State Financial Officers FOUNDATION

LOOK TO THE STATES

November 13, 2018

Dear Chairman Clayton,

The State Financial Officers Foundation (SFOF) was founded six years ago to promote fiscally responsible public policy, partner with key stakeholders, and educate the public about the role of finance in a free market economy. Today, SFOF represents over half of the nation's states and has grown to be the largest and leading organization for free market focused state treasurers, state auditors, and state controllers.

We write to you today to express concerns about recent news reports that the SEC may change its long-standing position and allow public companies to include forced arbitration clauses in their corporate governance documents. We understand the motivations for this change, but we believe any issues can and should be addressed without taking a step as drastic as overturning nearly a century of methodically-crafted policy.

Since their inception, the federal securities laws have provided for a dual enforcement regimen: public enforcement by government entities and private enforcement by harmed investors. Private shareholder suits play a critical role in helping to enforce securities laws, deter fraud, and compensate harmed investors. Both actions require expansive, expensive investigations and most shareholders are not positioned in a way to cover the costs associated with individual legal causes of action. Class action suits allow for the pooling of resources and causes of action to address all shareholders harms.

Allowing public companies to impose a private system of arbitration on investors undermines this dual system. It will eliminate the ability of all but the largest shareholders to seek recompence from criminals and may force massive expansion of government enforcement and oversight programs.

Our specific concerns in allowing companies to impose forced arbitration clauses that limit class action claims on investors include the following:

If companies are permitted to force waiver of class action claims, the vast majority of the burden of enforcement will fall on state and federal law enforcement.

- Today, private shareholder lawsuits are the primary mechanism for compensating defrauded investors. This would result in an unprecedented and wholly unnecessary need for the expansion of government intrusion into the markets, requiring immense increases to budgets and manpower, at a time when we are trying to reduce the government role in the free market. Private lawsuits, on the other hand, are a market-based remedy that do not require the expense of taxpayer money and resources.

Private, individual arbitration is not an adequate replacement for investor class actions.

- Hiring the lawyers and experts required to prove a complex securities fraud can cost many millions of dollars, which is unaffordable to almost all but the very large institutional investors. If individual arbitration becomes the only venue available to defrauded investors, it would result in a system of justice unavailable to most market participants (i.e. the small investors, who are the backbone of our economy). This would, in turn, do great damage to the dual purposes of private securities enforcement – deterrence and compensation. We fear that such a system would not be acceptable to the public or those tasked with managing public

funds, and, will necessitate the creation of a more robust bureaucracy of government action to step in where private enforcement fails.

Forced arbitration will increase investor risk, cost required for redress, likelihood of not recovering if fraud is perpetrated, and possibility that investors will avoid the market altogether.

- There is no doubt that choosing your venue for arbitration can be a benefit to large organizations with expansive market reach. Limiting exposure is a key tenant in all financial management. Forced arbitration decreases the market exposure of only one type of market actor: a company accused of fraudulent behavior. Forced arbitration increases investor risk by limiting access to redress, increasing the cost of any possibly private cause of action redress, and increasing the potential of fraudulent behavior by companies who no longer have to worry about paying out the vast majority of claims if they are caught. Furthermore, in cases where the investor is a state, these clauses act as forced waiver of sovereign immunity. This will likely force states to reassess whether making certain investments is worth the added risk and may force large, state-based institutional investors to place their money elsewhere; an externality in specific instances that stifles market growth.

It is questionable whether forcing investors into arbitration is legal under the securities laws.

- Both the 1933 and 1934 Securities Acts explicitly authorize private suits to be brought in district courts. In addition, both laws include so-called "anti-waiver" clauses that prohibit companies from forcing investors to agree to provisions or conditions that would allow the companies to waive compliance with requirements in the Acts. Consistent with this argument, in the past the SEC has repeatedly taken the position that it would be a violation of the "anti-waiver" provisions for public companies to place mandatory shareholder arbitration provisions in their corporate governance documents. We believe that this has been the wise course and urge you to take careful consideration before upsetting this decades-old precedent.

We are not arguing that the current system is free from issues, but are requesting that you look at the externalities of any action you take, from the perspective of the companies making offerings as well as investors big and small, before you change SEC policy. From time to time, Congress has had to step in with bipartisan legislation to address similar issues. Most recently, that occurred with the passage in 1995 of the Private Securities Litigation Reform Act (PSLRA) and then in 1998 with the Securities Litigation Uniform Standards Act (SLUSA). These laws established rules for private shareholder lawsuits and ensured that litigants couldn't avoid these rules by bringing cases in state courts. The laws were effective in curbing abuses. If further restrictions on securities suits are needed, SFOF would be happy to work with the Administration on legislation to address concerns.

SFOF members are leading the charge on the state level to promote free market principles and financially-responsible policies. Our small government/pro-growth agenda is working in states throughout the nation, allowing economies to flourish and free enterprise to grow. We recognize the same principles at work at the federal level under the current administration. With unemployment at a 20-year low, more Americans are finding themselves in the position where they are entering the securities marketplace for their retirement needs, sometimes on their own and sometimes through the retirement plans we oversee at a state level. For this and the reasons above, we request that you conduct a thorough and thoughtful analysis of any proposal that would require defrauded investors to arbitrate claims involving securities law violations. Any analysis should include looking at the burdens such a system would impose on state and federal regulators as well as the harm done to enforcement of the laws.

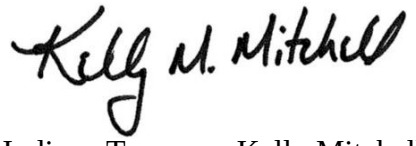
We stand ready to work with you to keep our economy humming and the free enterprise system strong.

Thank you for considering our views.

Sincerely,

Derek Kreifels, President
State Financial Officers Foundation

Kentucky Treasurer Allison Ball, National Chair
State Financial Officers Foundation



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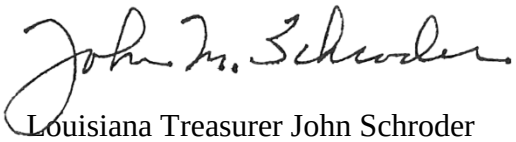

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