March 5, 2012

The Honorable Timothy Johnson
Chairman, Committee on Banking,
Housing and Urban Affairs
United Stated Senate
Washington, DC 20510

The Honorable Richard Shelby
Ranking Member, Committee on Banking,
Housing and Urban Affairs
United States Senate
Washington, DC 20510

Dear Senator Johnson and Senator Shelby,

We are writing as representatives of consumers and investors throughout the nation to express our strong opposition to a package of "capital formation" bills that is being rushed through the House based on exaggerated claims of the bills' potential to create jobs and with no attention to their potential harmful effect on investor protections and market integrity. While we are strong supporters of measures to promote job growth, these bills (recently repackaged as the JOBS Act) are premised on the dangerous and discredited notion that the way to create jobs is to weaken regulatory protections. Each of these bills would in its own way roll back regulations that are essential to protecting investors from fraud and abuse, promoting the transparency on which well-functioning markets depend, and ensuring the fair and efficient allocation of capital. Moreover, they ignore the basic free market principle, backed by extensive research, that investors respond to reduced regulatory protections by imposing a higher cost of capital. Because they are likely to result in higher capital costs that negate any compliance cost savings, these bills don't even offer any prospect of meaningful job creation to justify their attack on fundamental investor and market protections.

We understand these bills are likely to be taken up soon in the Senate. We are writing to urge the Senate to take a more thoughtful and balanced approach than was adopted in the House. Where the House has gone after regulatory protections with a hatchet, we urge the Senate to use a scalpel, carefully targeting provisions that may be undermining capital formation without destroying essential investor protections in the process. Such an approach would not only better protect investors from a recurrence of the scandals, frauds, and crises that have devastated the markets over the past decade, it would also be more likely to produce sustainable job growth.

Toward that end, we offer the following specific comments on each of the major bills included in the House "capital formation" package. As our discussion should make clear, in all but a few cases, extensive revisions would be needed to arrive at an appropriately balanced approach.

IPO On-Ramp (H.R. 3606, S. 1933)

For decades our regulations have maintained that the privilege of raising money from average, unsophisticated retail investors should come only when companies are prepared to meet their responsibilities to provide those investors with accurate and reliable financial information and to adopt appropriate corporate governance practices. Doing away with that basic standard, H.R. 3606 and S. 1933, its companion measure in the Senate, seek to make it easier for companies to go public *before* they are prepared to meet those responsibilities. They do so by phasing in key investor protections over a period of up to five years after a company first goes public. The result would be a two-tier system on our public markets that would be enormously confusing for investors to navigate, would open the door to accounting fraud for less scrupulous market entrants, and would actually increase long-run costs for well-intentioned companies. For this reason alone, these bills should be defeated. The bills also include these additional specific flaws.

- Although the legislation is presented as benefiting "emerging" companies, it defines emerging companies to include all but the biggest behemoths among new companies. By using $1 billion in annual gross revenues and $700 million in market float as the basis for the definition of an "emerging" company, the bill ensures that even very large, well established companies that could easily afford compliance would be given a pass on meeting the basic responsibilities that go with being a public company.

- Among the investor protections that would be delayed are requirements that no reasonable person would argue create a barrier to capital formation, including requirements to disclose executive compensation, to require shareholder votes on golden parachutes, and to require periodic say-on-pay votes. This suggests that the legislation has less to do with eliminating barriers to capital formation than with eliminating requirements the business community finds inconvenient or uncomfortable.

- The bills would also undermine market transparency and increase audit complexity by delaying implementation of new accounting standards and new auditing standards for "emerging" companies. As a result, investors would have to try to compare financial statements from competing companies prepared using different accounting standards, and accounting firms would have to train their employees to conduct their audits using different auditing standards depending on whether the company is an "emerging" or established company. Again this change is proposed without any evidence that compliance with new accounting and auditing standards imposes a significant cost burden on new companies.

- Most troubling, the bill would roll back investor protections adopted in the wake of massive and widespread analyst and accounting scandals. The predictable result would be a resurgence of the frauds these protections were adopted to address. Moreover, the provision delaying implementation of SOX 404(b) would actually institutionalize one of the factors that contributed to the initial high costs of implementation – that it is much more difficult and costly to retrofit 404(b)-compliant controls onto an existing financial reporting system than to build them in from the outset. The increased material weakness reports and financial restatements that would inevitably occur when the internal control audit was finally implemented after the phase-in period would cause significant avoidable losses for shareholders and a drop in investor confidence in the reliability of "emerging" companies' financial reporting.

In short, every provision of H.R. 3606 and S. 1933 is both unwarranted and misguided. It should not be included in any Senate "capital formation" package.

Crowd-funding (H.R. 2930, S. 1970, S. 1791)

Even the best of the crowd-funding bills would make it possible for the least sophisticated of investors to risk their limited funds investing in the most speculative of small companies. These investments would be made without the opportunity for extensive due diligence that venture capital funds and angel investors engage in before making comparable investments. At best, therefore, even if Congress does everything right in terms of imposing appropriate investor protections, most of those who invest through crowd-funding sites are likely to lose some or all of their money. At worst, crowd-funding web sites could become the new turbo-charged pump-and-dump boiler room operations of the internet age. Meanwhile, money that could have been invested in small companies with a real potential for growth would be syphoned off into these financially shakier, more speculative ventures. The net effect would likely be to undermine rather than support sustainable job growth. For that reason, we question the wisdom of adopting any of the proposed crowd-funding bills.

