April 25, 2023

Congresswoman Maxine Waters
Ranking Member
House Financial Services Committee
2221 Rayburn House Office Building
Washington, DC 20515

Congressman Patrick McHenry
Chairman
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

Re: April 26th Markup of House Financial Services Bills

Dear Chairman McHenry and Ranking Member Waters,

Consumer Federation of America (CFA)[1] writes to you in strong opposition to a number of bills that will be considered in the April 26th Markup, which are anti-consumer/anti-investor and harmful to our markets. The bills being considered would deprive retail investors of key information and expand private markets at the expense of public markets, with potentially dire consequences for individual investors, market transparency, efficiency, integrity, accountability, and the health of our overall economy.

In addition, the CFPB Transparency and Accountability Reform Act would threaten the Consumer Financial Protection Bureau's (CFPB) funding, organizational structure, and their ability to monitor the marketplace by impeding their rulemaking functions. These proposed changes would irreparably harm the CFPB's effectiveness, consumers, regulated entities, and our financial services marketplace.

For these reasons,

- **Vote NO on H.R. 1807, the Improving Disclosure for Investors Act of 2023**
- **Vote NO on The Expanding Access to Capital Act of 2023**
- **Vote NO on the "Bipartisan" Package Being Offered**
- **Vote NO on H.R.___, the CFPB Transparency and Accountability Reform Act**
- **Vote NO on H.R. 835, the Fair Investment Opportunities for Professional Experts Act**
- **Vote NO on H.R. 1579, the Accredited Investor Definition Review Act**
- **Vote NO on H.R. ___, the Equal Opportunity for All Investors Act**
- **Vote NO on H.R. 2793, the Encouraging Public Offerings Act of 2023**
- **Vote NO on H.R. 2610, a bill to amend the Securities Exchange Act of 1934 to specify certain registration statement contents for emerging growth companies, to**

[1] CFA is a non-profit association of more than 250 national, state, and local pro-consumer organizations. It was formed in 1968 to represent the consumer interest through research, advocacy and education.

permit issuers to file draft registration statements with the Securities and Exchange Commission for confidential review, and for other purposes

- **Vote NO on H.R. 2608, a bill to amend the Federal securities laws to specify the periods for which financial statements are required to be provided by an emerging growth company, and for other purposes**

<u>Background</u>

A. The Decline of Our Public Securities Markets

The disclosure obligations in the '33 Act and '34 Act are based on "a simple and straightforward concept: all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it. Only through the steady flow of timely, comprehensive, and accurate information can people make sound investment decisions."[2]

Adherence to that principle helped to build capital markets that were the envy of the world, engines of a vibrant and growing U.S. economy. Over the last four decades, however, Congress and the SEC have repeatedly chipped away at that basic principle. Through a series of new rules and legislation, they have allowed more and more securities to be offered and traded without providing the "basic facts" necessary to support an informed investment decision, to the point where the full and fair disclosure upon which our markets were built is the exception, rather than the rule. Today, we see mounting evidence that this four decades-long deregulatory crusade has gone too far, putting investors, our capital markets, and our economy at risk.

The benefits to investors, market integrity, and capital formation of public securities markets are manifest and indisputable.

Public markets require registrants to operate with transparency and accountability, and have critical safeguards. Specifically, in the public markets:

- investors receive the essential facts and material information needed to value their investments and make informed investment decisions;
- investors are guaranteed to receive the best available price when they trade on national exchanges;
- investors can quickly sell their securities when needed; and
- trading is inexpensive and efficient.

By comparison, private markets carry significantly higher risks for investors, and permit issuers to operate with neither transparency nor accountability. Specifically, in private markets:

- investors may not receive complete and reliable information;
- individual investors are not guaranteed the best available price when buying or selling private securities;

[2] U.S. Securities and Exchange Commission, About the Sec, What We Do, http://bit.ly/2MngEXy (last accessed August 16, 2019, quote subsequently removed).

- favored investors can get access to inside information that other investors don't receive; and
- private securities are generally illiquid and trading can be expensive and inefficient.

Today, hundreds of billions of dollars in private securities are now sold each year without providing the basic facts necessary for an informed decision. That poses significant risks, not just for the individual investors who risk making poor investment decisions, but also for the broader economy, which suffers when capital fails to flow to its best uses.

In light of these critical differences and the significant risks to investors that private markets give rise to, restoring a healthier balance between the lit and dark markets is of paramount importance. The answer is not to enshrine or perpetuate that broken system.

B. Perpetuating the Broken Approach to the Accredited Investor Definition Puts Investors and Markets at Risk

The accredited investor definition is of profound importance to the protection of investors and the health of our capital markets because of the gatekeeper function the definition plays in determining whether issuers can sell their securities to members of the investing public without providing the essential facts needed to evaluate the investment and to value those securities. An overly expansive definition of accredited investor is one of several deregulatory changes that has, over the past four decades, led to the serious decline of our public markets, with grave attendant risks to both investors and the health of our economy.

