Americans for Financial Reform Education Fund

March 6, 2024

The Honorable Charles Schumer
Majority Leader
United States Senate
Washington, DC 20510

The Honorable Mike Johnson
Speaker of the House
United State House of Representatives
Washington DC, 20515

The Honorable Mitch McConnell
Minority Leader
United States Senate
Washington, DC 20510

The Honorable Hakeem Jeffries
Minority Leader
United States House of Representatives
Washington DC, 20515

Re: **Opposition to H.R. 2799, the Expanding Access to Capital Act of 2024**

Dear Leader Schumer, Speaker Johnson, Leaders McConnell and Jeffries,

The following 10 undersigned organizations write to urge your opposition to H.R. 2799, the Expanding Access to Capital Act. The various "capital formation" provisions embodied in this misguided legislation would, in one way or another, change policies in ways that benefit insiders: securities issuers, brokers, and marketplace intermediaries, but come at the expense of investors, especially everyday retail investors whose retirement security may be at risk.

Fundamentally, H.R. 2799 weakens regulation of both the public markets (securities that are listed on securities exchanges and sold to the public) and the private markets (illiquid securities that are not listed on exchanges and are generally sold only to sophisticated investors). The bill contains numerous provisions the lower the bar for companies to become and remain public, while at the same time, making it dramatically easier for companies to raise unlimited amounts of capital in the private markets – including from retail investors - without the need to pursue an IPO or become a reporting company. Because it simultaneously reduces investor protection requirements across the board – with respect to both public and private markets – the bill ultimately lacks any cohesive policy vision. H.R. 2799 is thus a bad deal for investors of all types, and a boon to issuers interested in raising capital with the lowest possible degree of disclosure, compliance, accountability, and overall economic inefficiency.

I. H.R. 2799 stands to undermine and undercut America's public securities markets, to the detriment of U.S. investors, U.S. businesses, and economic growth.

The public securities markets allow companies to raise capital to create jobs and drive economic growth and enable workers and investors of all stripes to grow their personal savings over time and enjoy a secure retirement with dignity and stability. H.R. 2799 stands to cause profound damage to public securities markets by lowering the bar that issuers must meet to raise capital in these markets,

and at the same time, expanding private markets in a way that will discourage many issuers from using public markets to raise capital.

- ***Sec. 1202. Emerging Growth Company criteria.***

H.R. 2799 doubles down on the demonstrably failed experiment initiated in 2012 when Congress relaxed regulatory requirements for a subset of issuers known as Emerging Growth Companies (EGCs).[1] Specifically, the bill proposes to enact a two-year extension, that EGCs that are currently public would be allowed enjoy the relaxed regulatory treatment afforded to EGCs for an additional 2 years. It would also increase regulatory forbearance for EGCs by "updating the EGC financial statement accommodation to clarify that an EGC need not provide financial statements for a period earlier than the two years of audited financial statements required in its IPO registration statement."

Regardless of Congress's intent the EGC regime has failed to achieve the goal of stimulating IPOs. Indeed, a dozen years since Congress established reduced disclosure regime for EGCs, the primary discernable impact has been to precipitate and further drive deregulatory legislation and regulation, as issuers not initially eligible for EGC status have sought the same regulatory forbearance as EGCs in the name of equitable treatment of public companies.[2] When policymakers make exceptions for one group or subset of market participants, other market participants inevitably take notice and seek similar treatment. Often, the end result is a lowering of the bar for all market participants. Rather than expanding the EGC regime, Congress should take a hard look at the flood gates it opened when it created EGCs in 2012, and close them.

