Consumer Federation of America

March 12, 2018

Vote NO on H.R. 4263, the Regulation A+ Improvement Act

Dear Representative:

We understand the House is scheduled to vote this week on H.R. 4263, the Regulation A+ Improvement Act. This bill would arbitrarily and prematurely increase by 50 percent the amount that companies can offer and sell under Regulation A+ in a given 12-month period, from $50 million to $75 million. It would do so despite market evidence showing issuers of Regulation A+ offerings neither need nor merit more capital. For these reasons, we urge you to vote no on this ill-advised legislation.

This bill would increase the offering limit despite the fact that the SEC already has unlimited authority to raise the cap as it deems appropriate. Moreover, the SEC is required to review the offering limit every two years, with its next analysis expected to be released next month. By carefully analyzing the market – including the success rate for offerings, how proceeds are used, and investor acceptance in light of limited secondary market liquidity – the SEC can make an evidence-based decision regarding the appropriateness of raising the offering cap when it deems that doing so is consistent with its mission of protecting investors and promoting capital formation. A vote for this bill, before the SEC has had a chance to complete its analysis, is a vote against evidence-based policymaking.

If Congress were to take the time to consider the research that the SEC has conducted on the Regulation A markets since the Regulation A+ rules were adopted, it would find that there currently is no need to raise the limit.[1] For example, a November 2016 SEC report showed that a large majority of issuers sought to raise amounts well below the tier cap. Specifically, it found that, among all Regulation A offerings conducted between June 19, 2015 and October 31, 2016, the average issuer was seeking only $18 million. Just looking at Tier 2 offerings, the average amount sought was $26 million. Less than one-third of issuers across all offerings set maximum offer amounts equal to the tier cap. We understand that more recent data show these trends holding steady. These data suggest that issuers generally are not clamoring for more capital than is currently allowed to them under the rules.

It's important to remember that the issuers taking advantage of Regulation A offering rules are small, early-stage companies with limited collateral.[2] They often have no cash,

[1] Anzhela Knyazeva, "Regulation A+: What Do We Know So Far?" prepared for the Division of Economic and Risk Analysis, Securities and Exchange Commission, November 2016, http://bit.ly/2huFv17.
[2] *Id*. at 15.

property, plants and equipment, long-term debt, revenue, or net income, and their valuations are based mainly on growth potential, which is inherently speculative. This may help to explain why, among the relatively few issuers that seek to raise the maximum amount available to them, so few are able to do so. For example, as of December 31, 2017, only 3 of the 61 issuers that have reportedly completed Tier 2 offerings (5%) have raised the maximum amount.[3] The market appears to be sending a powerful message that it is unwilling to provide the capital that these firms want, perhaps because these companies don't merit it. Raising the threshold without concern for these businesses' characteristics or financing needs is simply irresponsible.

The market's tepid reaction to Regulation A offerings is surely also related to the largely abysmal performance of Regulation A offerings to date. According to Dealogic, for example, 7 of the 8 companies that listed on U.S. exchanges in 2017 under Regulation A are trading an average 42% below their offer price.[4] Meanwhile, the S&P 500 has risen 18% since the start of 2017 and the average traditional IPO listed on the major U.S. exchanges in 2017 has climbed roughly 22% since its IPOs.[5] A recent *Barron's* article provided an in-depth review of the Regulation A market, describing the "woeful performance" of the few dozen companies that are currently exchange-listed and the difficulty trading or getting a price quote for the vast majority of companies that aren't exchange listed.

The *Barron's* article further described how "[M]ost Reg A+ businesses haven't gotten beyond the startup phase known as the pipedream." Some examples that the article cites include businesses seeking capital for cannabis paraphernalia, flying cars, studying UFOs, telepathy, and light-speed travel. We wonder why the backers of this legislation would spend so much time and effort seeking to artificially prop up businesses of this sort. And while Regulation A's supporters have touted Regulation A's job creating potential, the *Barron's* article states that the only people Regulation A clearly has created jobs for are Regulation A underwriters and promoters on Wall Street, many of whom have "checkered stock market histories." Are these really the sorts of jobs Congress is intending to promote?

Meanwhile, companies of all sizes have a myriad of alternatives available to them for raising capital.[6] Given these facts, the failure of Regulation A to meet its job creation and capital formation potential suggests, not that companies are struggling to raise capital, but simply that they are choosing other more attractive capital formation options.

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[3] Analysis of Form 1As.

[4] Corrie Driebusch and Juliet Chung, *IPO Shortcuts Put Burden on Investors to Identify Risk*, WALL STREET JOURNAL, February 6, 2018, http://on.wsj.com/2p4n8kf. Averages don't tell the full story, however. Looking at specific companies: Chicken Soup for the Soul Entertainment is trading 25% below its offering price; Level Brands is trading 27% below its offering price; FAT Brands is trading 29% below its offering price; Myomo is trading at 43% below its offering price; Arcimoto is trading at 50% below its offering price; Shiftpixy is trading at 54% below its offering price; and Adomani is trading at 66% below its offering price. The only "success story" is Longfin, which is trading at 541% of its offering price and whose performance has been attributed to the company's acquisition of a company focused on blockchain. However, like other companies associated with blockchain technology, Longfin's share price has been highly volatile, losing more than 40% since its high on December 29, 2017.

[5] Bill Alpert, Brett Arends, and Ben Walsh, *Most Mini-IPOs Fail the Market Test*, BARRON'S, February 13, 2018, http://bit.ly/2FwKPw5

[6] *See, e.g.*, Staff of the Division of Economic and Risk Analysis, SEC, Report to Congress on Access to Capital and Market Liquidity, August 2017, http://bit.ly/2wLYBC5.

In conclusion, because this bill arbitrarily increases the offering limit without evidence that doing so is either necessary or beneficial, and in the face of evidence that Regulation A offerings to date largely have been market failures, we urge you to vote no.

Respectfully submitted,

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