There is extensive evidence that the current definition includes millions of investors who do not have special access to information regarding private offerings, lack the high level of financial sophistication needed to evaluate private offerings based on limited disclosures, and who qualify as accredited investors based solely on retirement savings amassed over a lifetime of work that they can ill-afford to put at risk in illiquid, opaque and speculative private market investments.[3]

Importantly, because the accredited investor definition relies on financial thresholds (net worth and income) that are not indexed to inflation, the number of investors who qualify as accredited has grown significantly. In 1982, when the financial thresholds were set, accredited investors represented a tiny sliver of the nation's wealthiest citizens – approximately 1.6% of U.S. households (1.31 million households), according to the SEC's estimates.[4] An analysis of the accredited investor population today would inevitably show that many of the 13% of U.S. households (16 million households that the Commission estimates now qualify as accredited investors)[5] are upper middle income households that qualify in large part as a result of a lifetime of savings in a defined contribution retirement account. Moreover, if the financial thresholds were tied to inflation since 1982, the requirement for yearly income would have grown from

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[3] *See* Barbara Roper and Micah Hauptman, *Comment Letter Re: Amending the "Accredited Investor" Definition*, File No. S7-25-19, March 9, 2020, https://bit.ly/442Sbiv; *See also* Recommendation of the Investor as Purchaser Subcommittee and the Investor Education Subcommittee: Accredited Investor Definition, https://bit.ly/3LhsS4E.
[4] Proposed Rule, Amending the "Accredited Investor" Definition, Release Nos. 33–10734; 34–87784 at 77 (Dec. 18, 2019), https://www.sec.gov/rules/proposed/2019/33-10734.pdf.
[5] *Id.*

$200,000 for an individual ($300,000 for a couple) to roughly $600,000 for an individual ($900,000 for a couple) and the net worth requirement would have grown from $1 million to $3 million. Current accredited investors are therefore likely to have very different characteristics – and a very different risk profile – than the members of the one percent who made up the accredited investor population in 1982. On the other hand, tying the existing thresholds to inflation on a going forward basis would do little to constrain the growth of private markets and the harms that retail investors suffer in private markets.

Proponents of locking in place or expanding the accredited investor definition often frame the accredited investor definition as "providing investors with access to valuable opportunities," but a more accurate way of framing it is providing businesses access to investors' hard earned money without any strings attached. Now, because the accredited investor definition is so expansive, businesses can engage in unlimited fundraising from the public without providing *any* information about their business, and as a result, investors can hand over their hard-earned money without any idea about whether doing so is a good idea. That's a great deal for businesses who run Ponzi schemes and frauds, such as FTX and Theranos. It's terrible for investors who can't afford to lose all their money without recourse.

Indeed, private markets appear to be more prone to fraud and other predatory practices. Lack of transparency, limited regulatory oversight, and weaker control mechanisms combine to make private markets more prone to fraud and other predatory practices than public markets. This is not merely theoretical. State regulators have for years raised serious concerns about investors' being preyed upon in private markets. In addition, FINRA has raised concerns about broker-dealers' role in private markets and has brought numerous enforcement actions against broker-dealers for selling unsuitable private placements. Most troublingly, the brunt of the harm often falls on the elderly, according to NASAA enforcement reports. For example, NASAA members specifically "identified the offer and sales of unregistered securities offerings as the scheme used most often to victimize seniors and other vulnerable adults," according to NASAA's 2018 Enforcement Report.[6] Expanding the definition would make this problem much worse, increasing the pool of investors who could be preyed upon. In consumer lending markets, we have predatory loans and loan sharks—if we were to expand the accredited investor definition, we'd be promoting a market of predatory capital and private capital sharks.

In addition, private markets are a two-tiered market. Individual investors are unlikely to have access to the best deals available among either the operating companies or the pooled investments that rely on Reg D to raise capital. Indeed, the private issuers that seek out direct investment from small-dollar retail investors are likely to be the smallest issuers with the worst prospects—the product of severe adverse selection, if not outright fraud.

In short, the potential harm to investors of enshrining or expanding the accredited investor definition would greatly outweigh any benefits to issuers or to small company capital formation.

[6] NASAA, 2018 Enforcement Report, Based on 2017 Data, https://www.nasaa.org/wp-content/uploads/2018/10/2018-Enforcement-Report-Based-on-2017-Data-FINAL.pdf

C. Congress Must Protect the Stable, Reliable Funding of the Consumer Financial Protection Bureau (CFPB)

In the aftermath of the 2008 financial crisis, which left 21 million Americans without work and more than nine million families without homes, Congress passed the critical Dodd-Frank Act, thus creating the Consumer Financial Protection Bureau (CFPB). In doing so, Congress transferred many of the powers from other prudential regulators, including the Federal Reserve, the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC), to the CFPB and thus wanted it to retain a similar funding stream as most other federal financial regulators.