- ***Section 1301. Auditor independence for certain audits occurring before an issuer is a public company; Section 1401. Provision of research; and Section 1501. Exclusions from mandatory registration thresholds.***

H.R. 2799 also proposes to undermine public securities markets by amending the Exchange Act to exclude qualified institutional buyers (QIBs) and institutional accredited investors from counting toward the mandatory registration thresholds set forth in Section 12(g) of the Exchange Act.[3]

Prior to 2012, Section 12(g) of the Exchange Act required companies with more than $10 million in assets and a class of equity securities held by 500 or more shareholders to register the securities with the SEC. Section 12(g) historically prodded companies to begin preparing for an IPO as they

[1] Under current law, Emerging Growth Companies are permitted: (1) to include less extensive narrative disclosure than required of other reporting companies, particularly in the description of executive compensation; (2) to provide audited financial statements for two fiscal years, in contrast to other reporting companies, which must provide audited financial statements for three fiscal years; (3) not to provide an auditor attestation of internal control over financial reporting, as required by the Sarbanes-Oxley Act; (4) to defer complying with certain changes in accounting standards, and (5) to use "test-the-waters" communications with qualified institutional buyers and institutional accredited investors. Additionally, EGCs (6) EGCs may use streamlined executive compensation disclosure and are exempt from the shareholder advisory votes on executive compensation required by the Dodd-Frank Act, and (7) may go public using wo years, rather than five years, of financial data. https://www.sec.gov/education/smallbusiness/goingpublic/EGC

[2] For example, The FAST Act of 2015 further enhanced certain benefits under the JOBS Act for EGCs. Most notably, the FAST Act provided further flexibility for EGCs to begin the SEC review process on Securities Act registration statements without all the required years of audited financial statements. In September 2019, the SEC voted to adopt a new rule that extended a "test-the-waters" accommodation— a tool previously available only to EGCs —to all issuers. In 2023, legislation was introduced in Congress to allow companies to remain EGCs for an additional five years and to be treated as EGCs even after they become accelerated filers. (See H.R.2624).

[3] In broad terms, QIBs are institutional investors that own or manage on a discretionary basis at least $100 million worth of securities. Institutional Accredited Investors are Business Development Companies or similar organizations with assets exceeding $5 million.

reached a certain size, and thereafter become public companies.[4] Since 2012, companies have been allowed to remain private so long as they have fewer than 2,000 shareholders of record or fewer than 500 unaccredited investors. The additional weakening of Section 12(g) contemplated by H.R. 2799 would make it even easier for large companies with broad shareholder bases to remain private.

The JOBS Act modified the rules of the road relating to analyst research reports and analyst interactions with non-research personnel in a number of significant ways.[5] H.R. 2799 proposes to expand exemptions from SEC rules on research reports that currently apply only to EGCs to all public issuers and relax attestation rules established by Section 103 of the Sarbanes-Oxley Act.[6] All of the proposed changes are contrary to the interests of the retail investors and the viability of America's public securities markets, and all should be rejected by Congress.

II. H.R. 2799 recklessly expands private securities markets in ways that will increase fraud and risk to "mom and pop" investors and discourage companies from pursuing IPOs.

Private markets stack the deck against ordinary "mom and pop" investors. They have a well-earned reputation for being opaque, risky, illiquid, and inefficient – but most significantly, perhaps, they are a quintessentially "insider's game," where issuers "permissibly discriminate between investors, providing some investors with no information and others with information that is both more timely and more reliable."[7] In the private markets, it is the wealthy investor with something to offer or promise issuers[8] that gets access to the best deals, terms, pricing, rights, and information.

- ***Sec. 2102. Safe harbors for private placement brokers and finders.***

H.R. 2799 would amend the Securities Exchange Act to exempt "private placement brokers," or third parties who help connect wealthy investors with private companies, from the registration requirements currently applicable to broker-dealer representatives under existing federal securities laws. The bill would also establish a regulatory "safe harbor" for so-called "finders."

As an initial matter, the definitions of private placement brokers and finders in the bill are overly broad and fail to impose meaningful limitations on the scope of their exemption from registration. If

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[4] For example, Microsoft, Google and Facebook all went public as they approached this 500 shareholder limit. As these companies grew, and their shareholder base expanded, their founders understood they would soon face the glare of public scrutiny that came with an IPO. See written testimony of Renee Jones, September 11, 2019. https://democrats-financialservices.house.gov/uploadedfiles/hhrg-116-ba16-wstate-jonesr-20190911.pdf

[5] Section 105(a) of the JOBS Act amended Securities Act Section 2(a)(3) to provide an exception from the definition of offer for purposes of Sections 2(a)(10) and 5(c) of the Securities Act for research reports issued by a broker-dealer regarding an EGC that is the subject of a proposed public equity offering. For purposes of this exception, a "research report" is defined expansively to include any "written, electronic, or oral communication that includes information, opinions, or recommendations with respect to securities of an issuer or an analysis of a security or an issuer, whether or not it provides information reasonably sufficient upon which to base an investment decision."

