



## Consumer Federation of America

December 11, 2017 (updated)

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:

We are writing on behalf of the Consumer Federation of America to urge opposition to two of the capital markets bills scheduled for mark-up tomorrow. Both bills continue a steady erosion in the health and integrity of our capital markets, undermining, rather than enhancing, capital formation and market integrity.

- **Vote No on H.R. 4529, the Accelerating Access to Capital Act of 2017**

By further expanding access to the “shelf registration” system, H.R. 4529 would make it easier for micro-cap companies to raise additional capital without appropriate regulatory scrutiny, increasing the risk of fraud and market manipulation. The shelf registration system was designed to enable well known, seasoned companies to access the markets more quickly, without undergoing prior review of their offering documents by the staff of the Securities and Exchange Commission (SEC). In 2007, the SEC extended the privilege of shelf registration to the smallest public companies, those with a public float of less than \$75 million, if they met three conditions associated with reduced risk of fraud: 1) the company’s shares are traded on a national exchange, 2) the company is not a shell company, and 3) it has not issued common equity in reliance on the exception in excess of one-third of the value of its public float in the preceding year. This bill would permit *any* exchange-listed company, regardless of size, to issue an unlimited number of shares in a given year using shelf registration. Worse, it would allow non-exchange-listed companies (e.g., those sold in the “pink sheets”) to sell up to one-third of the aggregate market value of their common equity using shelf registration.

While speedy access to markets enables companies to take advantage of favorable market conditions, it also facilitates several varieties of fraudulent and abusive conduct. These include accounting fraud, market manipulation, and insider trading, all of which have been found to be more common among micro-cap companies and particularly among non-exchange-listed companies. For example, a 2006 study of SEC enforcement actions found that 80 percent of

manipulation cases involved non-exchange-traded stocks.<sup>1</sup> A more recent study has found that over-the-counter (OTC) stocks are less liquid and more volatile than exchange-traded stocks, making them more prone to manipulation.<sup>2</sup> It was in light of these concerns that the Commission adopted its current requirements, requirements that would be stripped away by this bill.

As University of Mississippi MDLA Distinguished Lecturer and Professor of Law Mercer Bullard noted in testimony before the House Capital Markets Subcommittee, “The current shelf offering rules reflect careful analysis of the costs and benefits of allowing microcap issuers to access public markets with virtually no opportunity for market review.”<sup>3</sup> We agree with Professor Bullard that, “Non-exchange-traded micro-cap securities already provide market manipulators with the perfect petri dish of infrequent trading, low trading volume, high volatility, usually negative performance, extreme performance swings, and penny stock prices. This bill will further enrich the micro-cap market as a breeding ground for market manipulation and thereby unfairly inhibit capital formation for currently shelf-eligible micro-cap companies and inflict significant losses on unsuspecting investors.”

By increasing the risks of market manipulation and fraud, the bill would decrease rather than increase investor willingness to invest in micro-cap offerings and would thus undermine the flow of capital to legitimate micro-cap companies. We therefore urge you to oppose this bill.

- **Vote No on H.R. 4546, the National Securities Exchange Regulatory Parity**

H.R. 4546 would change the terms on which securities are deemed “covered securities,” and thus exempt from state oversight, by removing any requirement that they have to meet conditions comparable to the current listing standards on leading national exchanges. Instead, any security listed on an exchange that is a member of the National Market System (NMS) would be exempt from state regulation and oversight. Because the bill would not establish any core quantitative or qualitative requirements for covered securities to replace those eliminated by the bill, it would likely accelerate an already troubling race to the bottom in listing standards among NMS members. Moreover, the bill does not sufficiently protect against the possibility that a venture exchange could eventually be established specifically to meet the bill’s requirements for state preemption. If this were to occur, smaller, more local offerings typically overseen by states could be “designated as qualified for trading” on such an exchange without any assurance that can meet basic quantitative and qualitative standards designed to ensure investors are appropriately protected. Because it would leave investors without the protections afforded by

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<sup>1</sup> Rajesh Aggarwal and Guojon Wu, Stock Market Manipulations, 79 Journal of Business 1915, 1935 (2006). This total includes 29.58 percent of cases involving stocks for which market information was unavailable (which therefore presumably were not traded on a national securities exchange).

<sup>2</sup> See Ulf Brüggemann, Aditya Kaul, Christian Leuz, and Ingrid M. Werner, The Twilight Zone: OTC Regulatory Regimes and Market Quality, Fisher College of Business Working Paper No. 2013-03-09 (August 1, 2013) available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2290492](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2290492).

<sup>3</sup> Testimony of Mercer E. Bullard, President and Founder, Fund Democracy, Inc. and MDLA Distinguished Lecturer and Professor of Law, University of Mississippi School of Law, on Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens, Part II, before the Subcommittee on Capital Markets and Government Sponsored Enterprises, Committee on Financial Services, U.S. House of Representatives (May 13, 2015) available at <http://financialservices.house.gov/uploadedfiles/hrg-114-ba16-wstate-mbullard-20150513.pdf>.

state oversight, without the protections afforded by high listing standards, and without any reasonable hope that the SEC will be able to provide effective oversight at the federal level, we urge you to oppose this bill.

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This Committee continues to squander opportunities to carefully study our capital markets, identify factors that are impeding capital formation and undermining the public markets, and act to address those concerns. Instead, it continues to rush through ill-considered, poorly thought out bills, such as these, that will further undermine the capital formation process and contribute to the continued decline of our public markets. The end result will be bad for issuers, bad for market integrity, bad for investors, and bad for the economy as a whole.

Respectfully submitted,



Barbara Roper  
Director of Investor Protection



Micah Hauptman  
Financial Services Counsel