CALIFORNIA STATE TREASURER JOHN CHIANG

NEWS ADVISORY

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Treasurer Chiang Releases Joint Letter to SEC from Six State Treasurers Opposing Forced Arbitration in Shareholder Agreements

SACRAMENTO – Led by State Treasurer John Chiang, and citing "serious concern" that a shift in SEC policy could block shareholder lawsuits, a bi-partisan coalition of state treasurers today delivered the following letter to the chairman of the U.S. Securities and Exchange Commission:

July 2, 2018

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street N.E.
Washington, DC 20549

RE: State Treasurers Oppose Forced Arbitration Clauses or Class Action Waivers in Shareholder Agreements

Dear Chairman Clayton:

As a bipartisan coalition of State Treasurers from across the country, we recognize the dire fiscal matters that face our nation and understand the pitfalls that imperil the financial security of American investors. As institutional investors ourselves, we observe the critical importance of rigorous enforcement of the state and federal securities laws. That's why we write to express our serious concern with reports that the SEC may be considering a fundamental shift in policy that would—for the first time—allow publicly traded companies to block shareholder lawsuits through the use of forced arbitration clauses in IPO filings[1]. We write to express our support for your previous statements

[1] On July 17th, in a speech before the Heritage Foundation, SEC Commissioner Michael Piwowar strongly supported changing SEC policy to allow companies to place language into their initial public offering paperwork that would force shareholders to resolve claims through forced arbitration rather than in court as well as permitting class action waivers to be placed in the same documentation. See https://www.reuters.com/article/us-usa-sec-arbitration/u-s-secs-piwowar-urges-companies-to-pursue-mandatory-arbitration-clauses-idUSKBN1A221Y

indicating you would prefer not to take up the issue[2] and to urge you, should the issue arise in circumstances you do not control, to preserve the Commission's long-standing policy barring public companies from adopting forced arbitration clauses.

State Treasurers serve as custodians of state resources and ensure the prudent oversight and safekeeping of entrusted public funds. As our states' chief financial officers, one of our significant responsibilities is the prudent management and, in many states, the investment of both public taxpayer funds and some private savings. These investments include not just government resources not immediately used for operating expenses, but also college tuition savings accounts, investment accounts for disabled individuals, and – in some cases -- pension funds. An essential aspect of our obligation to prudently manage public funds is ensuring that investment managers entrusted with public funds make investment decisions with a full understanding of the potential for financial frauds and abuses on the part of the companies we invest in. As investors, we are interested in preserving the ability to redress diminished public funds through private shareholder litigation when violations of the state and federal securities laws occur. Forced arbitration directly threatens our ability to meet these responsibilities.

We want Americans to save for a better life for themselves and their families. Private savings can enhance quality of life and increase opportunities for the citizens of the states we serve, and private savings can also reduce the need for state resources and public assistance.[3] Targeted, private enforcement of state and federal securities laws furthers these goals by empowering Americans to directly combat financial misconduct, and get back their hard-earned investment dollars.

Forced arbitration provisions and class action waivers do just the opposite. Possessing the experience and responsibility of prudently investing billions of public dollars as State Treasurers, we are uniquely qualified to express significant reservations about the proposal to permit forced arbitration provisions. Unfortunately, individual police and firefighter pensioners, teachers and municipal workers, and other individual and retail investors simply do not possess the financial size or scale to contest the inclusion of a forced arbitration clause or class action waiver in a company charter or corporate bylaw. The choice is either to forego any reasonable hope of accountability in the wake of securities fraud, or to forego the investment entirely. We can all support concepts of individual choice and freedom of contract without sacrificing our commitment to ensure that such investment choices and contractual relationships are informed and not predatory.

Moreover, forced arbitration, by its very nature, helps to keep corporate misconduct and financial fraud secret by preventing such cases from reaching the light of public U.S. courtrooms. More specifically, arbitration clauses typically prohibit the disclosure of any information about proceedings. Bans on shareholder class actions ("waivers") prevent investors from banding together to seek redress for widespread investor harms, leaving over-stretched regulators to try to fill this role on their own. Taken together, this spells immunity for many financial actors, even the very worst. Without private shareholder litigation to police U.S. capital markets and make investors whole, investor confidence in our markets suffers, public participation diminishes, and your stated goal of attracting more companies

[2] Hazel Bradford, "SEC chairman says he's not ready to force arbitration," Pensions & Investments, Feb. 7, 2018. See http://www.pionline.com/article/20180207/ONLINE/180209852/sec-chairman-says-hes-not-ready-to-force-arbitration.
[3] See http://patreasury.gov/pdf/Impact-Insufficient-Retirement-Savings.pdf

to go public[4] will ultimately fail. In short, such a proposal hurts both investors and the companies in which they invest.

We come from a diverse coalition of states and perspectives, yet we share a common underlying core financial belief: American investors must be protected. Allowing public companies to adopt forced arbitration clauses and class action waivers at initial public offerings to deny shareholders reasonable ability to redress grievances threatens that protection. We encourage you to continue to resist this proposal and instead to uphold the Commission's longstanding policy of prohibiting forced arbitration clauses and class action waivers.

Thank you for the opportunity to share our views.

Sincerely,

JOHN CHIANG
California State Treasurer

MICHAEL FERICHS
Illinois State Treasurer

MICHAEL L. FITZGERALD
Iowa State Treasurer

TOBIAS READ
Oregon State Treasurer

JOE TORSELLA
Pennsylvania State Treasurer

[4] In June 2017, SEC Chairman Jay Clayton, in a speech, noted that one of his goals is for more companies to go public. See https://www.reuters.com/article/us-usa-sec-ipo/new-sec-chair-clayton-wants-more-companies-to-go-public-speech-idUSKBN19D1S2

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