[6] Section 103 of the Sarbanes Oxley Act addresses standards relating to auditing, quality control and ethical standards, stating that the Board shall, by rule, establish standards for the preparation and issuance of audit reports. In fulfilling its charge, the Board is directed to require that each registered public accounting firm prepare, and maintain for at least 7 years, audit work papers and any other information related to an audit report.

[7] *See* Written Testimony of Professor Gina-Gail S. Fletcher Before the House Committee on Financial Services, Subcommittee on Capital Markets. February 8, 2023. (P.4) Accessible at https://docs.house.gov/meetings/BA/BA16/20230208/115288/HHRG-118-BA16-Wstate-FletcherG-20230208.pdf

[8] For example, certain "Angel investors" not only bring financial capital to the table but also contribute valuable expertise and mentorship. Similarly, investment by one venture capital fund can function as a signal to other VCs and make it dramatically easier for an issuer to raise additional private capital. *See* Presentation by Pat Gouhin, CEO, Angel Capital Association, to SEC Investor Advisory Committee. September 21, 2023, https://www.sec.gov/files/pat-gouhin-presentation.pdf

enacted in the form in which it was approved by the HFSC, the bill would create a de-facto safe harbor for securities brokers to act in a host of new capacities that go far beyond the services traditionally performed by finders.[9] Further, there is a well-documented relationship between private offerings sold by brokers and an elevated risk of fraud. Indeed, an alarming proportion of the individuals who act as finders or brokers of private offering have "red flags" on their record.[11] Obviously, the presence of such overwhelming evidence that violations are widespread among individuals engaged in the sale of private placement offerings is directly opposite the bill's premise that actors in these markets should be subject to less oversight.

- ***Sec. 3202. Investment thresholds to qualify as an accredited investor; Sec. 3302. Investor attestation; and Sec. 3401. Accredited Investors include individuals receiving advice from certain professionals.***

The "Accredited Investor" definition is the central component of the most widely used exemptions from SEC registration, including Rules 506(b) and 506(c) of Regulation D.[2] These exemptions allow issuers to sell securities "to an unlimited number of accredited investors with no limit on the amount of money that can be raised from each investor or in total," and are routinely used by hedge funds, private equity funds, and venture funds to raise capital.[3] Under SEC rules, accredited investors may purchase these risky investments because, in the view of the SEC, their "financial sophistication" and "ability to fend for themselves" render "the protections of the Securities Act's registration process unnecessary."

Section 3401 of H.R. 2799 would revise the definition of "accredited investor" to include individuals receiving individualized investment advice or individualized investment recommendations from investment adviser professionals. Because most retail investors make their investments through their broker or investment adviser, the practical impact of this extremely ill-conceived provision would be to make most retail investor "accredited;" thereby opening the door for issuers conducting private offerings of risky and illiquid securities to sell them to "mom and pop" investors. We strongly oppose such a policy. We also oppose provisions in Section 3202, which would also allow individuals who do not meet the income or net worth thresholds be recognized as "accredited investors" to invest up to 10 percent of their income or net worth in a private offering. We also oppose Section 3302, which would direct the SEC to issue rules that permit individuals to qualify as accredited investors by attesting to the issuer that the individual understands the risks of investment in private issuers. Importantly, all of these provisions would not only increase risk to retail investors, but directly undermine the public securities markets by making private offerings more attractive.