The CFPB's reliable funding stream is critical to the CFPB's ability to govern large sectors of our economy, enforce consumer protection laws, and protect consumers and honest businesses alike. However, the stable funding stream does not mean that Congress lacks sufficient oversight over the CFPB. The opposite is in fact true—the Dodd Frank Act placed a number of intentional controls on the CFPB's authority to ensure that the agency pursues its consumer protection mission in a balanced and responsible manner. For example, the CFPB Director must testify semi-annually before Congress and the Bureau must regularly provide Congress with various reports on the financial marketplace. In addition, the Bureau must coordinate and consult with other federal financial regulators, its enforcement measures are appealable, and it is beholden to many other controls.

The CFPB is charged with enforcing federal consumer financial laws and has a number of tools to accomplish that task effectively, including law enforcement, statutory authority to combat unfair, deceptive or abusive acts or practices, direct supervision of financial institutions, and public education. Since its founding, the CFPB has been effective at its mandate to protect consumers when they engage with financial products and services.

The CFPB has successfully fought for consumers, made markets work more fairly, and stopped fraud and abuse across the financial marketplace. In total, CFPB enforcement actions have resulted in nearly $16 billion returned to over 192 million Americans who have been harmed by illegal, deceptive, and discriminatory practices of various companies.[7] Further, consumers across party lines overwhelmingly support the mission of the CFPB and the actions it has taken.[8]

The CFPB also provides honest businesses with the necessary rules of engagement needed for them to act in accordance with a host of laws meant to ensure the transparency and fairness of the marketplace.

The CFPB has effectively made consumer financial markets fairer and more transparent, put money back in the pockets of wronged consumers, and policed the rules of the road that make the financial system work better for responsible businesses and responsible consumers alike.

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[7] *See* CFPB, Enforcement by the Numbers, last accessed April 24, 2023, https://www.consumerfinance.gov/enforcement/enforcement-by-the-numbers/.

[8] Charla Rios, Center for Responsible Lending, *New Poll Shows Consumer Bureau Popular Among Republican, Independent and Democratic Voters*, December 2, 2022, https://www.responsiblelending.org/media/new-poll-shows-consumer-bureau-popular-among-republican-independent-and-democratic-voters.

Because of this remarkable track record, it would be a serious mistake for Congress to undo the CFPB's current stable funding, as it allows the bureau to govern, oversee, and regulate the financial marketplace, with sufficient oversight and accountability by Congress and other agencies.

D. Legislative Proposals Considered

Vote NO on H.R. 1807, the Improving Disclosure for Investors Act of 2023

Despite its Orwellian name, it is clear that this bill would do the exact opposite of improving investor disclosures; instead, it would diminish protections for retail investors.[9]

Specifically, this bill would allow firms to default retail investors into receiving electronic delivery (e-delivery) of important regulatory documents required by our securities laws, including investment disclosures and account statements. It would do so when there is no evidence that investors who prefer e-delivery face any difficulties in exercising that choice—it is a solution in search of a problem—and would ignore extensive evidence that the change is likely to reduce investor readership of key disclosures.

Financial firms persistently seek to convert investors from paper to electronic delivery and they make it incredibly easy for investors to make this change. As a result, virtually all investors are aware that electronic delivery is an option for receiving investor communications. It's clearly evident that investors who want communications by mail, and have up to now not chosen e-delivery, have made their choice. That choice should be respected; they should not be forced to jump through new hoops to make it again.

Under the current e-delivery framework, in order to encourage more investors to choose electronic delivery firms are incentivized to improve their users' experiences with e-delivery and to present shareholder disclosures on their websites in more user-friendly ways. Unfortunately, most electronically delivered communications consist of email messages with a link to a login screen to access information that is presented in static PDFs. This multi-step process can frustrate and dissuade recipients from reading important disclosures and can be especially harmful to those with less tech savvy or limited access to email and internet.

Unsurprisingly, most electronic deliveries today from financial institutions result in very low click-through rates to the disclosures they provide. For example, the email click rate for the financial services industry is on average about 1%, meaning only 1% of people clicked a link within an email, relative to the number of emails that were successfully delivered.

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[9] *See* Statement for the Record of Micah Hauptman, Director of Investor Protection, Consumer Federation of America, *U.S. Public Markets Built for the 21st Century: Exploring Reforms to Make Our Public Markets Attractive to Small and Emerging Companies Raising Capital*, Committee on Financial Services, Subcommittee on Capital Markets, March 9, 2023, https://bit.ly/3N0M3kt.

Recognizing that investor account statements are incredibly important disclosure documents, on March 2, 2023, the SEC's Investor Advisory Committee recommended that paper delivery continue as the delivery default, stating: "We recommend that account statements continue to be delivered to investors by paper as the default delivery method. For those investors who opt for electronic delivery of statements, the SEC and/or FINRA should encourage the use of technology to enhance disclosure and investor understanding of electronic account statements, such as the use of layered disclosure through embedded links, etc."

