

**THE JOBS ACT: IMPORTANCE OF PROMPT IMPLEMENTATION FOR ENTREPRENEURS, CAPITAL FORMATION, AND JOB CREATION**

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**JOINT HEARING**

BEFORE THE

SUBCOMMITTEE ON TARP, FINANCIAL SERVICES  
AND

BAILOUTS OF PUBLIC AND PRIVATE PROGRAMS  
OF THE

COMMITTEE ON OVERSIGHT AND  
GOVERNMENT REFORM

AND THE

SUBCOMMITTEE ON CAPITAL MARKETS AND  
GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES

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**JOINT HEARING ON THE JOBS ACT: IMPORTANCE OF PROMPT IMPLEMENTATION FOR ENTREPRENEURS, CAPITAL FORMATION, AND JOB CREATION**

**Thursday, September 13, 2012,**

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM'S  
SUBCOMMITTEE ON TARP, FINANCIAL SERVICES AND  
BAILOUTS OF PUBLIC AND PRIVATE PROGRAMS JOINT WITH  
THE  
COMMITTEE ON FINANCIAL SERVICES' SUBCOMMITTEE ON  
CAPITAL MARKETS AND GOVERNMENT SPONSORED  
ENTERPRISES  
*Washington, D.C.*

The subcommittees met, pursuant to call, at 10:00 a.m. in room 2154 Rayburn House Office Building, Hon. Patrick McHenry [chairman of the Subcommittee] presiding.

Present: Representatives McHenry, Issa, Bachus, Garrett, Schweikert, Neugebauer, Pearce, Posey, Hayworth, Hurt, Stivers, Dold, Canseco, Fincher, Waters, Lynch, Maloney, Himes, Green, Eakin, Quigley, Ravikant, and Thompson.

Staff Present: Will L. Boyington, Staff Assistant; Molly Boyl, Parliamentarian; Lawrence J. Brady, Staff Director; John Cuaderes, Deputy Staff Director; Brian Daner, Counsel; Linda Good, Chief Clerk; Peter Haller, Senior Counsel; Ryan M. Hambleton, Professional Staff member; Christopher Hixon, Deputy Chief Counsel, Oversight; Laura L. Rush, Deputy Chief Clerk; Rebecca Watkins, Press Secretary; Ashley Etienne, Minority Director of Communications; Carla Hultberg, Minority Chief Clerk; Adam Koshkin, Minority Staff Assistant; Lucinda Lessley, Minority Policy Director; Brian Quinn, Minority Counsel; Safiya Simmons, Minority Press Secretary; and Davida Walsh, Minority Counsel.

Mr. MCHENRY. The Committee will come to order.

This is a joint Subcommittee hearing of both the Subcommittee on Oversight and Government Reform for TARP, Financial Services, and Bailouts of Public and Private Programs and the Subcommittee on Financial Services on Capital Markets and Government Sponsored Enterprises.

This hearing is entitled: The JOBS Act, importance of prompt implementation for entrepreneurs, capital formation, and job creation.

We have a tradition on the Oversight and Government Reform Committee to read our mission statement, our Committee's mission

statement: we exist to secure two fundamental principles. First, Americans have a right to know that the money Washington takes from them is well spent. Second, Americans deserve an efficient, effective Government that works for them.

Our duty on the Oversight and Government Reforms Committee is to protect these rights. Our solemn responsibility is to hold Government accountable to taxpayers, because taxpayers have a right to know what they get from their Government. We will work tirelessly in partnership with citizen watchdogs to deliver the facts to the American people and bring genuine reform to bureaucracy. This is the mission statement of the Oversight and Government Reform Committee.

Because this is a joint Subcommittee, we are happy to be with my colleagues Scott and Mike and Maxine for this hearing today.

I will now recognize myself for five minutes for the purposes of an opening statement.

Current economic and jobs numbers remind us that the U.S. labor market continues to face unprecedented challenges. The unemployment rate has remained over 5 percent for 43 consecutive months, and nearly 24 million Americans are unemployed or under-employed. To effectively address our sluggish economic recovery, the House Oversight and Government Reform Committee and the Financial Services Committee have identified outdated securities regulations that limit job growth and access to capital, which is the lifeblood of our economy.

Our efforts come together in an overwhelmingly bipartisan bill known as the JOBS Act, which the President signed into law this April. Today's joint Subcommittee hearing represents continuing efforts by both Subcommittees to examine obstacles faced by entrepreneurs and small businesses and allow the JOBS Act to advance capital formation and facilitate public offerings.

Supported by every member of both Subcommittees, which is let's just say rare in this Congress, the JOBS Act has clear-cut intentions, and that is to revitalize the creation and growth of American small businesses.

So while Congress's intentions made and clearly stated in the legislation, several sections provide the SEC authority to promulgate rules and regulations in a timely fashion. Unfortunately, the SEC chairman has already abandoned her commitment to finish the Act's first deadline and most straightforward provision, which is lifting the ban on general solicitation to accredited investors, which is title two of the bill.

And although the SEC chairman has compared the recent regulatory delays of the JOBS Act to the regulatory delays of Dodd-Frank, the truth is that they are dramatically different. They are worlds apart. Dodd-Frank mandates 95 rulemakings, many of which concerned issues that are foreign to the Securities and Exchange Commission. In particular, extracted industries and conflict minerals.

In comparison, the JOBS Act simply looks at reforms that lie at the core of the Commission's expertise. So while the Dodd-Frank rules require careful and deliberate speed, the JOBS Act should be seen as a walk in the park for the SEC.

Having authored the original crowdfunding title of the JOBS Act, I'm concerned the SEC's habitual 11th hour decision defies the bipartisan foundation of the entire legislation and may even stymie capital formation for small businesses altogether.

This would be a tragedy for a bill whose only motive is to promote capital formation and unlock opportunities and information for investors and job creators.

