

April 24, 2023

Via Electronic Mail

The Honorable Speaker Steve Yeager
The Honorable Senator Melanie Scheible
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Via: SenJUD@sen.state.nv.us
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Re: Assembly Bill 75

Dear Speaker Yeager, Chair Scheible and Members of the Senate Judiciary Committee,

Thank you for the opportunity to provide commentary on Assembly Bill 75 (AB75). The Consumer Federation of America (CFA) writes to express its concerns with the proposed legislation. While CFA appreciates the intent of AB75 to drive economic development within Nevada, this legislation will expose retail investors to significant risks and losses and will therefore do more harm than good.

For background, CFA is an association of non-profit consumer organizations established in 1968 to advance the consumer interest. CFA's advocacy arm works to advance pro-consumer policies on a variety of issues before Congress, the White House, federal and state regulatory agencies, state legislatures, and courts. CFA communicates and works with public officials to promote beneficial policies, oppose harmful ones, and ensure a balanced debate on issues important to consumers. Today, more than 250 non-profit consumer groups participate in the federation.

AB75 poses serious risks to Nevadans because it entirely bypasses state and federal securities laws to create an intrastate offering exemption. This makes it possible to sell some of the most speculative, risky, and illiquid¹ assets to ordinary persons, and opens the door to substantial fraud and abuse of Nevadans. While the proposed amendment raises the investor income threshold from the median income to \$100,000, roughly 1 in 5 Nevadans will still qualify.² Moreover, the business revenue qualification provides a simple revenue figure but doesn't speak to the business's resources or sophistication. Despite the intent of the amendment to meet consumer protection concerns, substantial risk to Nevadans remains. Moreover, these charges are largely meaningless in the context of rising inflation without a mechanism for adjustment.

While it's true that states were the first authority in the United States to regulate securities, the Uniform Law Commission stepped in to provide model legislation in a

¹ Illiquidity occurs when a security or other asset cannot easily and quickly be sold on the open market or exchanged for cash without a substantial loss in value.

² Demographic Statistics Atlas of the United States, NEVADA HOUSEHOLD INCOME, (available at <https://statisticalatlas.com/state/Nevada/Household-Income>).

complicated domain. Nevada adopted the Uniform Securities Act in 1987, deferring largely to the Commission’s expertise on best practices.³ Deviating away from standardized legislation, and being the first state to enact offering exemptions of this type, can expose Nevadans to real financial hazard. As a policy matter, and because this legislation would risk draining away Nevadans’ hard-earned savings, we urge you to reject this legislation.

I. The Need to Protect Public Markets and Confidence in Financial Markets

One of the signal achievements of the 20th Century was the restoration of trust and confidence in the U.S. capital markets after the cataclysmic events triggered by the 1929 stock market crash. Between September of 1929 and July of 1932, the value of all stocks listed on the New York Stock Exchange plummeted from nearly \$90 billion to just under \$16 billion, a loss of 83 percent.⁴ Roughly half of the \$50 billion of new securities sold in the post-World War I decade ultimately proved to be either nearly or totally valueless. Even leading “blue chip” securities, such as General Electric, Sears, Roebuck, and U.S. Steel common stock, lost over 90 percent of their value between selected dates in 1929 and 1932.⁵ As the Senate Banking Committee later wrote, “The annals of finance present no counterpart to this enormous decline in security prices.”⁶

Congress addressed this problem by passing the federal securities laws which created a legal framework based on transparency and accountability. This legal foundation allowed the United States to develop the world’s deepest and most vibrant capital markets. Yet efforts by Congress and the U.S. Securities and Exchange Commission (SEC) have been underway for some time to chip away at this foundation and shift more investing to private instead of public markets.

Earlier this year, U.S. House Republicans held a hearing entertaining proposals to expand the availability of private offerings and relax investor limitations on these offerings.⁷ The SEC Investor Advisory Committee also recently held a panel discussion on the growth of private markets relative to public markets. During the panel, Faith Anderson of the North American Securities Administrators Association warned against widening access to the private markets, accurately stating: “[W]hile state regulators believe that retail investors deserve access to high-quality investment options, the unregulated nature of the private market stacks the deck against them.”⁸

³ NEV. REV. STAT. § 90.