But rather than heed that recommendation, this bill would do the opposite. First, it would allow a "notice and access equals delivery" approach, allowing firms to make disclosures available online and providing a notice (typically through a link) of the disclosure's availability instead of directly mailing disclosures, including account statements, to investors. The bill would also allow another "electronic method reasonably designed to ensure receipt of such regulatory document by the investor," giving firms the ability to decide how to effectuate disclosure delivery, which could further shift the burden onto investors to have to seek out and find the disclosures they are required to receive.

This bill would also apply to the delivery of investors' personal account statements, even though there is strong evidence that many investors want to receive these disclosures in paper form. And to the extent investors have already decided to receive these documents in paper, this bill would override their decision and force them to reaffirm the decision they have already made.

This bill would allow financial firms to deliver disclosures in a way that makes it more difficult for investors to access them and would establish a default that is contrary to many investors' preferences. At worst, this bill could provide an avenue for financial firms to effectively hide information (e.g., fees and conflicts) from investors, further undermining investors' ability to make informed decisions.

Vote NO on The Expanding Access to Capital Act of 2023

This package is composed of 23 separate bills, many of which would harm investors and market integrity significantly. Accordingly, vote no on this package. Among its most problematic provisions, the bill includes:

- **Accredited Investors Include Individuals Receiving Advice From Certain Professionals Act**

This bill would expand the definition of accredited investor to include non-accredited investors who rely on advice or recommendations from an investment adviser or broker-dealer. The standards of conduct that broker-dealers and investment advisers have under these circumstances would allow these financial professionals to have a financial stake in the investment being recommended and to receive direct or indirect compensation from the issuer when they complete a transaction for private securities. This lack of effective restrictions on conflicts of interest for the recommendation or advice to transact in private securities is particularly troubling, given the private placement market permits issuers to operate with neither transparency nor accountability.

Brokers typically receive significantly more compensation for selling private placements than they do for selling other investments typically sold to retail investors, such as mutual funds or ETFs. As Massachusetts Secretary of the Commonwealth William Galvin has stated, "Private placements are risky investments that reward the salesperson handsomely with high commissions."[10] There is evidence that brokers perpetuate investor harm when recommending private placements to retail investors. FINRA routinely brings enforcement actions against broker-dealers and registered representatives for violations of the securities laws related to private placement sales. Given the magnitude of the conflicts associated with private offerings and the evidence that brokers perpetuate investor harm when recommending private placements to retail investors, Reg BI does not, based on all available information, adequately ensure that harmful conflicts won't taint brokers' recommendations. And, it is highly unlikely that most retail investors would be capable of assessing the nature and extent of those conflicts or of assessing the quality of the private offering recommendation based on the disclosures brokers will be required to provide. As a result, it's likely that investors would receive inferior quality recommendations that they would unwittingly rely on, to their detriment.

Similarly, the investment adviser fiduciary duty does not protect investors in private offerings. While the Advisers Act theoretically holds investment advisers to a fiduciary duty to act in their clients' best interests, that's not how the SEC has chosen to enforce the standard. Instead, in case after case, the Commission has accepted disclosure alone as satisfying the adviser's fiduciary duty. Worse, the Commission has taken this approach, not only with regard to conflicts of interest, which would be troubling enough, but also with regard to affirmatively harmful practices.[11] Moreover, nothing in the Advisers Act fiduciary duty prevents the adviser from having a personal financial stake in the investment being recommended or from receiving direct or indirect compensation from the issuer, as long as those conflicts are disclosed.

As a result, the "protections" supposedly afforded by the Advisers Act fiduciary standard would do nothing to safeguard investors against the risks: 1) that they would receive highly conflicted advice from their adviser regarding private offerings; 2) that they would be incapable of assessing the nature and extent of those conflicts; 3) that they would similarly be incapable of assessing the quality of the private offering recommendations they received; and 4) that, as a result, they would receive inferior quality advice that they would unwittingly rely on, to their detriment.

For these reasons, we strongly oppose allowing the sale of private offerings to nonaccredited investors based on a recommendation from a broker-dealer or investment advice from an investment adviser.

- **The CFPB Transparency and Accountability Reform Act**

This dangerous package of bills would threaten the CFPB's funding, organizational structure, and its ability to monitor the marketplace by impeding their rulemaking functions. This package would irreparably harm the CFPB's effectiveness and consumers alike.

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[10] *Galvin Launches Investigation of Private Placement Sales by "Bad Actors,"* The DI Wire (July 6, 2018), http://bit.ly/2mIAhkx.

[11] Barbara Roper and Micah Hauptman, *Comment Letter Re: Amending the "Accredited Investor" Definition* at 15.

In the aftermath of the 2008 financial crisis, Congress created the CFPB and provided it with a stable funding stream to ensure it could consistently and effectively regulate the financial marketplace. The CFPB has made consumer financial markets fairer and more transparent, put money back in the pockets of wronged consumers, and policed the rules of the road that make the financial system work better for responsible businesses and responsible consumers alike. Because of this remarkable track record, it would be a serious mistake for Congress to undo the CFPB's current stable funding, as it allows the CFPB to govern, oversee, and regulate the financial marketplace, with sufficient oversight and accountability by Congress and other agencies.

