

IMPROVING INVESTMENT RESEARCH FOR SMALL AND EMERGING ISSUERS ACT

JULY 10, 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. 6139]

The Committee on Financial Services, to whom was referred the bill (H.R. 6139) to require the Securities and Exchange Commission to carry out a study to evaluate the issues affecting the provision of and reliance upon investment research into small issuers, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE AND SUMMARY

On June 19, 2018, Representative Bill Huizenga introduced H.R. 6139, the “Improving Investment Research for Small and Emerging Issuers Act”, which requires the U.S. Securities and Exchange Commission (SEC) to report to Congress within 180 days after enactment on issues that affect the provision of and reliance upon investment research into small issuers, including emerging growth companies (EGCs), other small issuers, such as nano-cap and microcap issuers, and companies considering initial public offerings (IPOs). Among the issues the SEC must consider are factors related to the demand for such research by institutional and retail investors, cost considerations for such research, and the impact on the availability of research coverage for small issuers due to a variety of market and regulatory conditions. The SEC’s report must include recommendations to increase the demand for, volume of, and quality of investment research into small issuers and pre-IPO companies.

BACKGROUND AND NEED FOR LEGISLATION

The goal of H.R. 6139 is to help understand the issues affecting the ability of smaller cap issuers and emerging growth companies in obtaining research coverage.

Section 105 of the Jumpstart or Business Startups (JOBS) Act (P.L. 112–106) changed the “gun-jumping rules” to provide an exception from the definition of an offer to allow for the publication or distribution by a broker or dealer of a research report about an emerging growth company that is the subject of a proposed public offering. However, few investment banks have published any pre-IPO research since passage of the JOBS Act, and research coverage in general on small issuers continues to be a problem—which affects investor interest in these growth companies, their trading liquidity, and their ability to access investment firm capital.

Title I of the JOBS Act explicitly provided a safe harbor for research related to offerings of EGC securities. Yet despite their similarities to these other asset classes, research that covers open-ended funds and ETFs, popular investment options for retail investors, does not benefit from similar safe harbors. Consequently, broker-dealers do not publish research regarding ETFs, depriving investors of useful information when deciding whether to invest in this product. The Fair Access to Investment Research (FAIR) Act (P.L. 115–66) corrects a problem that the Securities and Exchange Commission (SEC) had known about since 2001, but failed to address. Prior to the FAIR Act, federal securities law inhibited the free flow of investment research. The law directs the SEC to revise its regulations to create a safe harbor for certain publications or distributions of research reports by brokers or dealers distributing securities, such as Exchange Traded Funds (ETFs). The revised regulation shall declare that the investment funds research report shall not be deemed to constitute an offer for sale nor an offer to sell a security that is the subject of the offering pursuant to a registration statement that the issuer proposes to file, or has filed, or that is effective. The covered investment fund research report would satisfy the regulation’s requirements as well as those of any self-regulatory organization. The bill prohibits the SEC from imposing specified conditions and requirements when implementing the safe harbor.

A recent report by Cowen to the SEC Investor Advisory Committee noted that about 61% of all companies listed on a major exchange with less than a \$100 million market capitalization have no research coverage at all. For equities with a market cap below \$750 million, the average number of research analysts covering that stock is 1, while equities above \$750 million in market cap have an average of 12 research analysts covering the stock. Moreover, a 2017 survey by OTC Markets reported that 68% of respondents stated they had no research coverage and another 5% stated they did not know if they had any research coverage.

Additionally, the amount of research written on smaller cap companies has declined even as the percentage of individual investor ownership in smaller cap companies has increased. Little-to-no research coverage generally corresponds with lower stock liquidity, and since investment firms typically avoid investing in illiquid stocks, the lack of research coverage effectively precludes smaller

cap issuers with illiquid stocks from accessing investment firm capital. Moreover, reduced research coverage may be particularly disadvantageous to individual investors who have limited research capabilities on their own.

One study also found that an increase in the number of analysts covering an industry improved the quality of analyst forecasts and information flow to investors.

