Over-Regulation of Investment Managers Can Harm Ohioans

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Introduction

The Short Sale Transparency and Market Fairness Act introduced by House Finance Committee Chair Maxine Waters (D-CA)[1] would impose new and unnecessary regulatory burdens on market investors that will threaten investment returns across the board and risk fueling market volatility. The bill purports to enhance market transparency and prevent future short-sale market bubbles. Unfortunately, the bill instead will reward investment free riders, make markets less efficient, lower investment returns, and make market participation more expensive through accelerated and duplicative regulatory reporting obligations—all while making GameStop type short-sale squeezes easier and *more* likely to occur.[2]

More Burdens, More Problems

The Short Sale Transparency and Market Fairness Act imposes many new reporting requirements on institutional investors with $100 million under investment management. One new rule will allow the Securities and Exchange Commission (SEC) to require investment managers to disclose their investment positions monthly rather than quarterly as federal regulations currently require. The SEC, however, has already explained that faster mandatory reporting is not cost-effective[3] and securities regulators already have access to real time disclosure data.[4] Whether helpful for regulators or not, the new filing requirements will add-up, making it more expensive for fund managers to do their jobs and earn returns for their clients. And although the new rules may appear only to apply to large, institutional investment firms, they will ripple through the

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[1] **Amendment in the Nature of a Substitute to H.R. 4618 Offered by Ms. Waters of California**, July 28, 2021.

[2] Juliet Chung, **Melvin Capital Lost 53% in January, Hurt by Gamestop and Other Bets**, *The Wall Street Journal*, January 31, 2021.

[3] Staff of the Division of Economic and Risk, U.S Securities and Exchange Commission, ***Short Sale Position and Transaction Reporting***, U.S. Securities Exchange Commission, June 5, 2014.

[4] Isabelle Morales, **New Reporting Requirements on Institutional Investors Would Harm Retirees and the U.S. Economy**, Americans for Tax Reform, July 13, 2021.

investment pool and affect almost every American with a savings or retirement account. Wall Street hedge funds, after all, are not the only institutional investors covered by the proposed new rules—the bill's requirements also reach pension funds, endowment funds, mutual funds, banks, and other large joint investors.

In the name of transparency, Ms. Waters' bill also directs the SEC to draft new rules that could expand disclosure of short-selling positions—again, on a monthly basis—and make it harder for individual investment managers' disclosures to be kept confidential. Transparency in the form of aggregate short positions by issuer could be a useful metric for the public. However, the SEC should never be compelled to require individual managers to reveal their specific short positions or limit confidentiality as such requirements are problematic for several reasons.

First, market transparency is useful and good—especially for the public sector—but publicly "outing" short-sellers risks subjecting them to public scorn and retaliation. Short-sellers are important for markets. They discover fraud and mismanaged companies,[5] providing valuable information that makes the market more efficient and less volatile.[6] Short-sellers bet that a company is overvalued and its stock price will fall, making them unpopular with that company and with other investors who believe that the company will succeed.[7] Disclosing confidential and unpopular investor sentiment in today's hyper-partisan era may subject short-sale investors to public shaming—and if, as a result of that shaming and ridicule, institutional investors do less short-selling and take inefficient market positions, then fund performances will decline and the stock market could become more volatile.[8]

Secondly, compelled disclosure—especially on a frequent basis—can encourage more investment "free riding." Free riding occurs when copycat investors bypass performing their own original investment research, and instead copy other investors who have spent significant time and money conducting due diligence. By making it easier for free riders to capitalize on another's investment analysis, the bill discourages independent in-depth research, innovation, and risk-taking.[9] And when original investment research and risk-taking are devalued, then investors will be less likely to pay for it, which, in turn, will hurt fund performances—a domino effect confirmed by academic research.[10]

Poor performance and lower returns for institutional investors will mean lower returns for Ohio pensions and taxpayers. Ohioans have more than $50 billion[11] invested with financial institutions subject to the proposed inefficient rules—and all of them, from retirees to charities to schools and

[5] **Wirecard's Scandal shows the benefits of short-sellers**, *The Economist*, June 27, 2020.
[6] William N. Goetzmann, Ning Zhu, and Arturo Bris, **Efficiency and the Bear: Short Sales and Markets around the World**, working paper, National Bureau of Economic Research, February 2003.
[7] Kate Kelly and Matthew Goldstein, **Wall Street's Most Reviled Investors Worry About Their Fate**, *The New York Times*, February 8, 2021.
[8] **Brief of Amici Curiae The Buckeye Institute**, et al. in support of petitioners, *Americans for Prosperity Foundation v. Bonta*, March 1, 2021.
[9] Zhen Shi, ***The Impact of Portfolio Disclosure on Hedge Fund Performance, Fees and Flows***, Arizona State University, May 2011.
[10] *Ibid.*
[11] **Investing in Opportunity: Ohio**, (Last visited August 20, 2021).

universities could see smaller returns on their investments.[12] And Ohio's pension system that guarantees some benefits for retirees is already underfunded.[13] If the rate of return from pensions falls, then retirees could see benefits frozen or reduced, and Ohio taxpayers could face tax increases to off-set the decline and cover guaranteed benefits.[14]

Conclusion

The Short Sale Transparency and Market Fairness Act fails a simple cost-benefit analysis: it raises costs without delivering benefits. The bill will make institutional investing more expensive and the markets more hostile and volatile. The legislation offers a solution in search of a problem, with duplicative regulatory requirements that even the SEC has deemed unnecessary. And the unintended consequences of this misguided bill will ripple through the markets—with lower investment returns for pensions, retirees, non-profits, and universities—ultimately forcing taxpayers to make up the difference. Investors and taxpayers in Ohio and every other state deserve better.

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[12] Rea S. Hederman Jr., **Once Again Congress Sees Over-Regulation as a Solution**. The Buckeye Institute, July 27, 2021.

[13] Erick M. Elder and David Mitchell, ***Ohio Public Pension System: Traditional Funding Ratios Are Not Enough for Pension Funds***, Mercatus Center at George Mason University, December 13, 2016.

[14] Anna Staver, **OPERS funds finish strong in 2020 despite pandemic setbacks**, *The Columbus Dispatch*, January 21, 2021.

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