- ***Section 2402. Micro-Offering exemption.***

H.R. 2799 includes a dangerous and entirely unnecessary provision that would amend Section 4 of the Securities Act of 1933 to create a new exemption from registration. To qualify for this so-called "micro-offering" exemption, an offering would have to meet certain criteria regarding the number of purchasers, their relationship to the issuer, and the amount of capital raised. There is no evidence whatsoever to support the idea that Congress should create a "safe harbor" to permit unregistered

[9] *See:* NASAA letter to House Financial Services Committee Chairman and Ranking Member regarding H.R. 6127, the "Unlocking Capital for Small Businesses Act of 2018." November 19, 2018. Accessible at https://www.nasaa.org/letters-to-congress/nasaa-letter-to-house-financial-services-committee-leadership-regarding-h-r-6127-the-unlocking-capital-for-small-businesses-act-of-2018

securities offerings to be offered and sold, including through general solicitation, regardless of investor sophistication or financial wherewithal. Even as Section 2402 proposes to introduce new and totally unnecessary risk into securities markets, the goal of the provision remains unclear and its necessity is, at best, not well-established.[10] We are also concerned that under the terms of the bill, even persons who have been barred from the securities industry, convicted or otherwise prohibited from selling securities to the general public would technically be able to sell these small unregistered offerings, without any notice to regulators that they are being sold. This failure to disqualify "bad actors" creates an impossible situation for regulators attempting to protect investors.

- ***Section 2502. JOBS Act related exemption.***

H.R. 2799 would raise the maximum annual offering limit on securities exempt from public registration pursuant to "Tier 2" of SEC Regulation A from its current $75 million to $150 million and require the SEC to increase the new $150 million cap on a biannual basis to account for inflation. Like other provisions addressed, the primary effect of such a change would be to increase risks to retail investors – including risks of investment loss and outright fraud – and undermine public securities markets by encouraging issuers to raise capital in private offerings, including from retail investors. We see no basis for the proposed expansion of Reg. A and urge Congress to reject it.

- ***Sec. 2801. The "Restoring the Secondary Trading Market Act."***

H.R. 2799 amends the Securities Act of 1933 to exempt off-exchange secondary trading from State regulation where such trading is with respect to securities of an issuer that makes certain information publicly available[11]. We strongly oppose this proposed change, which would prohibit state securities regulators from exercising oversight with respect to secondary trading done "off exchange" for securities where information is publicly available. As the regulators closest to their communities and the investing public, state regulators have historically played a vital role in policing the offering and sale of securities that are traded "over the counter," as opposed to on a securities exchange, and changing this would leave investors more vulnerable to harm.

- ***Sec. 3102. Extension of Rule 701.***

We oppose provisions in H.R. 2799 that would expand SEC Rule 701, which exempts certain sales of securities to compensate employees, consultants, and advisors to issuers – in lieu of traditional compensation in the form of salary and benefits.[12] Congress last raised the Rule 701 threshold from

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[10] There are already various provisions at the state and federal level that small, microcap issuers can rely upon for limited offerings. For example, an issuer can raise funds under Rule 504, Section 3(a)(11) of the Securities Act of 1933 and its safe harbor Rule 147, and Section 4(a)(2) of the 1933 Act. Further, most states also have de minimus offering exemptions, allowing issuers to raise money with a limited number of purchasers through self-executing exemptions. Small issuers can also rely on federal crowdfunding rules and Regulation A. (See: https://www.nasaa.org/wp-content/uploads/2013/10/NASAA-Letter-to-House-Leadership-Re-HR-2201-The-Micro-Offering-Safe-Harbor-Act.pdf)

[11] Issuers wishing to avail themselves of Section 2801 of H.R. 2799 would be required to make publicly available the information required in the periodic and current reports described under paragraph (b) of section 230.257 of title 17, Code of Federal Regulations; or the documents and information required with respect to Tier 2 offerings, as defined in section 230.251(a) of title 17, Code of Federal Regulations. Both disclosure requirements are applicable to Regulation A offerings. Additional information is accessible at https://www.law.cornell.edu/cfr/text/17/230.257 and https://www.law.cornell.edu/cfr/text/17/230.251.