For that reason, it is important to examine current SEC rules and regulations that affect the ability of investment analysts to provide research coverage about small issuers. The Treasury Report on Capital Markets recommended a holistic review of rules and regulations regarding investment analyst research, including the Global Analyst Research Settlement, to determine which provisions should be retained, amended, or removed.

HEARINGS

The subcommittee on Capital Markets, Securities, and Investment held a hearing examining matters relating to H.R. 6139 on May 23, 2018.

COMMITTEE CONSIDERATION

The Committee on Financial Services met in open session on June 21, 2018, and ordered H.R. 6139 to be reported favorably to the House without amendment by a recorded vote of 58 yeas to 0 nays (recorded vote no. FC-192), a quorum being present.

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 recorded vote was on a motion by Chairman Hensarling to report the bill favorably to the House without amendment. The motion was agreed to by a recorded vote of 58 yeas to 0 nays (Record vote no. FC-192), a quorum being present.

Record vote no. FC-192

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Hensarling	X			Ms. Maxine Waters (CA)	X		
Mr. McHenry	X			Mrs. Carolyn B. Maloney (NY) ..	X		
Mr. King	X			Ms. Velázquez	X		
Mr. Royce (CA)	X			Mr. Sherman	X		
Mr. Lucas	X			Mr. Meeks			
Mr. Pearce	X			Mr. Capuano	X		
Mr. Posey	X			Mr. Clay	X		
Mr. Luetkemeyer	X			Mr. Lynch	X		
Mr. Huizenga	X			Mr. David Scott (GA)	X		
Mr. Duffy				Mr. Al Green (TX)	X		
Mr. Stivers	X			Mr. Cleaver	X		
Mr. Huftgren	X			Ms. Moore	X		
Mr. Ross	X			Mr. Ellison	X		
Mr. Pittenger	X			Mr. Perlmutter	X		
Mrs. Wagner	X			Mr. Himes	X		
Mr. Barr	X			Mr. Foster	X		
Mr. Rothfus	X			Mr. Kildee	X		
Mr. Messer	X			Mr. Delaney	X		
Mr. Tipton	X			Ms. Sinema	X		
Mr. Williams	X			Mrs. Beatty	X		
Mr. Poliquin	X			Mr. Heck	X		
Mrs. Love	X			Mr. Vargas	X		
Mr. Hill	X			Mr. Gottheimer	X		
Mr. Emmer	X			Mr. Gonzalez (TX)	X		
Mr. Zeldin	X			Mr. Crist	X		
Mr. Trott	X			Mr. Kihuen	X		
Mr. Loudermilk	X						
Mr. Mooney (WV)	X						
Mr. MacArthur	X						
Mr. Davidson	X						
Mr. Budd	X						
Mr. Kustoff (TN)	X						
Ms. Tenney	X						
Mr. Hollingsworth	X						

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. 6139 will help to identify the challenges small issuers face in obtaining research coverage and the subsequent impact this has on the trading liquidity of their securities and their ability to access investment firm capital by directing the SEC to conduct a study on the causes affecting the ability of such issuers to obtain research coverage.

NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

The Committee has not received an estimate of new budget authority contained in the cost estimate prepared by the Director of the Congressional Budget Office pursuant to Sec. 402 of the Congressional Budget Act of 1974. In compliance with clause 3(c)(2) of rule XIII of the Rules of the House, the Committee opines that H.R. 6139 will not establish any new budget or entitlement authority or create any tax expenditures.

CONGRESSIONAL BUDGET OFFICE ESTIMATES

The cost estimate prepared by the Director of the Congressional Budget Office pursuant to Sec. 402 of the Congressional Budget Act of 1974 was not submitted timely to the Committee.

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 rulemaking within the meaning of such section.

SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

Section 1. Short title

This Section cites H.R. 6139 as the “Improving Investment Research for Small and Emerging Issuers Act.”

Section 2. Research study

This section requires the SEC to conduct a study to evaluate the issues affecting the provision of and reliance upon investment analyst research for small issuers, including emerging growth companies, and other small cap issuers like nano-cap and microcap companies at the lower end of the market capitalization spectrum, and companies considering initial public offerings. The SEC is required to report to Congress within 180 days on its results and on recommendations to increase the demand for, volume of, and quality of investment research into small issuers.