Currently, there is a real chance that our entrepreneurs and innovators could lose their competitive advantage simply due to outdated securities laws. However, after recognizing efforts of Chairman Garrett, Ranking Member Quigley and Waters to modernize our Nation's securities laws, I am confident that our Committee can continue to promote policies that ensure the United States never becomes complacent about its environment for startups and innovation, and I believe that the JOBS Act is a first step in the right direction, but only if it is implemented correctly.

I thank our witnesses for attending today's hearing. Each of them is respected in the field of capital formation and securities laws or particularly in the creation of granola. So we are grateful for the witnesses today.

With that, I would like to yield the balance of my time to the full Committee Chair of the Oversight and Government Reform Committee, Mr. Issa.

Mr. ISSA. Thank you, Mr. Chairman. My goal in a short opening statement is, first of all, to thank you for your leadership on this. This is a joint committee hearing, a joint committee hearing for the reason that is pretty clear: Financial Services and Oversight have both worked tirelessly to try to be an active part of job creation. Our Committee and the Financial Services Committee both were involved in Dodd-Frank and both were involved in the JOBS Act.

Your earlier statement is exactly right: Dodd-Frank has been put in front of the JOBS Act. The SEC Chairwoman, in fairness, got Dodd-Frank first, but, in fact, since Congress got Dodd-Frank wrong she is having a difficult time implementing it. It is our opinion, and I believe today's hearings will show, that the creation of private sector jobs should come before the creation of new bureaucratic organizations, no matter how well meaning, in Washington.

More importantly, it is clear that many of the aspects of the JOBS Act are long overdue, and, if implemented, would have given a signal to the private sector that business was now again a priority. I commend the President for his quick signing of it, his ceremony, his statement, but, unfortunately, rose garden ceremonies do not take the place of actual implementation or allowing the private sector to create jobs.

In closing, Mr. Chairman, I believe we understand that if Government grows it may create private sector jobs by spending taxpayers' dollars, but only through private sector job growth will tax revenue close the deficit we already have.

With that, I thank the Chairman and yield back.

Mr. MCHENRY. Thank you, Mr. Chairman.

With that, I will yield to the Ranking Member, the gentleman from Illinois, Mr. Quigley, for five minutes.

Mr. QUIGLEY. Thank you, Mr. Chairman. I thank you Chairman McHenry and Chairman Garrett for holding today's hearing on im-

plementation of the JOBS Act. I'm also pleased to be joined by my colleagues on the Financial Services Committee Capital Markets Subcommittee, including Congressman Waters, the Ranking Member. This is the Subcommittee's third hearing on the implementation of the JOBS Act.

As you know, the JOBS Act was passed with bipartisan support and signed into law by President Obama on April 5, 2012. The act amends Federal securities laws and regulations to make it easier for small business and startups to raise capital. Under title three of the JOBS Act, for example, startups will be able to raise capital through crowdfunding. This is a big step forward toward innovation and job creation in this country, and I commend the President and Chairman McHenry for working together on this issue.

I am just as eager as my colleagues at the SEC to meet the aggressive rulemaking deadline set in the JOBS Act. I am also eager for the SEC to finish its rulemaking under the Dodd-Frank Wall Street Reform and Consumer Protection Act, which was passed by Congress back in 2010. The Dodd-Frank Act, once fully implemented, will roll back the perverse incentives that cause financial firms to become too big to fail. It establishes the stronger provincial regulation, closing many of the loopholes that allow Wall Street to engage in excessive risk-taking.

Especially pertinent to the SEC, Dodd-Frank takes steps to eliminate serious conflicts of interest at credit rating agencies. Their inflated ratings of poorly underwritten mortgage-backed securities directly contributed to the financial crisis. I believe it is important that the SEC implement the provisions of both the JOBS Act and the Dodd-Frank Act in a timely manner. However, it is also important that implementation is not rushed and that the SEC gives appropriate consideration to the impact on investor protection.

Rushed implementation of the JOBS Act could result in greater risk of fraud and harm to investors and that would ultimately defeat the act's intended purpose of increasing access to capital for business. In the long term, investors must have confidence in the integrity of U.S. capital markets, and that requires SEC rules and enforcement to prevent fraud from corrupting the new methods of raising capital.

In June the Oversight Committee held a two-part hearing on implementation of the JOBS Act. As I said at that hearing, just as clean water standards keep our water safe to drink, financial regulations protect us against unsafe financial products.

The SEC has a dual mission to facilitate capital formation and protect investors, and I believe that those must be equal priorities going forward.

There is also no reason that the JOBS Act should be prioritized in front of the pending Dodd-Frank rulemaking. The same standards should apply equally to all of SEC's rulemakings that are required by law. Rushed, haphazard implementation of either act is unacceptable. And so, while I urge the SEC to move forward expeditiously, I also urge the Commission to ensure both of its important missions are met.

Thank you, Mr. Chairman. I yield back.

Mr. MCHENRY. I thank the Ranking Member.

I will now yield five minutes to the Subcommittee Chairman on Capital Markets, Mr. Garrett, my good friend and wise friend.

Mr. GARRETT. Thank you, Mr. Chairman. I appreciate you and your staff for your collaboration with the Capital Markets Subcommittee on this very important hearing today.

Having this hearing as a joint subcommittee between two authorizing committees should show both the SEC and the American public the importance and the priority of this issue. Now, I, likewise, recently learned that the SEC, after missing its initial 60-day requirement for implementation of the general solicitation part of this bill, had again delayed implementation. This was even after the staff had proposed moving forward with the interim final rule.

You know, this type of delay on what is really a pretty simple, straightforward requirement from Congress is unacceptable. The rulemaking process is not setting up a regulatory framework for a multi-trillion dollar derivatives market; it is, however, on a topic that has been around for a long time, and is well known by the SEC and by market participants. This is both extremely disturbing, and I expect and hope that the SEC will move forward to finalizing this rule in the near future.

