



Consumer Federation of America

June 9, 2014

The Honorable Jeb Hensarling
Chairman
Financial Services Committee
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Maxine Waters
Ranking Member
Financial Services Committee
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Hensarling, Ranking Member Waters and Members of the Committee:

I am writing on behalf of the Consumer Federation of America to express our strong opposition to three small company “capital formation” bills scheduled for mark-up in the Financial Services Committee this week. These bills would reduce the regulatory oversight that promotes market integrity, reduce the transparency that promotes market efficiency, and strip away protections for the investors we rely on to provide the capital on which the capital formation process depends. As such, they would threaten not just investors, but the health of our capital markets and our economy. In order to ensure that our markets continue to be a place where investors can save for long-term financial goals and companies of all sizes can raise capital and grow, we urge you to vote no against the following bills.

1) Vote NO on H.R. 4697, the “Small-Cap Access to Capital Act.”

This legislation would require the Commission to revise the definition of “well-known, seasoned issuer” (or WKSIs) to include issuers that are neither well-known nor seasoned. As Columbia Law School Professor John Coffee noted in testimony before this committee, the primary effect of this legislation would be to make the vast majority of public companies eligible for automatic shelf registration, which permits the sale of securities without any prior review of the registration filing by the Commission. Professor Coffee went on to note that eliminating the opportunity for SEC review of registration filings “both invites misbehavior (if an issuer knows it will not be subject to prior review) and encourages costly litigation (if errors are later discovered).” Moreover, because WKSIs can register securities for sale for the account of selling shareholders without separately identifying “the selling security holders or the securities to be sold by such persons” until the time of the actual sale, the legislation is more likely to promote secondary sales by large shareholders than to promote capital formation. Such resales do nothing to raise additional capital and create jobs. Because it would weaken regulatory oversight, reduce market transparency, and do nothing to promote capital formation, we urge you to vote no on this legislation.

2) Vote NO on H.R. 2629, the “Fostering Innovation Act.”

This legislation is designed to exempt a broad swath of established public companies from requirements designed to ensure that they have effective procedures in place to prevent accounting fraud and material misstatements. As such, the only “innovation” it would foster is the “innovative” accounting that has in the past wreaked such havoc in our markets. Moreover, since it applies this regulatory relief to companies that have already gone through the initial expense of coming into compliance with these requirements, it would do little to reduce their regulatory burdens. But past experience tells us that it would significantly reduce the reliability of their financial disclosures and thus increase the risk of investor losses. Clearly, for some rolling back the Sarbanes-Oxley Act requirements that ensure that auditors include an evaluation of fraud controls as part of the financial statement audit has become an end in itself, without regard to the well-documented benefits of the independent assessments or their affordability for public companies of all sizes. Because it is not justified based on the costs of the audits and would reduce the reliability of information investors rely on for the efficient allocation of capital, we urge you to vote no on this legislation.

3) Vote NO on H.R. 4564, the “Equity Crowdfunding Improvement Act.”

Title III of the JOBS Act provided for the creation of a new online marketplace where early stage start-up companies can raise small amounts of seed capital from investors who are neither wealthy nor financially sophisticated. Although experience tells us that the majority of these early stage companies will fail, leaving their investors with nothing, the Securities and Exchange Commission has proposed rules that give scant attention to investor protection concerns. For this reason, the proposed rules were roundly criticized by investor advocates¹, state securities regulators, and even the chief sponsor of the Senate crowdfunding bill. At its most recent meeting, the SEC’s Investor Advisory Committee unanimously approved a set of recommendations calling for the rule proposals to be strengthened.²

Instead of mitigating the risks in the Commission’s anti-investor approach to crowdfunding implementation, this legislation would make them much worse. It would, for example, greatly increase the risk that crowdfunding investors would invest based on an insufficient understanding of the risks and that they would suffer unaffordable losses on their crowdfunding investments. We understand that Rep. McHenry plans to offer an amendment that purports to address some of the most severe investor protection concerns posed by the original bill, including by reducing the amount that non-accredited investors would be permitted to invest through crowdfunding. However, even with the proposed change to the investment limits, the legislation would permit moderate income investors to suffer unaffordable losses in a market with a high risk of issuer failure. And the investment limits themselves are poorly drafted, raising questions over which individuals would be subject to the proposed five percent investment limit by virtue of their income or net worth and not be exempt from the limits as accredited investors.

¹ CFA’s detailed comment on the proposed rules is available here: <http://www.sec.gov/comments/s7-09-13/s70913-78.pdf>.

² The IAC crowdfunding recommendation is available here: <http://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-adviser-crowdfunding-recommendation.pdf>.

Moreover, based on a draft that we have reviewed, the amended bill continues to be extremely harmful to investor protection. In at least one respect, the proposed amendment poses even greater risks to investors than the original bill, as it would allow intermediaries not just to “curate” offerings (something we support) but to effectively operate as brokers (making recommendations and offering “incidental” advice) without being appropriately regulated as brokers. This is an invitation to abusive practices. The amendment also includes a backdoor mechanism to permit general solicitation to accredited investors without verification of accredited investor status. It allows financial statements to be provided using non-GAAP accounting, reducing the reliability and comparability of those disclosures for investors and complicating the transition to public company status for issuers that grow and prosper. It allows issuers to game the system, and avoid appropriate regulatory restrictions, by simultaneously conducting offerings under separate exemptions. Finally, the legislation would allow rules to be adopted through an interim final rule process that does not allow an appropriate opportunity for public comment, something that House Republicans have, in other contexts, decried as an assault on the proper functioning of the regulatory process.³ And it imposes an unreasonably short time period for rulemaking that precludes the possibility of the careful economic analysis that it simultaneously requires.

Because it would dramatically increase the risk that crowdfunding investors would suffer devastating financial harm, we urge you to vote no on this legislation, with or without the proposed amendment.

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The JOBS Act enshrined a radical concept, that the best way to promote small company capital formation is to reduce the transparency that promotes market efficiency and to strip away protections for the providers of capital. With much of the legislation not yet implemented, and the rest too new to allow for meaningful evaluation, it is too soon to tell whether the JOBS Act will produce the jobs-promoting benefits promised by its supporters or the wealth-destroying harms predicted by its opponents. It is certainly far too early to double down on an approach that ignores the historic correlation between investor protection, market transparency, and the cost of capital. We therefore urge you to vote no on these reckless, unfounded, and ill-advised bills.

Respectfully submitted,



Barbara Roper
Director of Investor Protection

³ See, for example, U.S. House of Representatives, Committee on Oversight and Government Reform, *Broken Government: How the Administrative State has Broken President Obama’s Promise of Regulatory Reform*, September 14, 2011, available [here](#).