based on oversight activities under clause 2(b)(1) of rule X of the Rules of the House of Representatives, are incorporated in the descriptive portions of this report.

PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee states that H.R. 6319 mandate the SEC to conduct a study on the effect of the 10% diversified fund limit threshold on mutual funds and their ability to take investment positions within small-cap companies that will help provide liquid markets for newly-listed companies.

NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the estimate of new budget authority, entitlement authority, or tax expenditures or revenues contained in the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

CONGRESSIONAL BUDGET OFFICE ESTIMATES

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, July 17, 2018.

Hon. JEB HENSARLING,
Chairman, Committee on Financial Services, House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 3555, H.R. 6177, H.R. 6319, H.R. 6320, H.R. 6321, H.R. 6322, H.R. 6323, and H.R. 6324.

If you wish further details on these estimates, we will be pleased to provide them. The CBO staff contact is Stephen Rabent.

Sincerely,

MARK P. HADLEY
(For Keith Hall, Director).

Enclosure.

Securities and Exchange Commission Legislation

On July 11, the House Committee on Financial Services ordered eight bills to be reported related to the rules, regulations, and operations of the Securities and Exchange Commission (SEC). The bills are:

- H.R. 3555, the Exchange Regulatory Improvement Act, would require the Securities and Exchange Commission (SEC) to issue regulations regarding its definition of what constitutes a facility used by a national securities exchange;
- H.R. 6177, the Developing and Empowering our Aspiring Leaders Act of 2018, would direct the SEC to conduct a rulemaking to expand what types of asset acquisitions are considered qualifying investments for a venture capital fund;
- H.R. 6319, the Expanding Investment in Small Business Act, would require the SEC to conduct a study on the limitation on the amount of outstanding securities a closed-end fund may hold from a single issuer and still be classified as diversified;
- H.R. 6320, the Promoting Transparent Standards for Corporate Insiders Act, would require the SEC to conduct a study of various proposals to change agency rules regarding the use of written trading plans by certain securities traders;
- H.R. 6321, the Investment Adviser Regulatory Flexibility Improvement Act, would require the SEC to revise the definitions of a small business and small organization applicable for assessing the effect of the agency's rulemakings under the Investment Advisers Act of 1940 on those entities;
- H.R. 6322, the Enhancing Multi-Class Share Disclosures Act, would direct the SEC to issue a rule requiring securities issuers with multi-class stock structures to make disclosures regarding the voting power of certain individuals;
- H.R. 6323, the National Senior Investor Initiative Act of 2018, would direct the SEC to establish a taskforce to identify challenges that senior investors face and to report on its findings every two years; and
- H.R. 6324, the Middle Market IPO Underwriting Cost Act, would direct the SEC to study the costs associated with small

and medium-sized companies undertaking an initial public offering and to report on its findings.

Using information from the SEC regarding the costs of similar activities, CBO estimates that implementing seven of those bills—H.R. 3555, H.R. 6177, H.R. 6319, H.R. 6320, H.R. 6321, H.R. 6322, and H.R. 6324—would each have a gross cost of about $1 million for the agency to conduct the required studies and rulemakings and to issue reports. CBO estimates that implementing the eighth bill—H.R. 6323—would have a gross cost of $7 million over the 2019–2023 period for the SEC to establish and carry out the functions of the taskforce established under the bill.

However, the SEC is authorized to collect fees sufficient to offset its annual appropriation; therefore, CBO estimates that the net effect on discretionary spending of implementing each of those bills would be negligible, assuming appropriation actions consistent with that authority. H.R. 6323 also would require the Government Accountability Office (GAO) to conduct a study on the economic costs of the financial exploitation of senior citizens and CBO estimates that implementing that section would cost GAO less than $500,000; such spending would be subject to the availability of appropriated funds.

None of the bills would affect direct spending or revenues; therefore, pay-as-you-go procedures do not apply for any of the eight bills.

None of the bills would increase net direct spending or on-budget deficits in any of the four consecutive 10-year periods beginning in 2029, CBO estimates.

None of the bills contain intergovernmental mandates as defined in the Unfunded Mandate Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments. All of them would require the SEC to take actions that could raise the agency's administrative costs and the fees it collects to offset those costs. If the SEC increased fees, it would increase the cost of an existing mandate on private entities required to pay those fees. CBO estimates that none of the bills would increase fees in an amount that would exceed the annual threshold for private-sector mandates established in UMRA ($160 million in 2018, adjusted annually for inflation).

The CBO staff contacts for this estimate are Stephen Rabent (for federal costs) and Rachel Austin (for mandates). The estimate was reviewed by H. Samuel Papenfuss, Deputy Assistant Director for Budget Analysis.

FEDERAL MANDATES STATEMENT

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995.

The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of the section 102(b)(3) of the Congressional Accountability Act.

EARMARK IDENTIFICATION

With respect to clause 9 of rule XXI of the Rules of the House of Representatives, the Committee has carefully reviewed the provisions of the bill and states that the provisions of the bill do not contain any congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of the rule.

DUPLICATION OF FEDERAL PROGRAMS

In compliance with clause 3(c)(5) of rule XIII of the Rules of the House of Representatives, the Committee states that no provision of the bill establishes or reauthorizes: (1) a program of the Federal Government known to be duplicative of another Federal program; (2) a program included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111–139; or (3) a program related to a program identified in the most recent Catalog of Federal Domestic Assistance, published pursuant to the Federal Program Information Act (Pub. L. No. 95–220, as amended by Pub. L. No. 98–169).

DISCLOSURE OF DIRECTED RULEMAKING

Pursuant to section 3(i) of H. Res. 5, (115th Congress), the following statement is made concerning directed rule makings: The Committee estimates that the bill requires no directed rule makings within the meaning of such section.

SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

Section 1. Short title

This section cites H.R. 6319 as the "Expanding Investment in Small Businesses Act."

Section 2. SEC study

This section directs the SEC to carry out a study on the 10% threshold limitation applicable to the definition of a diversified company under section 5(b)(1) of the Investment Company Act of 1940. In conducting this study, the SEC may take public comments, and the SEC shall issue a report of its findings—including any legislative recommendations—within 180 days of enactment of the bill.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

H.R. 6319 does not repeal or amend any section of a statute. Therefore, the Office of Legislative Counsel did not prepare the report contemplated by Clause 3(e)(1)(B) of rule XIII of the House of Representatives.

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