Now, earlier this year Congress passed the JOBS Act. This legislation would ensure that overburdensome regulation does not strangle innovation and job creation. Specifically, the JOBS Act would ease the burden on capital formation on entrepreneurs and growth companies. In addition, the legislation would provide a larger pool of investors with access to information and investment options.

So with venture capital fundraising stagnant now in this Country and initial public offerings, IPOs, market basically closed off, innovative startup companies who cannot access the capital markets they need to grow have been forced to delay research on medical technologies, scientific technological breakthroughs. That has hurt everyone—the economy, our global competitiveness. You know, developing medical cures to help people live longer, healthier lives requires capital. Developing technology to improve the speed of communication requires capital. Developing alternative energy technologies to reduce our dependence on fossil fuels requires capital.

So the implementation of the JOBS Act will provide these startup companies with a cost-effective means to acquire startup capital and keep the Country at the forefront of medical, scientific and technological breakthroughs.

So with our Nation still struggling with persistent high unemployment, it is essential, Mr. Chairman, that the bipartisan JOBS Act implementation becomes a high priority for the SEC to be done in the near future.

With that, I yield now to the gentleman from Alabama, the chairman of the full Financial Services Committee.

Mr. BACHUS. I thank Chairman Garrett and Chairman McHenry for holding this joint subcommittee hearing to review the implementation of the JOBS Act.

The JOBS Act was a victory for job creation and for job creation in small businesses. Let's not tarnish this victory with regulatory

red tape that stifles the innovation, economic growth, and job creation that is intended by this bill.

As Chairman of the Financial Services Committee, I am proud of this legislation, comprised of six pieces of legislation that originated in our Committee and passed our Committee with overwhelming bipartisan support. The JOBS Act is proof that when we put our minds together, Republicans and Democrats can work together, find common ground, and help small businesses, which are the growth engine of our economy.

In previous economic recoveries, nearly 65 percent of new jobs were created by small businesses. That is not the case today, however. What we are seeing now is that almost all job growth, such as it is, comes from small corporations. Small businesses are not growing for two reasons. Owners and entrepreneurs tell us that the first reason is excessive regulation, almost all of it coming from Washington. A second reason is lack of capital. When these regulations consume too much of our time, energy, and finances, capital is even more critical.

In the JOBS Act we removed some of the unnecessary and outdated Depression Era job barriers to capital formation so entrepreneurs have more freedom to access capital, hire workers, and grow their businesses.

Unfortunately, the SEC has already missed three JOBS Act deadlines, and we are here today to discuss how important prompt implementation of the JOBS Act is to our economic recovery. The JOBS Act was a positive step taken by Congress and the Administration to promote capital formation. It should be implemented by the SEC without further delay.

With each job report, it becomes more urgent. American innovation and job creation must not be stifled by slow-moving government bureaucracy.

At this time, Subcommittee Chairmen McHenry and Garrett, I would like to introduce some of the younger Members to a former colleague of ours, Congressman Chip Pickering, who is seated in the first row. Chip was a senior staffer and served in this Body with distinction for several years.

I am just sorry that some of the younger Members didn't have an opportunity to serve with you, Chip. We welcome you back to Congress where you are so well thought of.

Thank you, Chairmen McHenry and Garrett.

Mr. MCHENRY. Thank you, Mr. Chairman.

We will now recognize the Ranking Member of the Capital Markets Subcommittee, Ms. Waters of California.

Ms. WATERS. Thank you very much.

Normally we start out testimony by thanking the Chair for holding the hearing. I won't be doing that this morning because I basically believe that this hearing is not necessary.

I think that what we wouldn't see is what gets in the way of bipartisan efforts. As a matter of fact, each of our members this morning have talked about how we cooperated to get the JOBS bill passed, and we did. I reluctantly supported the act with the hope that it would help facilitate capital formation and create jobs, but I think this kind of attack on the SEC and the kind of accusations

that are being made does not help us to foster bipartisan support for other efforts.

I expressed some concerns about particular provisions in the act, including the elimination of the walls between investor banking and research, the expansive definition of emerging growth companies, and increasing sanctions for provisions punitively by Sarbanes-Oxley and Dodd-Frank.

I understand that today we are going to focus on some aspects of the JOBS Act that requires SEC rulemaking before they can become effective. Some of my colleagues on the other side of the aisle will criticize the Commission for not just rushing through the process and putting a finalized rule into place before any public comment. Apparently, being upset that the SEC missed a deadline. There are rules that were supposed to come out in July 2012.

I guess I would have more sympathy or concern if I didn't also see a push to delay other rulemaking by the SEC, because, while there are complaints about slow rulemaking on a provision that would relax industry regulation, what I also find is there have been attempts to delay by passing legislation to delay any of the rulemaking for two years, asking regulators to re-propose the bulk of the rules which were also due in July and trying to buy the SEC down by an additional cost-benefit requirement, while not supporting an increase in the budget.

Now, again, I voted for the JOBS Act and I want to see it get implemented, but complaints about the slow pace of rulemaking under the act are simply unreasonable given these facts that I have highlighted. I am pleased that the SEC is taking public comment of the proposed rule eliminating the ban on general solicitation and advertising under title two of the JOBS Act. I had an amendment to that title which required that issuance of securities using reasonable steps to verify that the purchasers of the securities were, in fact, accredited investors or individuals or entities that are supposedly sophisticated and not in need of protection. Given that the general solicitation ads have been around for decades, and given that many stockholders had questions on how to implement my amendment, it is appropriate occurred that the public had the opportunity to comment on this provision.

After considering the SEC proposal, I am disappointed that it didn't require more robust verification procedures on behalf of issuers, and the Commission also should have considered the many suggestions offered by investor advocates and other stakeholders for additional measures that would decrease fraud in these expanded offerings.

I would make sure that as the SEC implements these provisions they are putting equal focus on all facts of their mission, including not just facilitating capital formation, but also protecting investors and maintaining market integrity.