[12] Incentives in the form of private shares have been described as "golden handcuffs" because employees given such incentives have extreme difficulty selling them or accurately valuing them the event the leave the company. (See Anat Alon-Beck, Bargaining Inequality: Employee Golden Handcuffs and Asymmetric Information, Maryland Law Review. Accessible at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4037705)

$5 million to $10 million in 2018, and we question the basis for any further expansion at this time. Importantly, the issuers covered by Rule 701 are private issuers, and therefore the securities in question tend to be highly illiquid and difficult to value. In our view, so-called "Gig workers" should, like all Americans, have the ability to invest their savings in various securities or investments. But they should not be put into a situation where they are compelled – explicitly or implicitly - to accept alternative forms of compensation, including highly illiquid, difficult to value securities in lieu of direct monetary payment. This provision accelerates the misclassification of workers as independent contractors that do not receive the protections they deserve as employees (like wage and hour laws and unemployment coverage). Further, the proposal would preempt and effectively revoke employee rights for gig workers under state laws that confront job misclassification.

III. In addition, we oppose several amendments to H.R. 2799 that have been filed with the House Committee on Rules.

- ***The Improving Disclosure for Investors Act (Amendment #12, Rep. Huizenga, R-Mich)***

The Improving Disclosure for Investors Act would allow broker-dealers to default retail investors into receiving electronic delivery (e-delivery) of important regulatory documents required by our securities laws, including investment disclosures and account statements. While we appreciate that e-delivery may make sense for many Americans, there is no evidence that investors who prefer to receive statements and disclosures electronically face any difficulties in exercising that choice.

Further, it continues to be the case that for some Americans, e-delivery is not even a practical option. Indeed, more than one in four people age 65 and older do not routinely use the internet, and roughly 39 million Americans over 50 are lacking home internet service.[13] In addition, at least 20 percent of people living in rural areas of the United States still do not have access to broadband.

We also note that, in view of the importance of investor account statements and disclosure documents, on March 2, 2023, the SEC's Investor Advisory Committee recommended that paper delivery continue as the delivery default for disclosure mandated by the federal securities laws.[14]

As presently constituted, the improving Disclosure for Investors Act appears to be more of an effort to coerce investors into receiving the statements and disclosures to which they are entitled electronically than an actual attempt to improve disclosure. As such, we oppose the legislation.

- ***The Helping Angels Lead Our Startups (HALOS) Act (Amendment #10, Rep. Lawler. R-NY)***

The HALOS Act would require the SEC to amend Rule 506 of Regulation D to specify that SEC prohibitions on "general solicitation" and general advertising in Rule 506(b) do not apply to sales

[13] *See* AARP letter to HFSC Chair McHenry and Ranking Member Water regarding H.R. 1807, The Improving Disclosure for Investors Act of 2023. (April 26, 2023). Accessible at https://lxrdc.com/wp-content/uploads/2023/04/aarp-letter-of-opposition-to-h.r.-1807-april-26-2023.pdf

[14] SEC Investor Advisory Committee. "Recommendation of the SEC Investor Advisory Committee's Disclosure Subcommittee to Improve Customer Account Statements to Better Inform Investors." Approved March 2, 2023. Accessible at https://www.sec.gov/files/20230221-recommendation-account-statements.pdf

events (also called "demo days," or "pitch days") sponsored by a governmental entity, a college or university, a nonprofit organization, an angel investor group, a trade association, a venture forum, or a venture capital association.

We are concerned that the HALOS Act would be extremely challenging to implement, owing to both its complexity and the limited oversight of Reg. D, Rule 506 offerings. We also note that the new exemptions established for solicitation of Rule 506(b) offerings are entirely unnecessary in light Title II of the JOBS Act, which created a new exemption – Rule 506(c) – that expressly permits general solicitation, including under all circumstances contemplated by the HALOS Act.

Further, the HALOS Act, as posted by the Rules Committee, includes highly worrisome provisions that explicitly bar the SEC from taking steps to protect investors should the need for additional protections become apparent. Even if the policy choices contemplated by H.R. 1553 were sound – and we believe they are not – the presence of such egregious statutory restrictions on the SEC's authority to act for the benefit of investors are grounds to oppose it.