⁴ Joel Seligman, THE TRANSFORMATION OF WALL STREET (THIRD ED.), Wolters Kluwer L. & Bus., at 1.

⁵ *Id.* at 2.

⁶ *Id.* at 1.

⁷ See *Sophistication or Discrimination? How the Accredited Investor Definition Unfairly Limits Investment Access for the Non-wealthy and the Need for Reform: Hearing Before the H. Subcomm. on Capital Markets*, 117th Cong. (2023).

⁸ Faith Anderson, North American Securities Administrators Association, Written Statement to the Sec. Exch. Comm’n, Investor Advisory Committee, *Panel Discussion Examining the Growth of Private Markets Relative to Public Markets: Drivers and Implications*, (Mar. 2, 2023), (available at <https://www.sec.gov/files/faith-anderson-remarks-030223.pdf>).

The SEC and Congress have created exemption after exemption to the public offering requirements while claiming to serve small business needs. The current federal “accredited investor” standard now allows persons with some wealth to access many private market offerings. To qualify, an investor must make an annual income of \$200,000 for individuals (or \$300,000 for couples) or have a net worth of at least \$1 million, excluding the entire value of their primary residence.⁹

What were once proposed as narrow exemptions have now turned into a gaping loophole allowing private markets to balloon in size. Despite this growth, as far we can determine, neither Congress nor the SEC has ever seriously examined whether providing broad new exemptions to enable capital raising based on minimal disclosures actually leads to sustainable job creation and economic growth. It seems more likely that these exemptions create more and more room for frauds, abuse, and losses.

Critically, private markets are supposed to be limited to investors who can “fend for themselves” without the protections afforded by the public markets. This means private offerings should only be offered and sold only to those investors who are sophisticated, who can bear the risk of total loss of the investment, and have access to the kind of information that they would have access to in the public markets. In creating the federal accredited investor definition, the SEC attempted to strike some balance between capital formation and investor protection.¹⁰ The income and net worth thresholds limit accredited investors to those with at least some capacity for bearing private market risks.¹¹ Yet as Professor Fletcher discussed in her letter to this committee and her testimony to Congress, even the most sophisticated investors struggle to value private market offerings.¹² This is because investors in private offerings fundamentally lack the information necessary to value their prospective investments.

Public markets benefit society because investors can review information and consider the relative risks and rewards offered by different issuers. The system allows capital to flow to its highest value use and creates the largest possible economic benefit. Undermining public capital markets undermines the health of our capitalist economic system.

As a general matter, we urge Nevada’s legislature to decline this and any other invitation to further weaken public markets by channeling more capital formation into private markets. As this trend continues, it weakens public markets and the overall economic vitality of the United States.

II. Specific Concerns with AB75

As explained below, we write to highlight specific concerns with AB75.

A. Adverse Selection Means That AB75 Will Enable the Lowest Quality Offerings

⁹ 17 CFR § 230.501(a).

¹⁰ Accredited Investor Definition, 85 Fed. Reg. 197,64235 (Oct. 9, 2020) (codified at 17 CFR 230.501(a)).

¹¹ Accredited Investor Definition, 85 Fed. Reg. at 197,64241.

¹² Gina-Gail Fletcher, Comment Letter on Assembly Bill 75, 2023 Leg., 82nd Sess. (Nev. 2023).

AB75 also raises concerns about adverse selection. AB75 seeks to enable companies unable to obtain financing under the current rules to gain access to capital from Nevada certified investors. As investors generally invest for the purpose of earning a return on their investment, the companies currently unable to raise capital under the current rules are overwhelmingly likely to be the ones offering the opportunities with the absolute worst prospects. Functionally, AB75 would simply expose vulnerable retail investors to private companies unable to otherwise raise capital. This process creates real danger to investors because they will likely only be offered opportunities to invest where better informed, wealthier, and more sophisticated investors have already passed.