I look to explore that with our witnesses here today, and I will yield time to the gentleman from Connecticut.

Mr. HIMES. I thank the Ranking Member and I just want to add my observation. I will tell you in a moment of a hall of mirrors, and this is truly a hall of mirrors.

I have been listening since the Dodd-Frank passage to Republicans complaining constantly daily, weekly, monthly that we

should delay the implementation of the regulations that are there to keep Americans—delay, we should reverse it. Now here we are saying that the SEC, in language, frankly, which is not promotive of the kind of comity we would have on Capital Hill, saying that the SEC should do it faster. I heard the Chairman of this Committee say that this should be a walk in the park. At the core of what we are talking about is protecting American investors from risky securities.

I supported the JOBS Act. I worked very hard on the JOBS Act. But we are talking about protecting not just those investors, but the integrity of our critical capital markets. The Chairman of the Government Reform Committee said we should put the creation of new jobs ahead of creating new regulations. That is actually a novel idea.

The military, when something goes wrong they do something called a stand-down, where they figure out what went wrong and how to proceed with prudence and deliberation. The private sector, whether it is new Coke or Gibson Greetings, when they make a mistake, they stand back and they ask, how can we avoid that happening again? We should do this, but we should do it with care and deliberation and not worshipping at the altar of deregulation.

Mr. ISSA. Would the gentleman yield?

Mr. HIMES. I am out of time.

Mr. MCHENRY. Well, comity is a little different than comedy, so at this point I will just say that Members will have seven days to submit opening statements for the record.

We will now recognize our first panel. I had a request from the Chair of the Financial Services Committee to recognize and introduce Naval Ravikant. With that, I will recognize Mr. Bachus to so.

Mr. BACHUS. Thank you, Chairman McHenry, for allowing me to introduce my friend.

I first met Naval before the House considered H.R. 2440, which became Title II of the JOBS Act. It was refreshing to hear from someone who had so much passion for helping companies access capital they need to grow and create jobs—in fact, he has been the catalyst for several Internet companies which are now household words. He was a strong supporter of H.R. 2940 and H.R. 2930, your crowdfunding bill, Subcommittee Chair, in the House, and was instrumental in getting the Senate to act on the JOBS Act, which, as we know, was not an easy thing to do.

Using technologies such as Twitter, Naval and AngelList put together a letter of support for the House bill that contained signatures from over 5,000 investors, entrepreneurs, and small businesses. Without Naval's support, we probably wouldn't be here discussing the implementation of the JOBS Act.

Also, a fascinating thing for me to do, I visited one of the sites which was responsible for new Internet companies in San Francisco, and saw a building full of young entrepreneurs. They had video games, they had basketball courts, they were watching sports, and they were also creating new companies. Several of them had been with Google, eBay, and other companies, and were part of the formation of other companies.

I didn't see any ties. I had a tie on when I first got there and I took it off fairly quickly. But those are the job creators, and, as

we all know, our identity is really not in homeownership, it is in our occupation or our job, and without a job, it really denies us a part of who we are and our identity.

So I thank you, Naval, and I thank Congressman Pickering for your help as a former staffer for the Commerce Committee, senior staff. Thank you.

Mr. MCHENRY. Thank you, Mr. Chairman. In the interest of time, I will introduce the rest of the panel. Mr. Robert Thompson is the Peter P. Weidenbruch Jr. Professor of Business Law at Georgetown University Law Center. Mr. Jeffrey Van Winkle is the Treasurer of the National Small Business Association and a partner at Clark Hill. Ms. Alison Bailey Vercruysse is the founder of 18 Rabbits, a small business that makes granola and granola bars, and from what I hear they are delicious. And Mr. Rory Eakin is the Founder and Chief Operating Officer of CircleUp, which is a form of crowdfunding, a wonderful website.

Both with AngelList and with CircleUp, it has been fascinating to see what you all are doing to link up innovators and capital.

And with that it is the policy of Oversight and Government Reform Committee that all witnesses be sworn before they testify, so please rise and raise your right hands. Do you solemnly swear or affirm that the testimony you are about to give will be the truth, the whole truth, and nothing but the truth?

[Affirmative answers by all.]

Mr. MCHENRY. Let the record reflect that the witnesses answered in the affirmative and they are now seated.

In order to allow for time for discussion, if you could summarize your opening statement, keep it to five minutes. We have a light system. Green means go, obviously. Yellow means hurry up and finish. And red means stop.

With that, we now begin with Mr. Eakin for five minutes.

## WITNESS STATEMENTS

### STATEMENT OF RORY EAKIN

Mr. EAKIN. Mr. Chairman, Ranking Members, distinguished members of the Committee, thank you for the honor of appearing before the Joint Committee today with an opportunity to speak on the issue of critical importance to the American economy.

I am the founder of CircleUp, a small business which supports other small businesses seeking growth capital from accredited investors through the Reg D 506 exemptions.

CircleUp is a private investment platform that focuses on businesses outside the technology sector providing growth capital for consumer brands and products and companies through a network of accredited investors. My partner and I were inspired to found CircleUp because we saw a gap in the market, namely, established, high-grade businesses struggling to find affordable capital, and a network of investors eager to fuel their growth. They needed a simpler, more accessible way to come together. CircleUp provides a platform to do just that.

America is a Country full of ideas and entrepreneurs pursuing their dreams. Over the last two decades, small and new businesses have been responsible for creating two out of every three new jobs,

and today the Country's 28 million small firms employ 60 million workers, fully half the private sector workforce.

Investment capital is the oxygen on which young businesses survive, and today investment capital market remains on a slow path to recovery. Bank lending, venture capital, and individual investing all remain below their pre-2008 levels, 13 percent below in the case of angel investments.