- ***H.R. 3606, The Retirement Fairness for Charities and Educational Institutions Act (Amendment #3, Rep. Wagner, R-MO)***

Currently, the federal securities laws require mutual funds and variable annuities that are sold to 403(b) plans to register with the SEC. Such registration requirements serve to ensure the disclosure of essential information about the products, including their key features, risks, and costs. SEC staff review these disclosures to ensure that they provide full and fair disclosures and comply with rules relating to the proper form and content of registration statements.

Amendment #3 is based on H.R. 3063, the Retirement Fairness for Charities and Educational Institutions Act. The bill would amend the federal securities laws to authorize the use of collective investment trusts (CITs) and unregistered insurance company separate accounts within 403(b) retirement savings plans. As a practical matter, the amendment would create a new loophole that would facilitate the sale of unregistered securities - namely mutual funds and variable annuities - by unregistered brokers, to both ERISA and non-ERISA 403(b) plans and plan participants.

We are deeply concerned about H.R. 3063. Despite the bill's being characterized by its proponents as an innocuous technical fix to bring about parity with respect to the ability of 401(k)'s and 403(b)'s to invest in CITs, the primary effect of the amendment would be to encourage the sale of products that have detrimental features, by financial professionals who have no obligation to comply with rules and regulations designed to ensure basic investor protections.[15] For example, under H.R. 3036, brokers of the products in question would <u>not</u> be obligated to provide any disclosures to investors to enable informed decision making. They would also <u>not</u> be subject to SEC Regulation Best Interest ("Reg BI"), FINRA and SEC advertising rules, recordkeeping requirements, or supervisory responsibilities, or examination and oversight by the SEC, FINRA, or state securities regulators.

[15] As Consumer Federation of America explained in a recent letter addressed to the HFSC, "Since non-ERISA 403(b)s are commonly offered to public school teachers, the practical effect of this bill would be to remove any meaningful safeguards for teachers saving for retirement. The bill would allow and encourage the sale of unregistered products that have detrimental features, by unregistered financial professionals who have no obligation to comply with broker-dealer consumer protections, to public school teachers. As a result, this bill would dangerously foist inordinate risk upon public school teachers, who are often among the most vulnerable retirement savers." See: CFA letter Re: May 24th Markup of House Financial Services Committee Bills. May 17, 2023.

- ***The Increasing Investor Opportunities Act (Amendment #3, Rep. Wagner)***

Long-standing SEC policies prohibit closed-end funds sold to non-accredited investors from investing more than 15% of their net assets in private securities. The SEC Staff considers this restriction necessary for investor protection.[16] One of the amendments made in order to H.R. 2799, the Increasing Investors Opportunities Act, would amend the Investment Company Act to override this SEC requirement and prohibit the SEC from imposing any limitations on closed-end companies' investments in private funds. If adopted, Amendment #3 would enable closed-end funds sold to retail investors to invest up to their entire portfolio in private offerings.

AFR is not aware of any valid basis for allowing closed-end funds sold to retail investors to invest their entire portfolio in risky and illiquid private offerings.

Thank you for your attention to our views. Please do not hesitate to contact Andrew Park at andrew@ourfinancialsecurity.org with any additional questions or concerns.

Sincerely,

Americans for Financial Reform

AFL-CIO

American Association for Justice

American Federation of State, County, and Municipal Employees

Consumer Federation of America

Communications Workers of America

Economic Policy Institute

National Employment Law Project

Private Inequity

Public Citizen

[16] The SEC Staff has taken the formal position that closed-end funds offered to non-accredited investors may not hold more than 15% of their assets in private funds. If a closed-end fund has more than 15% of net assets in private funds, it must sell that fund only to accredited investors. The stated rationale for the staff position is investor protection concerns. *See:* PLI Investment Management Institute by Dalia Blass, Director of the SEC's Division of Investment Management (Jul. 28, 2020), available at https://www.sec.gov/news/speech/blass-speech-pli-investment-management-institute.