



**Americans for Financial Reform**  
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February 15, 2012

To: Members of the U.S. Senate Committee on Banking, Housing, and Urban Affairs

Dear Senator:

We understand that the Committee expects to turn its attention in coming weeks to the various legislative proposals that have been put forward to promote job growth by reducing supposed barriers to capital formation. Americans for Financial Reform (“AFR”) is a coalition of over 250 national, state, local groups who have come together to advocate for reform of the financial industry. Members of AFR include consumer, civil rights, investor, retiree, community, labor, faith based and business groups along with prominent independent experts. As such, we have a strong interest in ensuring that policy proposals to promote job growth don’t undermine the protections we rely on to keep our capital markets honest and transparent.

With millions of Americans still out of work in the wake of the recent financial crisis, we agree that an exploration of job creation strategies is timely. Moreover, given the central role that our capital markets play in the job creation process and the dramatic changes that have occurred in those markets over the past few decades, it is appropriate that any such review include a careful analysis of whether companies of all sizes and at all stages of development have access to the capital they need to grow and prosper. We are concerned, however, that current legislative proposals rely too heavily on anecdotal evidence of a problem and ideologically driven “solutions.” As the bills have raced through the House, too little study has been devoted to determining the true underlying causes of the recent drop in small company IPOs to allow for appropriately targeted legislative solutions. And inadequate attention has been given to the implications of proposed regulatory changes for investors. As a result, the proposals currently under consideration risk exposing investors to a new round of fraud and abuse without producing any meaningful or sustainable job growth.

In keeping with its traditional more deliberative approach, this Committee has an opportunity to provide the careful analysis that so far has been lacking. Toward that end, we offer the following brief views regarding the risks to investors posed by each of the bills currently under consideration. We hope you will take these views into account as you decide whether and how to move forward on the various bills before you.

- **IPO On-Ramp (S. 1933)**

We strongly oppose this bill, which legitimizes the idea that companies should be allowed to go public and raise money from average, retail investors without being able to meet basic standards designed to ensure that they provide those investors with accurate and reliable information on which to base their investment decisions. S. 1933 would give new companies, including all but the very largest such companies, up to five years to raise money from the public without complying with SOX 404(b). Since the Sarbanes-Oxley Act was implemented, research has shown that requiring an independent audit of internal controls results in higher quality financial reporting and fewer restatements. Moreover, experience with implementation of SOX tells us that, absent an independent controls audit, all too many managers will attest to the adequacy of clearly deficient control systems. As a result, delaying implementation of the independent internal controls audit would significantly increase the risk that companies would face both a material weakness report and higher costs to fix inadequate controls once the independent audit requirement kicked in. For these reasons, companies as well as investors would be far better off building their systems to be SOX 404(b) compliant from the outset.

Like the provision to delay implementation of SOX 404(b), the proposal to weaken restrictions on research analysts ignores the widespread fraud and abuse that led to their adoption. Moreover, it ignores recent research suggesting that there has been no recent decline in post-IPO analyst coverage.<sup>1</sup> The legislation also includes a number of other special interest provisions that clearly have nothing to do with eliminating barriers to capital formation, such as delaying compliance with shareholder say-on-pay and golden parachute voting requirements as well as compensation disclosure requirements. And it includes an extremely poorly thought out proposal to delay implementation of accounting and auditing standards for new companies. The result of the latter proposal would be less transparent markets, with competing companies reporting financial data using different rules depending on whether they were an established or emerging company. Auditing would be less efficient as well, as audit firms would be required to train their auditors to comply with different auditing standards for different clients. Moreover, this is precisely the sort of attack on the independence of the standard-setting process that this Committee has traditionally opposed under Democratic and Republican leadership alike.

Because it ignores the real reasons that small companies have become less likely to opt for an early-stage IPO (changes in the profitability of small independent companies, the institutionalization of the markets, changes to Regulation D, and changes to the economics of the broker-dealer business model, to name a few), S. 1933 exposes investors to these risks without offering any realistic prospect that it will promote sustainable job growth. It should not become law.

- **Crowd-funding (S. 1970, S. 1791)**

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<sup>1</sup> Ritter, Jay R., Gao, Xiaohui and Zhu, Zhongyan, Where Have All the IPOs Gone? (November 4, 2011). Available at SSRN: <http://ssrn.com/abstract=1954788> or <http://dx.doi.org/10.2139/ssrn.1954788>. This article also calls into question the argument that the Sarbanes-Oxley Act is behind the last decade's drop in IPOs.

Crowd-funding is a gimmick that offers little prospect of meaningful job creation and the significant risk that most individuals who invest in the highly speculative start-ups that rely on crowd-funding for capital will lose some or all of their money. That said, there is a very real difference between the various crowd-funding bills in terms of their potential to protect investors from fraud and abuse. While both Senate bills are preferable to the House bill, only S. 1970 includes a robust set of investor protections commensurate with the risks of crowd-funding. Its provisions to set an aggregate investment cap, require SEC registration and oversight of crowd-funding portals, to impose appropriate regulatory obligations on crowd-funding portals, and to preserve state authority are a must. Making it easier for average, unsophisticated Americans to risk their money in such ventures is questionable policy at best. At the very least, we urge you to insist on inclusion of S. 1970's provisions to ensure that crowd-funding doesn't also become a mecca for fraud.

