



## Consumer Federation of America

July 27, 2021

The Honorable Maxine Waters  
Chairwoman  
Committee on Financial Services  
U.S. House of Representatives  
Washington, D.C. 20515

The Honorable Patrick McHenry  
Ranking Member  
Committee on Financial Services  
U.S. House of Representatives  
Washington, D.C. 20515

Dear Chairwoman Waters, Ranking Member McHenry, and Members of the Committee:

We are writing in advance of tomorrow's planned markup to voice CFA's support for a number of the investor protection bills scheduled for consideration. In general, these bills respond to weaknesses in the regulatory regime governing our securities markets revealed by recent market disruptions, including the frenzied trading of meme stocks in January and the implosion of Archegos Capital Management in March. As such, they will contribute to both the protection of investors and the fair and orderly operations of our markets.

CFA supports adoption of the amendments in the nature of a substitute (ANS) for the following bills as listed on the Committee website:

- The Short Sale Transparency and Market Fairness Act (H.R. 4618)
- The Trading isn't a Game Act (H.R. 4685)
- The Order Flow Improvement Act (H.R. 4617)
- Untitled legislation to limit the family office exemption (H.R. 4620)
- Untitled legislation to further restrict trading ahead by market makers (H.R. 4619)
- The Financial Exploitation Prevention Act (H.R. 2265)

All of these bills have the potential to deliver important benefits to investors and markets. Two of the bills – Chairwoman Waters' Short Sale Transparency and Market Fairness Act and Rep. Casten's Trading isn't a Game Act – address issues CFA has identified as investor protection priorities. As such, we offer the following additional comments in support of these bills.

### **The Short Sale Transparency and Market Fairness Act**

Congress adopted Section 13(f) of the Securities Act at a time when institutional investors were having an increasing impact on the market in order to close "gaps in information about the purchase, sale and holdings of securities by major classes of institutional investors." The SEC

had at the time expressed concern that it could not adequately assess the condition of the markets or develop appropriate regulatory policies without better information on institutional investment managers' investment practices.<sup>1</sup> Since then, the role of institutional investors has dramatically expanded, their investment strategies have increased in complexity, and the need for regulators and other market participants to have a clear understanding of their potential impact on the market has grown accordingly, as the recent collapse of Archegos helped to illustrate.

It has been apparent for some time, however, that the 13F reports are no longer adequate to provide a complete picture of all significant investment activities of institutional investment managers.<sup>2</sup> As far back as 1998, then House Energy and Commerce Committee Chairman John Dingell complained that, because the list of securities that have to be reported has become obsolete, the information reported “does not reveal much about the trading activities of hedge funds or the ways in which they raise capital or their risk profiles.”<sup>3</sup> Of particular concern was the resulting ability of a “determined investment adviser” to evade the reporting requirement “by employing sophisticated derivative hedging techniques to create or enhance portfolio opacity,” because “holdings of other options and derivatives need not be disclosed” in the 13(f) filings.<sup>4</sup>

H.R. 4618 would address these shortcomings in 13F reports by expanding the list of covered securities that institutional investment managers would have to report to include equity derivatives, by authorizing the SEC to make the reports both more frequent and timelier, and by directing the SEC to finally complete Dodd-Frank Act rulemaking related to short sale disclosures. These changes are generally consistent with those recommended by CFA in our 2020 comment letter to the SEC.<sup>5</sup>

We understand an amendment in the nature of a substitute (ANS) will be offered at Wednesday's markup to address questions that have been raised about the appropriate scope and timing of the reporting requirement. The ANS would establish basic parameters for rulemaking, but delegate to the SEC responsibility for making those final determinations regarding which types of derivatives must be reported and how quickly the reports need to be filed. We support this approach, which would ensure that progress is made on improving transparency while giving all interested parties an opportunity to weigh in on the details during the notice and comment rulemaking process. Because we believe this bill would bring much needed transparency to our securities markets, to the benefit of regulators, investors, and a host of other users of 13F reports, we urge Committee Members to vote yes on H.R. 4618.

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<sup>1</sup> Report to Accompany S.249, Securities Act Amendments of 1975, Sen. Rep. No. 94-75, at 85, 94th Cong. 1975 at 79, <https://bit.ly/3c2Endd>. (The SEC had stated that “the course of future developments could not be accurately gauged, or reasoned regulatory policies be determined, without a continuing flow” of timely information about “institutional holdings and trading in the equity security markets.”)

<sup>2</sup> See, e.g., U.S. Securities and Exchange Commission, Office of the Inspector General, Office of Audits, Review of the SEC's Section 13(f) Reporting Requirements, Report No. 480 (Sept. 27, 2010), at 25-26, <https://www.sec.gov/about/offices/oig/reports/audits/2010/480.pdf>.

<sup>3</sup> Edward Pekarek, *Hogging the Hedge? “Bulldog’s” 13F Theory May Not Be So Lucky*, Fordham Journal of Corporate & Financial Law, Vol. 12, No. 6 (2007), at 1092-93, <https://bit.ly/3mjV5JL>.

<sup>4</sup> *Id.*

<sup>5</sup> Letter from CFA Director of Investor Protection Barbara Roper to SEC Secretary Vanessa A. Countryman, regarding File No. S7-08-20, Reporting Threshold for Institutional Investment Managers (Sep. 16, 2020), <https://bit.ly/3f1D7JR>.

## **GAO to Study the Impact of Gamification on Retail Investors (Draft Bill)**

As investing and trading increasingly occur through online platforms and fintech apps, some such platforms are making use of gamification, psychological nudges, and other sometimes subtle design techniques to influence investor behavior. Such techniques can be used in ways that are beneficial to investors, by encouraging them to save more, for example, or helping them to better understand risks. But they can also be used to encourage questionable trading practices – such as frequent trading or trading options – that may be profitable for the firm but potentially harmful to financially unsophisticated retail investors. Investors may not understand how their actions are being influenced.

This bill directs the Government Accountability Office to carry out a thorough and balanced study of how these practices are being used by broker-dealers and investment advisers and what impact that is having on investors. Because gamification is a topic very much on the minds of officials at the SEC, FINRA, and the state securities commissions, this study will help to inform any regulatory decisions that these regulators may take. Here again, we understand an amendment in the nature of a substitute will be offered. We strongly support the approach in the ANS, which lays out a set of issues to be addressed in the study. By focusing on both the most significant potential threats to investors and the potential benefits when these techniques are used responsibly, the study should support more informed policymaking on this important topic. We therefore urge Committee members to support this bill.

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Hearings held in the House Financial Services Committee and the Subcommittee on Investor Protection, Entrepreneurship, and Investor Protection throughout this year have helped to increase our understanding of the root causes and harmful consequences of recent market disruptions related to both trading frenzy in meme stocks in January and the Archegos collapse in March. The legislation developed out of those hearings will help to address those regulatory failures, benefitting both investors and the fair and orderly operations of our markets. We encourage members of the Committee to vote to approve the above listed bills.

Respectfully submitted,



Barbara Roper  
Director of Investor Protection