In practice, the failure rate for these investments will be astoundingly high. Startup Genome recently reported in its 2019 Global Startup Ecosystem Report that only 1 in 12 startups succeed – a 92% failure rate.¹³ And these are the opportunities that persuade people to invest under the existing system. Outcomes under AB75 will almost certainly be worse.

B. Investments Made Under AB75 Would Be Difficult or Impossible to Value

Nevada certified investors under AB75 would have no reasonable mechanism to calculate the value of any investment made in a private offering. In contrast, public market investments generally have a public market price that is based on reliable and accurate publicly available information. That same valuation tool doesn't exist with private offerings. In private markets, where there is no information, or the information is suspect, investors can't make informed decisions about their finances. In reality, as no open market for these investments will exist, investors should not assign any value to these investments.

C. The Transaction-Based Restriction and Investor Limitation Creates Real Dangers of Abuse

Early-stage businesses often seek capital again and again. AB75's transaction-based restriction to 10% of an investor's net worth creates real dangers. Investors with part of their net worth already invested under AB75 will need to calculate their net worth again to make the next investment. AB75 does not appear to contemplate how Nevadans assure they only invest 10% of their net worth and not more. As drafted, the bill appears to rely on self-certification without any mechanism to ensure the cap is meaningful in practice. In order to be effective, some certification system must be established to protect against Nevadans investing beyond their means, either knowingly or unknowingly.

Additionally, businesses seeking capital under AB75's exemption will have strong incentives to convince investors that their first investment has grown in value—despite the absence of any credible evidence. Investors with part of their net worth already invested under AB75 will need to calculate their net worth again to make the next investment. Once Nevada certified investors accept high valuations for their initial investments, AB75's transaction-based restriction to 10% of an investor's net worth becomes largely meaningless.

¹³ Startup Genome, GLOBAL STARTUP ECOSYSTEM REPORT 2019, <https://startupgenome.com/reports/global-startup-ecosystem-report-2019> (May 19, 2019).

Moreover, the amendment proposes to limit the number of investors per business to 75 individuals. This change carries some benefit in preventing businesses from issuing unlimited offerings, but it changes the intent of the legislation dramatically. As originally presented, the bill sought to enable businesses to seek small amounts of capital from a large pool of investors. Limiting the number of investors means businesses will have to seek larger investments from fewer people. Additionally, businesses will be forced to continually seek capital from the same 75 original investors. Understanding the sheer odds of a successful investment, this cyclical process wherein businesses continually draw from the same small number of individuals creates an even higher risk of loss. Those seeking capital could also circumvent this 75-person limitation simply by creating additional businesses, like in a series LLC.¹⁴

D. AB75's Investments Would Be Illiquid

No market for securities sold under AB75's proposed exemption exists. Unlike public market transactions, there is no parallel market for private offerings. Participating investors will likely be stuck with their investment until the company collapses or is acquired by some other company. Notably, with the proposed amendment narrowing those who qualify, the pool of potential resale buyers is even more substantially limited.

Allowing these illiquid investments would create liquidity risk for ordinary Nevadans. Although many persons buy stock and plan to hold for the long term, life's events sometimes force persons to sell their investments to meet expenses. A person might lose their job or need to help a relative with medical expenses. Ordinary public market securities can be sold to allow investors to liquidate their holding and access their funds. In contrast, any wealth tied up in investments made under AB75 would be inaccessible and unavailable.

E. AB75 Would Harm Retirement Security

AB75 risks bleeding assets from Nevada's retirement savers and retirees alike. Nevada, like the rest of the country, faces a retirement crisis. Americans simply do not have enough funds saved for retirement. As amended, pensions and 401ks remain within the pool of net worth a retiree can invest from. Diverting funds which would have otherwise been invested in public capital markets toward illiquid private offerings simply increases the likelihood that Nevadans will be unable to retire or face retirement with inadequate savings and financial resources.