Beyond these broad statistics are the Americans, small businesses, and investors currently limited by the ban on general solicitation. We see these companies every day at CircleUp. Kim Walls, the Founder and CEO of Episencial, a skin care company in Los Angeles. Kim founded her company in 2009 to bring baby-safe, all natural skin care products to market. After extensive product development process and strong early traction from hospitals and consumer buyers, she needed to raise expansion capital. Her company had a passionate following of customers, parents, supporters interested in helping their business grow. Yet, because of current regulations Kim could not even make a passing motion of the opportunity to invest in Episencial to her 20,000 fans on Facebook.

Or consider Zak Normandin, a father of three who lives in Brooklyn, New York. Three years ago, dissatisfied with unhealthy snack food options available for his children, Zak created a new company to create organic, healthy snack options for all children. Today, Little Duck Organics is a rapidly growing small business. They are expected to increase seven fold this year. Little Duck has hundreds of thousands of consumers across the Country. They are passionate about the company, but Zak is not permitted to inform them about a capital raise. These consumers, many of whom are investors, would surely want at least the opportunity to learn more about Zak's company and his vision for a suite of products delivering healthy, organic food to children of all ages. Yet, under current regulations, Zak's fundraising process is limited to closed door conversations with existing angel investors, many of whom were not yet familiar with the brand.

Mr. Chairman, our current system is one that rewards entrenched investors, an insular network of institutions and individuals that favor private investor access more than the creation and growth of new businesses. But, with modern technology and this Act, this is going to change.

Lifting the ban on general solicitation will spur entrepreneurship and unlock small business growth opportunity to every corner of America, including some of the towns that today investors might consider unlikely or uncommon. But, like Little Duck Organics, and Episencial, we know they are not uncommon at all. Today, thousands of small businesses just like them are waiting to connect with investors who want to participate directly in our national recovery, by backing a young company and receiving a stake in the business in return. We just need to open the doors and make it happen.

Of course, investor protection is also essential. I believe the best protection is transparency and accountability. As an industry participant, I strongly support the SEC in oversight and regulations that protect investors while providing a more efficient flow of cap-

ital. If fraudulent investment schemes are permitted to prey upon unsophisticated investors, we will all lose.

The SEC has put forth a workable set of rules to increase the capital available for small businesses by lifting the ban on general solicitations. When adopted, the rules will increase the amount of information available to prospective investors. The time is now to implement these rules, fulfilling the mandate enacted with broad, bipartisan support in Congress and the President's approval without further delay.

Mr. Chairman, Ranking Members, members of the Committee, I thank you again for the honor of this opportunity and will be pleased to respond to any questions.

[Prepared statement of Mr. Eakin follows:]

**Testimony to the Committee on Oversight and Government Reform Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs and the Committee on Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises**

Rory Eakin  
Founder and COO of CircleUp  
September 13, 2012

**The Urgent Need for Swift Implementation of the Jobs Act**

Mr. Chairman, Ranking Member(s), Distinguished Members of the Committees,

Thank you for the honor of appearing before the joint committee today and for the opportunity to speak on an issue of critical importance to the future of the American economy.

I am here today as an entrepreneur and small-businessman. My remarks focus specifically on the estimated \$50 billion market for small businesses raising growth capital from accredited investors through the Regulation D 506 exemption. While these transactions account for less than 10 percent of the dollar volume for the exemption, they are instrumental to the overall performance of our economy as the primary source of capital for new, high-growth start-up businesses. Lifting the ban on general solicitation, as is mandated by Title II, will result in a direct benefit for this market – providing more access to capital for growing businesses, more information and choice for investors and, as I think we all want, more jobs for Americans.

**Background**

I am the founder of CircleUp, a start-up business which supports other small businesses raising growth capital from accredited investors through the Reg D 506 exemption. CircleUp is a private investment platform that focuses on businesses outside of the technology sector, providing growth capital for consumer brands and products and retail companies through a network of accredited investors. My partner and I were inspired to found CircleUp because we saw a gap in the market – namely, established, high growth businesses struggling to find affordable capital and a network of investors eager to fuel their next stage of growth. They needed a simpler, more accessible way to come together. CircleUp provides a platform to do just that.

We founded our company in October 2011 and opened to investors in April of this year. Today, we have six full time employees and hope to double that over the next six months. More importantly, we are creating jobs across the country, unlocking investment capital, and fueling the growth of the next generation of small business in America. Mr. Chairman, Members of the Committee, we believe this is the American dream and that every investor and small businessperson deserves access to it.

We saw the difficulty of the general solicitation ban first-hand when going through the capital-raising process for our own company. As entrepreneurs, we were limited to going to a select few entrenched 'Angel' investors for fundraising and were prohibited from reaching out to wider networks. We believed in our idea and knew we wanted supportive investors from a wide range of backgrounds to partner with us on our journey. However, because of the ban on general solicitation, we could not publicly advertise the investment opportunity. Together, my partner and I had thousands of business contacts that we could have informed with one simple click. Instead, the process was manual – introductions from investors we knew well, hundreds of meetings, calls, emails and follow-up questions with investor after investor, all using decades old technology.

We were fortunate, and closed our investment round in a few months, because we are entrepreneurs with deep roots in Silicon Valley and because we are a technology-driven company. For many businesses, however, especially those outside the technology industry, it often takes a year, or more, to

raise capital. As any entrepreneur can attest, the process is laborious and inefficient. More profoundly, it distracts entrepreneurs from doing what they do best – running and growing the businesses that fuel our economy, create jobs, and invent the technologies and products that allow America to continue to lead the global economy.

#### **The Primary Role of Small Business in America**

Every year, our start-up experience is repeated hundreds of thousands of times across the country. America is a country full of ideas and entrepreneurs pursuing their dreams. Over the last two decades, small and new businesses have been responsible for creating 2 out of every 3 net new jobs, and today the country's 28 million small firms employ 60 million workers, fully half of the private sector workforce.