- **Exclude QIBS and IAAs from the Record Holder Count for Mandatory Registration**

By excluding qualified institutional buyers (QIBs) and institutional accredited investors (IAAs) when calculating "holders of record" for purposes of the mandatory registration threshold, this bill would increase the number of private companies and disincentivize them from going public. In turn, this would increase the number of companies that operate without transparency or accountability. The way "holders of record" are calculated is already woefully outdated and doesn't accurately reflect the actual number of investors holding a company's securities. The way to address this problem is to make the calculation a more accurate reflection of the company's investor base, not to further erase the number of investors from the calculation.

- **Unlocking Capital for Small Businesses Act of 2023**

This bill would dramatically expand the ability of unlicensed individuals, so-called "finders," to engage in a broad array of brokerage activities on behalf of private issuers, and to be compensated through transaction-based payments, without being subject to appropriate regulations or oversight.

As attorney Gregory C. Yadley explained, some of those operating as unregistered finders "represent 'the dark side' of the securities business: purveyors of fraudulent shell corporations; front-end fee con artists; purported Regulation S specialists who send stock off-shore and wait to dump it back into the U.S. through unscrupulous brokerage firms or representatives who are receiving under-the-table payments for promoting stocks and micro-cap manipulators."[12] Investors aren't the only ones put at risk by these activities. Issuers who deal with unscrupulous finders may never see any funding materialize. Even when they do receive funding, dealing with unscrupulous finders can present significant problems for the issuer. "They can taint an offering by creating the basis for rescission rights, raise enforcement concerns, make fraudulent representations and engage in general solicitation which disqualifies the offering for exemption from registration."[13] In the absence of both complete and reliable disclosures and effective regulatory oversight of this market to ensure fair dealing, these investors, many of them older,

[12] Gregory C. Yadley, *Notable by the Absence: Finders and Other Financial Intermediaries in Small Business Capital Formation* (Jun. 3, 2015), https://bit.ly/2HvdWSD.
[13] *Id.*

are often ill-equipped to determine whether the securities being offered represent fair value, let alone to protect themselves from deceptive and abusive solicitation activities.

- **Increasing Investor Opportunities Act**

Currently, the SEC caps the amount that closed-end funds can invest in private funds at 15% of assets to be sold to non-accredited investors. If a closed-end fund has more than 15% of assets in private funds, it must sell that fund only to accredited investors. This bill would allow closed-end funds to invest 100% of their assets in private funds and be sold to non-accredited investors, which would effectively create a private fund for retail investors without these investors having to meet the accredited investor definition. This would increase the amount of risky, illiquid, and opaque private funds that are sold to retail investors, who may not be able to appreciate the risks or sustain the risk of loss of these investments. It would also allow for the layering of multiple levels of fund fees, which could make such investments exorbitantly expensive.

- **Risk Disclosure and Investor Attestation Act**

This bill would expand the definition of accredited investor by allowing individuals to qualify if they self-certify that they understand the risks of investment in private issuers and sign a form that is no longer than 2 pages in length. This is effectively a "check the box" exercise that allows individuals to qualify as accredited regardless of whether they actually have the level of sophistication and access to information necessary to evaluate the investment and value the securities, or ability to withstand losses.

- **Investment Opportunity Expansion Act**

This bill would expand the definition of accredited investor to include individuals who invest 10% or less of the greater of their net assets or annual income in a private offering. This would allow private securities to be marketed and sold to retail investors without any disclosures and little accountability. Moreover, the private issuers that seek out direct investment from small-dollar retail investors are likely to be the smallest issuers with the worst prospects—the product of severe adverse selection, if not outright fraud. There is a strong likelihood that small dollar investors would be targeted with the worst of the available private offerings, and many of these investors would be ill-equipped to withstand the risks of these private offerings.

- **Gig Worker Equity Compensation Act**

This bill would expand Securities Act Rule 701 to include gig workers so that gig economy companies can choose to pay gig workers in securities rather than cash. Gig workers are already notoriously underpaid; paying them in equity compensation in lieu of a salary benefits the company employing the workers. Additionally, Rule 701 offerings are illiquid and subject to valuation risk given the lack of public financial disclosure by non-reporting issuers. The shares may also have inferior rights relative to other investors, and they may suffer substantial dilution as a result of subsequent offerings. It is highly unlikely that gig workers would be able to gain access to the kind of information that is necessary to evaluate the investment and value those securities. In the end, gig workers could get stuck with worthless or highly illiquid investments instead of being paid in cash that pays the bills.

- **Improving Crowdfunding Opportunities Act**

This bill would expand crowdfunding markets, despite the evidence that crowdfunding has, since its inception, been characterized by a "culture of noncompliance," as discussed in detail in research by Professor Mercer Bullard.[14] Instead of expanding crowdfunding markets, Congress should ensure that the SEC and FINRA are properly examining and enforcing crowdfunding laws and rules to ensure compliance.

