Consumer Federation of America

July 12, 2023

The Honorable Kevin McCarthy (R-CA)
Speaker
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Hakeem Jeffries (D-NY)
Democratic Leader
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Steve Scalise (R-LA)
Majority Leader
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Katherine Clark (D-MA)
Democratic Whip
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Tom Emmer (R-MN)
Majority Whip
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Pete Aguilar (D-CA)
Democratic Caucus Chairman
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Elise Stefanik (R-NY)
Republican Conference Chairman
U.S. House of Representatives
Washington, D.C. 20515

The Honorable James Clyburn (D-MD)
Assistant Democratic Leader
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Gary Palmer (R-AL)
Republican Policy Committee Chairman
U.S. House of Representatives
Washington, D.C. 20515

Re: Oppose H.R. 2799, the Expanding Access to Capital Act of 2023, as amended

Dear Speaker McCarthy and Republican and Democratic leaders:

Consumer Federation of America (CFA)[1] writes to you in strong opposition to the Expanding Access to Capital Act of 2023. This legislative package is comprised of 19 separate bills, most of which would reduce transparency, integrity, and accountability in U.S. securities markets, undermining the health of our overall economy.[2] These bills would do so in two primary ways: 1) expanding dark and unaccountable private markets at the expense of transparent and

[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.
[2] https://docs.house.gov/meetings/BA/BA00/20230426/115834/BILLS-118-HR-M001156-Amdt-13.pdf

accountable public markets; and 2) expanding the pool of investors who can be taken advantage of in dark and unaccountable private markets.

I. **Background**

A. The Decline of Our Public Securities Markets

The disclosure obligations in the Securities Act of 1933 and Exchange Act of 1934 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."[3]

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;
- 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.

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

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.

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.[4]

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. If the financial thresholds were tied to inflation since 1982, the requirement for yearly income would have grown from $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 accredited investor population in 1982.

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

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[4] *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.

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.[5] 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.

II. We oppose many of the bills included in this legislation. Some of the most problematic are discussed below, although they do not constitute all of our concerns about this legislation.

- **Exclude QIBS and IAAs from the Record Holder Count for Mandatory Registration (Division A, Title V)**

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, as this bill seeks to do.

- **Unlocking Capital for Small Businesses Act of 2023 (Division B, Title I)**

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

[5] *See, e.g.*, 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

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."[6]

- **Small Entrepreneurs' Empowerment and Development Act of 2023 or the ''SEED Act of 2023'' (Division B, Title IV)**

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 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.

- **Regulation A+ Improvement Act of 2023 (Division B, Title V)**

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,"[7] and Renaissance Capital has referred to the Reg. A+ market as "the wild west of IPOs."[8] 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.

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[6] Gregory C. Yadley, *Notable by the Absence: Finders and Other Financial Intermediaries in Small Business Capital Formation* (Jun. 3, 2015), https://bit.ly/2HvdWSD.
[7] *Id.*
[8] 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.).

- **Improving Crowdfunding Opportunities Act (Division B, Title VII)**

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.[9] 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.

- **Restoring the Secondary Trading Market Act (Division B, Title VIII)**

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.[10] 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.

- **Gig Worker Equity Compensation Act (Division C, Title I)**

This bill would expand Securities Act Rule 701 to include gig workers so that private companies can choose to pay gig workers in exempt (privately issued) securities rather than cash. Gig workers are already notoriously underpaid; paying them in equity compensation in lieu of a salary would benefit the company employing the workers, not 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.

- **Investment Opportunity Expansion Act (Division C, Title II)**

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

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

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

allow private securities to be marketed and sold to more 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.

- **Risk Disclosure and Investor Attestation Act (Division C, Title III)**

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.

- **Accredited Investors Include Individuals Receiving Advice From Certain Professionals Act (Division C, Title IV)**

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. 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, it is unlikely that Reg BI will adequately ensure that harmful conflicts won't taint brokers' recommendations.

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.

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

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.

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Conclusion

This legislation would double down on a deregulatory approach that is likely to harm investors/consumers and undermine market integrity. For the above reasons, VOTE NO on this misguided legislation.

Respectfully,

Micah Hauptman
Director of Investor Protection

Dylan Bruce
Financial Services Counsel