US SENATORS TAMMY BALDWIN & JEFF MERKLEY

THE BROKAW ACT

Strengthening oversight of activist hedge funds

The Problem of Short-Termism & Activist Hedge Funds

The problem of short-termism is real and there is growing chorus who believe short-termism is holding America back from reaching its full potential to create stronger economic growth for our nation. Put simply, short-termism—also known as "quarterly capitalism"—is the focus on short time horizons by both corporate managers and financial markets. It results in corporate funds being used for payouts to shareholders in the form of dividends and buybacks rather than investment in workers, R&D, infrastructure, and long-term success.

Activist hedge funds are leading the short-termism charge in our economy. They abuse lax securities laws to gain large stakes in public companies. Once there, they make demands to benefit themselves at the expense of the company's long-term interests. The most common demands are for more debt, stock buybacks, reduced R&D, cost-cutting, layoffs, and general reduction any investment in long-term growth.

The pressures of short-termism stem from the increasing influence that Wall Street has over the Main Street economy. This has been witnessed first-hand in Wisconsin when an out-of-state hedge fund bought up the legendary Wausau Paper company. A "wolf pack" of hedge funds seized control, expelled the company's executives, and demanded short-term returns and buybacks at the expense of the company's long-term future. The wolf pack closed all its Wisconsin mills, including one in Brokaw that had operated for over 100 years—forcing job layoffs and destroying the small town's finances.

This is one example of a larger problem that demands action. The number activist campaigns has risen annually by 60 percent since 2010, and there were 348 activist campaigns in 2014. There is also growing evidence that firms targeted by activists experience lower investment and R&D, provided they survive at all. These investments are the lifeblood of our economy. If our corporations no longer attempt to develop new products, train-up workers, or expand into new ventures, our national competitiveness will suffer.

We cannot allow our economy to be hijacked by a small group of investors who seek only to enrich themselves at the expense of workers, communities and taxpayers. The rules that govern our economy today no longer work and they need to change. Activist hedge funds and short-termism demand a government response and that is why we need to reform Depression-era rules for today's financial abuses.

U.S. Senators Tammy Baldwin (D-WI) and Jeff Merkley (D-OR) have introduced *The Brokaw Act,* which would put in place the following reforms to increase transparency and strengthen oversight of activist hedge funds:

Restore Transparency to the Marketplace

Congress has long recognized the potential for abuse when activist hedge funds form loose associations of "wolf packs" and engage in "tipping" allies to the impending 13 (d) disclosure. *Dodd-Frank* explicitly gave the SEC the power to address abuse, yet the Commission has been unwilling to use this authority. This legislation removes the opportunity for riskless gains that activists achieve by shortening the 10-day disclosure window to 2 days.

Protect Businesses from Wolf Packs

The Brokaw Act reforms the definition of "person or group" in order to prevent wolf packs from skirting the intent of the disclosure rules. Activists' collective stake in a company may be well above 5 percent, but individually, they stay below the threshold to avoid disclosure. This reform identifies these funds as a single group to require disclosure.

End Secret "Net Shorts" by Requiring Derivative Disclosure:

Derivatives are part of every activist's toolkit. In some cases they are used to create a "net short" that allows the activist to profit by secretly voting against the company's interests. Currently, derivatives and other synthetic instruments do not require disclosures despite the fact that they can have substantial impacts on the price of the security and its issuer. This can allow funds to secretly bet against a company they are invested in. This legislation strengthens oversight of these instruments under the purview of 13(d).