Specifically, this bill would double the offering limit for crowdfunding issuers, from $5 million to $10 million. This increase comes shortly after the SEC raised the offering limit, from $1 million to $5 million. There is simply no reasonable justification for increasing the offering limit this soon after the SEC just raised it. Doing so will likely result in more issuers being able to raise more money from retail investors without complying with the law and without complying with basic investor protections. Retail investors are likely to pay the price. In addition, the bill would impede state regulators from exercising oversight over capital-raising efforts in their states and preventing harm to investors.

- **Regulation A+ Improvement Act of 2023**

This bill would expand Reg A markets, despite the evidence that expansion of Reg. A has been an unmitigated disaster for investors. The Wall Street Journal has described the Reg. A+ market as "tainted by poor post-IPO performance and concerns about fraud,"[15] and Renaissance Capital has referred to the Reg. A+ market as "the wild west of IPOs."[16] Examples of suspect filings, deceptive marketing, and boiler room tactics abound. Instead of expanding Reg A markets, Congress should ensure that the SEC is properly examining and enforcing Reg A issuers' to ensure issuers comply with the law and investors are not harmed.

Specifically, this bill would double the offering limit for Reg A from $75 million to $150 million. This increase comes shortly after the SEC raised the offering limit, from $50 million to $75 million. There is simply no reasonable justification for increasing the offering limit this soon after the SEC just raised it. Doing so will likely result in more issuers being able to raise more money from retail investors, who are likely to pay the price of investing in dud businesses, if not outright scams.

- **Small Entrepreneurs' Empowerment and Development Act of 2023 or the ''SEED Act of 2023''**

This bill would create yet another unnecessary and unwarranted exemption from the Securities Act of 1933 to enable the sale of micro-cap offerings (those involving sales of securities valued

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[14] Mercer Bullard, *Crowdfunding's Culture of Noncompliance: An Empirical Analysis*, 24 Lewis & Clark L. Rev. __ (forthcoming 2020), http://bit.ly/2l8Upfv.

[15] *Id.*

[16] Renaissance Capital, *Reg. A+ is the wild west of IPOs and here's the latest example*, July 10, 2019, http://bit.ly/2m4WyJr (describing a Chinese company that announced plans to raise $700 million, despite Reg. A's offering limit of $50 million, the company listed its auditor's office in New York, CA, it listed George Soros as a cofounder, secretary and director, and much of it appeared to be "plagiarized whole cloth" from Ares Management Corp's 2014 IPO prospectus.).

at $250,000 or less in a single year without appropriate regulatory protections). The bill: doesn't require issuers to notify regulators of the offering; doesn't require them to provide even minimal disclosures; doesn't impose any limits on the amount individuals can invest; doesn't limit the total number of investors in such offerings; doesn't require that inventors have the financial sophistication to understand the potential risks of the offering or the financial wherewithal to withstand any losses; doesn't contemplate any ability of investors to access the kind of information that they would receive in a public offering; and doesn't include any restrictions on secondary sales.

In addition, this bill preempts state authority over what are likely to be predominantly local offerings, raising the very real concern that there will be no meaningful regulatory oversight of these offerings. Certainly, the SEC doesn't have the resources to provide that oversight for offerings of this type. Because this exemption would quickly and predictably become an avenue enabling questionable offerings to avoid regulatory scrutiny, causing countless retail investors to suffer devastating losses.

- **Helping Startups Continue To Grow Act**

This bill would increase the Emerging Growth Company (EGC) revenue threshold from $1 billion to $2 billion and lengthen the EGC qualification period from 5 years to 10 years. In doing so, this bill would allow many large public companies to continue to take advantage of the exemption from required independent audits of their internal financial controls over financial reporting for a decade. Such audits promote both investor confidence in the financial reports of a company, and help a company to more quickly and effectively resolve problems that often affect profitability. In addition, an auditor's attestation of internal controls serves as an independent check on the company's financial reporting. By eliminating this requirement for more companies, many of which are large companies, investors would lose critical protections from potentially inaccurate or fraudulent financial disclosures.

There is cause for concern with EGC financial reporting: 50 percent of the EGCs that provided a management report on the company's internal controls over financial reporting, indicated at least one material weakness.[17] Additionally, 61 percent of the nonexchange-listed EGCs and 25 percent of the exchange-listed EGCs had an audit report that included a going concern paragraph, meaning the company's auditors did not foresee the EGC continuing to operate into the foreseeable future (or for the next twelve months).[18]

- **Helping Angels Lead Our Startups Act of 2023**

This bill would direct the SEC to revise Regulation D to not extend the prohibition on general solicitation or general advertising to events with specified kinds of sponsors, including angel investor groups unconnected to broker-dealers or investment advisers, so long as certain conditions are met. This bill would legislatively codify and further deregulate changes that the SEC made in 2020. Specifically, the SEC promulgated Rule 148, which states the conditions

[17] PCAOB, *Characteristics of Emerging Growth Companies and Their Audit Forms* at 1 (November 15, 2021), https://bit.ly/3KXfKR3.
[18] *Id.*

under which an issuer would not be deemed to have engaged in general solicitation at a demo day. This bill, however, would expand the types of eligible sponsors beyond what the SEC thought was appropriate. Even more troubling, this bill prohibits the SEC from issuing any rule that would apply additional filing requirements (including requirements to file information with the Commission before or after a general solicitation or general advertising) to a general solicitation or general advertising of such a security that were not in effect on the date of enactment of this Act. This bill would therefore undermine the SEC's ability to amend and improve Form D. This restriction would further hamper the SEC's and state regulator's ability to police the Reg D market.