Investment capital is the oxygen on which young businesses survive and today the investment capital market remains on a slow path to recovery. There are essentially two core options for companies to raise money: debt and equity. Small business lending, at close to \$300 billion, is the largest source of capital. Overall lending fell dramatically from 2008 to 2011, and still has not recovered to its pre-2008 levels.

More importantly, for the high-growth businesses most associated with stimulating job creation, early-stage equity capital has also not fully recovered. Venture capital and "angel" equity investments are the most important source of capital for these companies because it allows them to reinvest into their business, rather than repay debt. Investment levels today remain lower than pre-2008 levels. Like lending, the number of venture capital deals completed fell more than 10 percent between 2008 and 2011. While the "angel" market has shown some signs of recovery, the amount invested in 2011 remains more than 13 percent below 2007 levels.

Behind these broad statistics are real Americans, small businesses, and investors, currently limited by the ban on general solicitation. We see these companies every day at CircleUp. There is Kim Walls, the Founder and CEO of Episencial, a skincare company in Los Angeles. Kim founded her company in 2009 to bring baby-safe, all-natural skincare products to the market. After an extensive product development process and strong early traction from hospitals and consumer buyers, she needed to raise expansion capital. Her company has a passionate following of customers, parents, and supporters interested in helping the business grow. Yet, because of current regulations, Kim could not make even a passing mention of the opportunity to invest in Episencial to her 20,000 fans on Facebook.

Or consider Zak Normandin, a father of three who lives in Brooklyn, New York. Three years ago, dissatisfied with the unhealthy snack food options available on the market for his children, Zak created a new company to deliver organic, healthy snack foods for children. Today, Little Duck Organics is a rapidly growing small business, with sales expected to increase seven fold this year. Little Duck has hundreds of thousands of consumers across the country, many of whom are passionate about the company, but Zak has no way to inform them about a capital raise. These consumers, many of whom are investors, would surely want at least the opportunity to learn more about Zak's company and his vision for a suite of products delivering healthy, organic food to children of all ages. Yet, under current regulations, Zak's fundraising process was limited to closed door conversations with existing "angel" investors.

Mr. Chairman, our current system is one that rewards entrenched investors, an insular network of institutions and individuals that favors private investor access more than the creation and growth of new businesses, but with modern technology and this Act, this is going to change.

#### **Why Changing the Rules Matters**

Lifting the ban on general solicitation is the most important part of the JOBS Act for small businesses. The ban on general solicitation creates an inefficient market for start-ups to raise capital. By

limiting the information available to market participants, the ban imposes a cost on both companies and investors involved in each transaction. Investors must spend time developing relationships and networking to gain access to 'deal flow' they may not otherwise ever find, let alone gain access to.

This market is inefficient and investors lack choice and access. First, participation is limited. Today, less than 5 percent of accredited investors participate in the market. To be sure, "angel" investing is a high risk, potentially illiquid investment, which requires investor education and knowledge. However, given historically strong returns for the asset class, it is likely that many more Americans would participate, in at least limited ways, if given the opportunity. Especially after the performance of the public markets over the past few years.

"Angel" investing provides investors with a direct connection to the business they are funding. "Angels" often report this direct connection to helping a young company get off the ground and credit building a new business as an important motivation for their investment decision. Increasingly, there are other motivations including, social and environmental impact, community development, and even job creation. Impact investing is a rapidly growing investment class and one that will benefit tremendously once the ban on general solicitation is lifted and communities of interest can more openly develop, share, and vet investment opportunities.

Second, investing is highly concentrated by both geography and industry. The lion's share of investment goes to technology and health care start-ups and just three regions – California, New York and New England – account for approximately 50 percent of all investments. In other U.S. capital markets, capital flows to where it receives the highest returns. But not in Angel investing, because without the means of open communication, the "angel" investing market is highly fragmented and inefficient.

Sectors and geographies outside of this historical focus traditionally receive little attention. For example, consumer products spending is a full 20 percent of the American economy, yet represents only 4 percent of the "angel" investing market. These are the sectors, and companies, that will benefit the most from lifting the ban on general solicitation. To be clear: Lifting the ban on general solicitation is *not* about funding the next high tech company in Silicon Valley. Those markets exist already within decades-old, robust networks of investors and venture capitalists. This is about spurring entrepreneurship and unlocking small business growth opportunities in every corner of America—including in cities and towns that many of today's entrenched investors would not likely consider. But, like Little Duck Organics and Episencial, we know they're not uncommon at all. Today thousands of small businesses just like them are waiting to connect with investors who want to participate directly in our national recovery by backing a young company and receiving a stake in the business in return. We just need to open the doors and make it happen.

#### **Investor Protections are Critical**

Of course, investor protection is also essential. But, importantly, we can open access and protect companies and investors at the same time. As an industry participant, I strongly support SEC and FINRA oversight and regulations that protect investors while providing for a more efficient flow of capital. If fraudulent investment schemes are permitted to prey upon unsophisticated investors, we all lose.

The best protection against fraud is transparency and accountability. Transparency is a natural antiseptic to fraud. Like most illicit activity, fraud thrives in the shadows, where victims are isolated from information and choice. At CircleUp, we advocate greater transparency in the marketplace – with an open flow of information to and between investors. Importantly, when the ban on general solicitation is lifted, issuers will still be, and should be, subject to the antifraud provisions under the federal securities laws. We believe having the capital raised in public will reduce, not increase, the rate of fraud, as the public nature of the solicitations can help investor protection groups, regulators and the investors themselves detect fraudulent activity.

In addition to creating transparency, investor education is also critically important. Private placement investments are often high-risk, illiquid investments. Investors should be aware of the risks involved with making these investments and should be provided with education, guidance, and tools to help them manage these risks. We believe investment networks – both the offline “angel” groups across the country and online communities such as CircleUp – can be a valuable addition. We believe it is good business for these communities to help with investor education and thereby distinguish themselves from others in the market.