Among the various bills, however, S. 1970 stands out as a serious and responsible effort to ensure that crowd-funding sites are appropriately regulated. In particular, we support S. 1970's inclusion of an aggregate cap on investments, its requirement that crowd-funding sites be registered with and subject to regulatory oversight by the SEC, its more robust requirements regarding the duties of those intermediaries to prevent fraud, its prohibition against active solicitation by sites that are not registered as a broker-dealer, and its preservation of state authority. If Congress insists on moving forward with this legislation, therefore, it should at least adopt the more robust investor protections in S. 1970 to minimize the extent of harm that results to unwary investors and to maximize the potential that investments through these sites go to support legitimate businesses.

Regulation D Revisions (H.R. 2940, S. 1831)

Private offerings under Regulation D are flourishing, with roughly $900 billion raised through such offerings in 2010 alone and an estimated 20,000 to 30,000 such offerings issued each year in recent years. At the same time, Reg D offerings have become a source of significant market abuses, as documented by the North American Securities Administrators Association. This legislation would greatly increase the risks associated with these offerings by eliminating restrictions on general solicitation of investors. Supporters of the legislation argue that the limitation on general solicitation is not needed, since the offerings are sold exclusively to accredited investors. But neither the $200,000-$300,000 in income standard for accredited investors nor the $1 million in net worth requirement is a guarantee of financial sophistication or an ability to withstand losses. For example, a retiree who has accumulated $1 million over a lifetime of saving, and who depends on that money for income in retirement, would be a particularly poor candidate for investment in a private offering. But, if limitations on general solicitation were eliminated, such individuals would soon be flooded with such "opportunities." Moreover, neither of these bills as drafted limits itself to offerings sold exclusively to accredited investors.

While the rules regarding general solicitation may indeed merit review, this legislation represents a radical redrawing of the lines between public and private markets and should not be rushed into without greater attention to the potential risks of such an approach. We urge you, therefore, to conduct further study in order to determine whether legislation is needed and, if so, to adopt a much more narrowly targeted approach.

Shareholder Thresholds (H.R. 2167, H.R. 1965, S. 1824)

These bills would make it possible for companies, including very large companies with a large number of shareholders, to avoid making the periodic disclosures on which market transparency depends. The various bills would do this by simultaneously raising the limit on the number of shareholders of record who can hold a stock without triggering reporting requirements and exempting employees who hold company stock from the count. In addition, they would allow banks and bank holding companies to "go dark" if the number of shareholders of record dropped below 1,200, a move that would likely have a very negative affect on the value of investor holdings. Moreover, the bills would do all this without addressing the outdated and easily manipulated reliance on "shareholders of record" in making this determination.

Given the justifications that are offered for this legislation, it is unclear why both elimination of employees from the count and an increase in the shareholder threshold is needed. One or the other would seem to be adequate to address the stated concerns. At the very least, if you include broad shareholder threshold relief in a package of capital formation bills, we urge you to use a measure that is less subject to manipulation, such as beneficial owner, in determining the reporting threshold.

Regulation A Revisions (H.R. 1070, S. 1544)

These bills would increase from $5 million to $50 million the amount of capital that companies could raise from the public without triggering the full reporting and other obligations that go with registration. It is unclear whether the primary effect of this change would be to increase the number of small companies that choose to go public, with potential benefits for job creation, or to encourage companies that would otherwise have gone public to raise capital using the less transparent Reg A approach, with no similar beneficial effects and a potential to increase the cost of capital for such companies. Thus, this issue deserves a careful, balanced approach completely absent from the House bill.

While we cannot support either bill in its current form, we do appreciate that the sponsors of the Senate bill 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. While the House bill is completely unacceptable, a relatively few revisions to S. 1544 would address our remaining concerns. Specifically, we urge you to impose a cumulative, multi-year cap on use of the Regulation A exemption, to minimize pressure on the SEC to further increase the ceiling and to limit the amount that the SEC could raise the ceiling in the future, and to impose a strict liability standard to better ensure accurate disclosures in this loosely regulated market. Taken together, these changes would minimize the potential for investor harm while still significantly expanding access to Regulation A offerings.

* * *

Millions of Americans continue to suffer the consequences of a financial crisis brought about by weak and ineffective financial regulation. They deserve better from Congress and this

Administration than dangerous deregulatory “capital formation” proposals masquerading as job creation policy. We urge you to reject the many anti-investor proposals included in this so-called jobs creation package and to adopt instead a narrowly targeted, balanced approach that preserves regulatory requirements vital to the protection of investors, the promotion of market transparency, and the preservation of fair and efficient allocation of capital.

Sincerely,

AFSCME
Americans for Financial Reform
Chicago Consumer Coalition
Consumer Action
Consumer Federation of America
Consumer Federation of California
Consumer Federation of the Southeast
Empowering and Strengthening Ohio's People (ESOP)
Florida Consumer Action Network
Main Street Alliance
Massachusetts Communities Action Network
National Association of Consumer Advocates (NACA)
National Consumers League
National Education Association
NEDAP
ProgressOhio
Public Citizen
SAFER: The Economists' Committee for Stable, Accountable, Fair, and Efficient Financial Reform
U.S. PIRG
Virginia Citizens Consumer Council
Will Will Win, Inc.

Cc: Members, United States Senate