Instead of hampering regulators from overseeing the Reg D market, the SEC should amend and improve Form D to require the filing of a Form D before any offer or sale under Reg D, including any general solicitation under Rule 506(c). Further, the SEC should require the filing of a closing amendment to Form D upon the termination of an offering. These disclosures would provide important information to regulators about who is seeking private capital, how they are doing so, and potential risks that they pose to the investing public.

- **Expand the Protection for Research Reports to Cover All Securities of All Issuers**

This bill would expand the research report exception to include reports about any issuer that undertakes a proposed offering of public securities. The bill could allow broker-dealers that have a vested interest in distributing an issuance to broadly disseminate reports to potential investors that do not contain *all* material information on which to make a fully informed investment decision. Under FINRA rules, research reports are only required to contain "information reasonably sufficient upon which to base an investment decision."[19] These potential gaps in information may cause investors to make decisions that are not fully informed, based on the contents of the report.

Undermining the quality and independence of research has the potential to harm investors and the market. For example, in the research scandals during the dot com era, "analysts published research which was presented as objective but was actually a sop to win investment banking fees for their firms."[20] As former SEC Chair William Donaldson observed of the research scandals during the dot com era, "When a firm publishes favourable research without revealing to its customers that the research - far from being independent - was essentially bought and paid for by the issuer, we had no choice but to conclude that the research system was broken."[21] Donaldson continued, stating that analysts should "resume the role of gatekeeper and shed the recently acquired identity of cheerleader or marketer."[22]

- **Definition of Well-Known Seasoned Issuer (WKSI)**

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[19] FINRA Rules, Rule 2241: Research Analysts and Research Reports, https://www.finra.org/rulesguidance/rulebooks/finra-rules/2241.

[20] David Teather, *Analyst Scandal Costs Wall St. $1.4bn*, The Guardian (April 28, 2003), https://www.theguardian.com/business/2003/apr/29/8.

[21] *Id.*

[22] *Id.*

This bill would lower the aggregate market value of voting and non-voting common equity necessary for an issuer of securities to qualify as a WKSI from $700 million to $75 million. As a WKSI, a company qualifies for automatic shelf registration, which allows offerings to be immediately effective upon filing a Form S-3, since their shelf registration statements are not subject to SEC review. For shelf offerings, WKSIs do not need to disclose as much detail in their base prospectuses. For example, they do not need to specify the amount of securities they plan to sell or name selling shareholders. The idea behind being a WKSI is that sufficient information about the issuer is already in the public domain, given that these companies include the largest, most widely-followed issuers.

Lowering the public float requirement of the WKSI status would defeat the purpose of being a WKSI and allow many more public companies for which there is not sufficient information about them in the public domain to be WKSIs. These companies could engage in shelf offerings with reduced transparency to investors and reduced accountability to the SEC. Remarkably, the legislation would allow EGCs to simultaneously qualify as a WKSI, meaning these "small" and "emerging" companies to provide even less disclosure to investors, without being subject to any pre-offering SEC review.

- **Restoring the Secondary Trading Market Act**

This bill would impede state regulators from exercising oversight over certain secondary trading of securities that occurs "off-exchange," or over the counter, as long as the issuer makes certain information regarding the securities publicly available under SEC Regulation A and SEC Rule 15c2-11. Regulation A offerings and trading often occur off-exchange because national securities exchanges have determined that many of these securities lack quality. Accordingly, exchanges have tightened listing requirements in order to better ensure that only legitimate businesses list.[23] The answer is not to weaken oversight of the trading of these offerings, it's to strengthen it in order to prevent harm to investors.

<u>Vote NO on the "Bipartisan" Package Being Offered</u>

This package includes a bill that would lock in place an approach to the definition of accredited investor based on financial thresholds that have been shown to be ineffective in defining a population of investors that can fend for themselves without the protections afforded in the public markets. It also includes several bills that would legislatively enshrine rulemakings that the Trump Administration undertook. The Democratic bills that have been included in this package are simply not sufficient to make up for this bill's deficiencies.

<u>Vote NO on the Following Individual Bills</u>:

- **Vote NO on H.R. 835, the Fair Investment Opportunities for Professional Experts Act**

[23] *See* Alexander Osipovich, *Exchanges Shy Away From Mini-IPOs After Fraud Concerns*, Wall Street Journal, June 10, 2019, https://on.wsj.com/2lrPWET.