I believe the provisional rules promulgated by the SEC find the right balance for investor protections and market efficiency. I support the use of a broker dealer, or other third party verifier, to ensure investor accreditation. As intended, broker dealer involvement in a private placement transaction provides additional assurances against fraud.

**Urge Swift Implementation**

The SEC has put forth a workable set of rules to increase the capital available for small businesses by lifting the ban on general solicitation. The Staff has worked to balance the rules for companies like CircleUp, who are working to connect investors and small businesses across the country. When adopted, the rules will increase the amount of information available to prospective investors. The time is now to implement these rules, fulfilling the mandate enacted with broad, bipartisan support in Congress and the President’s approval.

Mr. Chairman, Ranking Members, and Members of the Committee, I want to thank you again for this opportunity to appear before you, and I would be pleased to respond to any questions that you may have.

Mr. MCHENRY. Thank you, Mr. Eakin.  
Now with that we will recognize Ms. Vercauysse.

**STATEMENT OF ALISON BAILEY VERCRUYSSSE**

Ms. VERCRUYSSSE. Thank you, Mr. Chairman and other distinguished Members. I am the Founder and CEO of 18 Rabbits. I started my business in San Francisco, and we create, like Mr. Chairman said, organic granola and granola bars.

I started this in my kitchen with literally a toaster oven, and now today we make millions of bars a year that we sell. So I am in favor of lifting this ban because we make a very easily understood and approachable product. So here it is.

Our customers include people like the Fresh Market, Peet's Coffee and Teas, Duane Reade, Google, Virgin America. That is where we currently sell. And we also sell them in hotels, spas, yoga studios.

All of our production takes place in the United States, in California right now, and 85 percent of our ingredients come from U.S. farms, and most of them small farmers that I have a direct relationship with.

Our competitors are large companies like Quaker Oats and Kashi and Nature Valley, and in order to compete against these mega companies we need the capital in order to raise brand awareness about who we are and what we are about and who we are selling to and why choose us.

So to grow our company what we did is we raised money from our friends and families. I sat in my father's living room and asked him for \$10,000, so that is how we started the company. And then we recently closed a \$500,000 round from CircleUp. Thank you, Rory.

So in between all of that, over the course of the three years, I applied and spoke in front of about five or six angel networks, and then I also met with ten private equity and venture capital firms in our State. Time and time again I was told, okay, come back when you are X amount of revenue, and then only to be told when I came back when we did reach that milestone, Oh, we need double that now. So that was really frustrating, and it also takes a lot of time. It takes time from me being innovative and getting my ideas out there to market, and also that is not providing value to the customer who is actually purchasing our product. What is providing value is for me to get in there and to continue to create and change the world with what I am making.

So the other thing that we did is we went and talked to banks and we asked them for funding. And so then we were told, Well, do you have positive cash flow? Do you have profit? well no. If I want to grow my business, I need to plug all the cash I am making in revenue back into the business.

So then what happened is luckily in 2009 there was the American Recovery and Reinvestment Act where we got a micro loan from the city of San Francisco for \$25,000. That really helped us. We were actually able to hire a couple of more people on our team. Right now we are at about eight people.

And then the next thing that we got was a line of credit from a bank. So last year we actually did have a profitable last quarter.

And this year we are growing even more rapidly and we are seeing some profit, and next year we will be profitable every quarter.

But what we need in order to continue to expand is access to more capital, and being able to go to our loyal customers and ask them for their money.

So a specific example about where the lack of capital held us back was at the launch of our bunny bars. This is a package that you will see hopefully very soon in Costco, in October. These little bars are geared towards kids, and they are healthy and organic and there is nothing like them on the marketplace because of the kinds of ingredients that we use.

So because we didn't have the access to the necessary capital, we had to delay the launch of the product, and then we haven't been able to penetrate the market deep or wide enough, where all of our competitors have a lot of money to do advertising and get it all out there, we don't have that right now, so it keeps us from our mission of putting healthier food in kids' bodies.

So we also could be providing more bars through our community service, through our 1 percent for kids program, whereby we actually give one bar out of every hundred bars made to kids in urban schools so we can start telling them or sharing with them that we have healthy snacks, that you don't have to reach for a bag of chips.

So starting a small business in America should not feel like starting a fundraising business. With lifting the ban on general solicitation, entrepreneurs like me and some of you can focus on running and building the business instead of using that valuable time to raise money.

Thank you.

[Prepared statement of Ms. Vercruyse follows:]



September 10, 2012

*Testimony for Congressional Hearing September 12, 2012 on behalf of the Committee on Oversight and Government Reform Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs and the Committee on Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises*

Capital is the energy behind great ideas. Manifesting those ideas is the foundation of this country. At 18 Rabbits, we make a very easily understood product with a straight-forward business and loyal customers. With the lifting of the General Solicitation ban, those customers could participate in the growth and success of our business paving the way for more entrepreneurs to start businesses.

18 Rabbits, launched in 2008, brings food back to its roots by creating delicious granola and granola bars using clean, premium ingredients. Our bars are the bridge between health and a treat. We have nationwide distribution and our customers include: Whole Foods, Wegmans, Virgin America, Google, [Amazon.com](http://Amazon.com), The Fresh Market, Peet's Coffee & Tea and Duane Reade. Additionally, we are available in upscale "lifestyle" establishments such as yoga studios, boutique hotels, sporting goods stores and spas. We have 18 distinct healthy and organic granola-based products spread over three product lines. All of our production takes place in the US and 85% of our ingredients are sourced from US farms. Today we directly employ 8 full and part time employees.

Our competitors are large corporations such as Quaker Oats, Kashi and Nature Valley. To compete with the mega companies, we need capital to raise awareness for our brand, attract an experienced team or have the means to train an enthusiastic young staff and produce more product.

To grow our company, we raised money from friends and family starting with a \$10,000 check from my father and more recently we closed a \$500,000 round of funding going through a site called [CircleUp.com](http://CircleUp.com).