Because of its astonishingly low thresholds, AB75 also poses substantial risks to veterans. Many servicemembers retire with substantial military pensions. Some will qualify as Nevada certified investors on their pensions alone, while others will qualify simply if they earn some income from a part-time job.¹⁵ The risk runs even higher for veterans with disabilities and

¹⁴ A series LLC is a tiered-down structure that consists of the "parent" or "umbrella" LLC and one or more sub-LLCs established underneath the parent company.

¹⁵ Defense Finance and Accounting Service, MILITARY BASIC DRILL PAY TABLES 2023, https://www.dfas.mil/Portals/98/Documents/militarymembers/militarymembers/pay-tables/2023%20AC_RC%20Pay%20Table1.pdf (last updated Jan. 1, 2023).

dependents.¹⁶ AB75 risks depleting their savings without any meaningful prospect of a financial return.

F. There Are Other Methods Available for Companies to Raise Capital Already

There is no need for this legislation. Beyond accredited investors, there are existing options available for companies to raise equity capital that do not present undue burdens on the company. Equity crowdfunding is one alternative, allowing companies to raise capital from a larger pool of investors without the same level of regulatory requirements as a full public offering.¹⁷ However, as an exempt offering, even crowdfunding invites a host of issues – namely a lack of industry compliance.¹⁸ A 2019 study of 362 crowdfunding offerings revealed that roughly 25% of issuers that were required to file two annual reports did so, and less than 15% of issuers timely filed the final amount raised in their offering.¹⁹ It's reasonable to anticipate similar problems will accompany any exempt offering simply by nature of an unregulated private market scheme.

Early-stage businesses may also raise funds without selling securities. A simple, easy option is to sell branded t-shirts or other merchandise. For businesses seeking to raise small amounts, these alternative avenues allow businesses to acquire enough money to start their operations without selling securities.

G. Eliminating the Counsel Opinion Requirement Would Expose Investors to Harm.

The amended version of the bill also proposes to remove a provision of law requiring an attorney opinion as to the legality of a security under NRS 90.490. This provision of statute reflects both the Uniform Securities Act language and sound public policy. Requiring an opinion of counsel as to the basic legality of an offering ensures at least a de minimis check that the offering complies with the law. Removing this requirement enables shady ventures and exposes potential investors to far riskier opportunities.

H. AB75 Would Enable Frauds and Scams

Finally, AB75 would enable scams and frauds. Expanding exemptions to basic securities laws exposes ordinary retail investors to predatory ventures without the safeguards existing under federal and state laws. Consider one recent Ponzi-scheme that devastated many Nevada families. Between 2017 and 2022, more than 900 people fell prey to a form of affinity fraud²⁰ that marketed a nearly risk-free opportunity to earn 50% annual returns by lending money to slip-and-fall victims awaiting settlement checks. Over \$500 million was collectively lost as a result. Relaxed securities laws only invite more opportunities for this kind of abuse. At a minimum, AB 75 should account for anticipated fraud by requiring notice be given to the state

¹⁶ U.S. Department of Veterans Affairs, 2023 VETERANS DISABILITY COMPENSATION RATES, <https://www.va.gov/disability/compensation-rates/veteran-rates/> (last updated Jan. 1, 2023).

¹⁷ See Press Release, Securities and Exchange Commission, SEC Adopts Rules to Permit Crowdfunding (Oct. 15, 2015) (available at <https://www.sec.gov/news/press-release/2015-249>).

¹⁸ Mercer Bullard, Crowdfunding's Culture of Noncompliance: An Empirical Analysis, 24 LEWIS & CLARK L. REV. 19 *Id.*

²⁰ Affinity fraud is a financial crime that exploits bonds of trust, such as a share affiliation with a religion or group.

Securities Division. Notice requirements ensure an initial screening to catch fraud before it fully develops.

III. Conclusion

Ultimately, broadening access to private markets will do more harm than good. This bill directs low-dollar private placements toward the most vulnerable of investors and lacks necessary balance between healthy markets and investor protections. Thank you for your consideration on this important matter.

Sincerely,

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Consumer Federation of America

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