This bill would lock in place an approach to the definition of accredited investor based on financial thresholds that have been shown to be ineffective in defining a population of investors capable of fending for themselves without the protections afforded in the public market. It would also expand the definition to include individuals who have "demonstrable education or job experience to qualify such person as having professional knowledge of a subject related to a particular investment." It's not clear who would qualify under such a test or whether such person would be able to gain access to the kind of information that is necessary to evaluate the investment and value those securities.

- **Vote No on H.R. 1579, the Accredited Investor Definition Review Act**

This bill would legislatively enshrine the SEC's 2020 rulemaking to permit qualification based on certain certifications, designations, or credentials and to direct the SEC to review and adjust or modify the list of certifications, designations, and credentials accepted with respect to meeting the requirements of the definition of "accredited investor" within 18 months of the date of the bill's enactment and then not less frequently than once year five years thereafter. This bill would constrain the SEC from reconsidering certain qualifications and certifications, even if the SEC decides that this approach is no longer appropriate. Moreover, it would unnecessarily burden SEC resources by requiring the agency to revisit these reviews every five years.

- **Vote NO on H.R. ___, the Equal Opportunity for All Investors Act**

This bill would expand the accredited investor definition by adding individuals who pass a certification examination established by the SEC. The bill's fatal flaw is that it requires the exam to be "designed to ensure that an individual with financial sophistication or training would be unlikely to fail," which suggests a predetermined outcome irrespective of the level of financial sophistication or training and irrespective of whether the individual is able to gain access to the kind of information that is necessary to evaluate the investment and value those securities.

- **Vote NO on H.R. 2793, the Encouraging Public Offerings Act of 2023**

This bill would legislatively codify changes the SEC has already made to allow all companies, not just EGCs, to get confidential review of their draft registration statements and allow them to test the waters. This is the wrong approach. Confidential review assumes the SEC staff can catch all issues with a registration statement, which is not a reasonable assumption, given their workload and the time they spend reviewing such disclosures. Confidential review places too much burden on SEC staffers. It also hinders the ability of private market participants, who may have strong economic incentives to catch issues, to carefully evaluate such disclosures. It also hinders the ability of other third parties to publish material information to the market that would enable investors to make informed decisions about the offering.

- **Vote NO on H.R. 2610, a bill to amend the Securities Exchange Act of 1934 to specify certain registration statement contents for emerging growth companies, to permit issuers to file draft registration statements with the Securities and Exchange Commission for confidential review, and for other purposes**

This bill would legislatively codify changes the SEC has already made to allow all companies, not just EGCs, to get confidential review of their draft registration statements and allow them to test the waters. This is the wrong approach. Confidential review assumes the SEC staff can catch all issues with a registration statement, which is not a reasonable assumption, given their workload and the time they spend reviewing such disclosures. Confidential review places too much burden on SEC staffers. It also hinders the ability of private market participants, who may have strong economic incentives to catch issues, to carefully evaluate such disclosures. It also hinders the ability of other third parties to publish material information to the market that would enable investors to make informed decisions about the offering.

- **Vote NO on H.R. 2608, a bill to amend the Federal securities laws to specify the periods for which financial statements are required to be provided by an emerging growth company, and for other purposes**

This bill states that EGCs would not need to present acquired company financial statements for any period prior to the earliest audited period of the EGC presented in connection with its IPO, and in no event would an EGC that loses its EGC status be required to present financial statements of the issuer or the acquired company for any period prior to the earliest audited period of the EGC presented in connection with the IPO. This bill strips the SEC of its authority to exercise judgment when additional financial statements would be helpful to investors.

Vote NO on H.R.___, the CFPB Transparency and Accountability Reform Act (offered as a standalone)

This dangerous package of bills would threaten the CFPB's funding, organizational structure, and its ability to monitor the marketplace by impeding their rulemaking functions. This package would irreparably harm the CFPB's effectiveness and consumers alike.

In the aftermath of the 2008 financial crisis, Congress created the CFPB and provided it with a stable funding stream to ensure it could consistently and effectively regulate the financial marketplace. The CFPB has made consumer financial markets fairer and more transparent, put money back in the pockets of wronged consumers, and policed the rules of the road that make the financial system work better for responsible businesses and responsible consumers alike. Because of this remarkable track record, it would be a serious mistake for Congress to undo the CFPB's current stable funding, as it allows the bureau to govern, oversee, and regulate the financial marketplace, with sufficient oversight and accountability by Congress and other agencies.

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Conclusion

At a moment when evidence suggests our public markets are in serious decline, Congress should be promoting carefully thought out policies to restore an appropriate balance between public and private markets. That is essential, not just to ensure that investors are adequately protected, but to promote productive, sustainable capital formation and the overall health of our economy.

Instead, this Committee has decided to double down on a deregulatory approach that is likely to harm investors/consumers and undermine market integrity. For the above reasons, VOTE NO on all of the bills discussed above.

Respectfully,

Micah Hauptman
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