- **Regulation A Revisions (S. 1544)**

This legislation dramatically increases the amount of capital that companies can raise from the public without triggering the full reporting and other obligations that go with registration. While we cannot support this legislation in its current form, we do recognize that the sponsors have made a good faith effort to balance easier access to capital with appropriate investor protections, including up-front disclosures, periodic reporting, audited financial statements, SEC oversight, and a negligence-based litigation remedy. A relatively few revisions could be adopted that would address our remaining concerns.

As written, the bill would permit companies to game the system and avoid full registration and reporting requirements by repeatedly conducting Regulation A offerings. Imposing a cumulative, multi-year cap on use of Regulation A exemption should address that concern. In addition, we are concerned that, even as the legislation dramatically increases the ceiling for Regulation A offerings from \$5 million to \$50 million, it places no restriction on the ability of the SEC to increase it further. We urge you to cap the amount that the SEC could raise the ceiling without congressional approval. In addition, while we appreciate the inclusion of a negligence-based liability remedy in the legislation, we believe that strict liability is the appropriate standard to better ensure accurate disclosures in this loosely regulated market.

These changes would minimize the potential for investor harm while still significantly expanding access to Regulation A offerings.

- **Regulation D Revisions (S. 1831)**

We strongly oppose this legislation, which would remove the prohibition on public solicitation of investors in the sale of unregistered offerings. We are sympathetic to the argument that the current media environment makes it all but impossible for companies

in which there is significant media interest to abide by Regulation D solicitation restrictions. However, Regulation D offerings are an area that is already rife with abusive conduct. Any measure to address this issue must take both these problems into account. Supporters of eliminating the general solicitation prohibition argue that, since sales are limited to sophisticated investors, it is unnecessary to also limit the means by which they can be sold. There are several fallacies embedded in that argument. First, the legislation as drafted is not limited to those Regulation D offerings that are sold strictly to accredited investors. Second, because of shortcomings in the definition of accredited investor, many accredited investors are not financially sophisticated. Third, NASAA has documented extensive evidence of non-compliance with existing requirements, a problem that would only get worse if current restrictions were loosened.

While this is an issue that deserves further attention, the current legislative proposal would create more problems that it would solve. It should be shelved while a more responsible and balanced approach to the issue can be developed.

- **Shareholder Thresholds (S. 1824)**

We strongly oppose this bill, which makes it easier for companies with a large number of highly dispersed investors to avoid providing the periodic disclosures on which transparent markets depend. It does this by simultaneously raising the limit on the number of shareholders of record who can hold a stock without triggering reporting requirements from 500 to 2,000 and exempting employees who hold company stock from the count. In addition, it would allow banks and bank holding companies to “go dark” if the number of shareholders of record dropped below 1,200. Moreover, it does all this without addressing the outdated and easily manipulated reliance on “shareholders of record” in making this determination.

As a general matter, we question the wisdom of reducing both market transparency and the incentives companies have to go public. Moreover, we’ve seen no clear explanation for why lifting these restrictions is necessary or justified. We are particularly concerned that this legislation would raise these limits, and raise them dramatically, without addressing the outdated reliance on shareholder of record, a measure that can easily be manipulated. At the very least, we would urge the Committee to use a measure, such as beneficial owner, that is less subject to manipulation and less likely to permit even very large companies with large numbers of investors to evade basic reporting requirements. Ideally, we encourage the Committee to give this issue further study before taking action.

Investors have endured an unremitting stream of scandals, frauds, and financial crises over the past decade. The effect on investor confidence has been devastating. Equally devastating has been the effect on the economy, capital formation, and jobs. A policy that relies on rolling back investor protections and undermining market transparency will not produce sustainable job growth and will instead further undermine investors’ confidence in the integrity of our capital markets. Instead of rushing through these poorly conceived legislative proposals, we urge you to

take the time to study the issue in order to produce the thoughtful jobs package that Americans so desperately need.

Sincerely,

Americans for Financial Reform

Cc: Members, U.S. Senate

## **Following are the partners of Americans for Financial Reform.**

*All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.*

- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- Americans for Democratic Action, Inc
- American Income Life Insurance
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Greenlining Institute
- Good Business International
- HNMA Funding Company
- Home Actions

- Housing Counseling Services
- Information Press
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lake Research Partners
- Lawyers' Committee for Civil Rights Under Law
- Move On
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Council of Women's Organizations
- Next Step
- OMB Watch
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers

- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

*List of State and Local Signers*

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR



- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending
- NOAH Community Development Fund, Inc., Boston MA

- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

### *Small Businesses*

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- The Holographic Repatterning Institute at Austin
- UNET