Over the course of 3 years, I applied and spoke in front of five to six angel investor networks. I also met with over 10 private equity and venture capital firms specializing in our space. Time and time again, I was told to return when we reached X million dollars of revenue only to be told when we reached that threshold to come back at double the amount.

It is a full time job to attract and build relationships with perspective investors, which takes me away from running and growing the business. Without the divine intervention of meeting a sole angel investor in New York City who invested in 2010, I would not be sitting in front of you today.

# 18 RABBITS

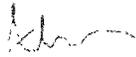
We also sought funding from banks, but without a positive cash flow or profit, we were turned down. We were able to get a micro loan of \$25,000 in mid-2009 as part of the American Recovery and Reinvestment Act and then a line of credit from a local bank for \$100,000 in 2011. To grow and hit our targets though, we need a line of at least \$500,000.

We are part of the solution to provide healthier snacks to the marketplace to turn back the unprecedented rates of childhood obesity. Our vision at 18 Rabbits is that everyone has the right to pure and simple food. As part of that vision, we created a junior bar line called "Bunny Bars". Because we didn't have the necessary capital, the launch was delayed, and we have not been able to penetrate the market deep or wide enough. Ultimately, the lack of capital is keeping us from our mission of putting healthier food in kids' bodies. As a new mother, this solution is particularly close to my heart and to the Company's culture.

We also could be providing more bars for our community service through our 1% for kids program whereby we give 1 out of every 100 bars made to kids in urban schools.

Starting a small business in America, should not feel like starting a fundraising business. With the lifting of the ban on General Solicitation, entrepreneurs like me, and some of you, can focus on running and building the business instead of using that valuable time to raise money. It allows for more innovation to drive healthy competition and allows more businesses to start employing more people. Ultimately, it is supporting the American Way. Thank you for your attention and for inviting me to be here.

Sincerely,



Alison Bailey Vercauteren  
Founder and CEO, 18 Rabbits  
T: 415.922.6006  
C: 415.307.7342  
E: Alison@18rabbits.com

Mr. MCHENRY. Thank you. I know when you held up the bars I think there were questions here on the dias whether or not you have enough for everyone.

Ms. VERCRUYSSSE. Hopefully.

Mr. MCHENRY. And I thank my friend Scott for suggesting that. With that, Mr. Van Winkle.

#### STATEMENT OF JEFFREY VAN WINKLE

Mr. VAN WINKLE. Thank you. My name is Jeff Van Winkle. I appreciate the opportunity to be here to present the views of the National Small Business Association. I am the volunteer treasurer of the NSBA and a former chairman of the Small Business Association of Michigan. I am also a member of the law firm of Clark Hill

The focus of my practice is assisting small-and medium-sized businesses, particularly in connection with raising capital.

The NSBA was founded in 1937 to advocate for the interests of small businesses. It is the oldest small business organization in the U.S., representing more than 65,000 small businesses throughout the country in virtually all industries and of all varying sizes.

The JOBS Act has the potential to dramatically and positively transform the ability of small firms to access the capital they need to grow, to innovate and to create jobs. Counsel for issuers have long sought increased flexibility to connect issuers with investors. The high-cost large broker dealer model has become a substantial barrier to getting capital to small-and medium-sized businesses that are seeking to grow.

The passage of the JOBS Act demonstrates the broad bipartisan understanding that existing securities laws pose an unreasonable burden on the ability of small firms to access the capital markets. The JOBS Act does this while continuing strong investor protections by retaining all existing State and Federal anti-fraud laws.

The SEC and FINRA are under significant pressure from State regulators and others who oppose the JOBS Act to use the regulatory process to accomplish what they could not accomplish in Congress. We are deeply concerned that either the SEC or FINRA or both will impose such a high regulatory burden on issuers and crowdfunding portals that important aspects of the JOBS Act may become a dead letter. This would frustrate the act, the intent of Congress and the President, and have a severely adverse impact on the ability of small firms to raise capital.

Both the SEC and FINRA must guard against complex regulations that will undermine the purpose of the act, and instead the regulatory framework should be straightforward and streamlined, imposing no more necessary costs and regulatory risks in small firms seeking to raise capital.

The Act required the SEC to issue a rule by early July to implement general solicitation provisions contained in title two of the Act. On August 29 the Commission issued a proposed rule that mostly restated the applicable statutory language in the JOBS Act.

No matter how the SEC ultimately proceeds, the reasonable belief standard regarding accredited investor status should be retained and the rule needs to be written so that Rule 506 offerings not involving general solicitation are not in a worse position than they were prior to the passage of the JOBS Act.

In our judgment, the traditional and almost universal practice of using investor suitability questionnaires combined with investor self-certification to establish accredited investor status should continue to be allowed and be deemed to constitute taking reasonable steps to verify that purchasers of securities are accredited investors, as is required by the JOBS Act.

On balance, after careful consideration of the likely outcome of the current situation, NSBA has decided to support the proposed rule in its current form. It is better to let practitioners, experience, and courts work out the contours of the verification requirement over time. Perhaps the issue can be revisited after some period of experience with the proposed rule.

Now Title III of the act creates a crowdfunding exception to registration requirements, this provision has the potential to be of major importance to small firms seeking capital. However, the success or failure of crowdfunding will depend upon the regulatory scheme applied to the portals and crowdfunding issuers. We are deeply concerned that the SEC and FINRA will both regulate crowdfunding, but only broker dealers will become portals and crowdfunding will become also a dead-letter-like regulation as it is today.

We are concerned that the SEC and FINRA will miss the year-end deadline for adopting rules.

Further, regulation must be substantially different from broker dealer; otherwise, the process will be too expensive for a million dollar offering or less. The Commission also needs to resist the temptation to make issuer disclosure and reporting requirements for crowdfunding issuers a close cousin of the requirements imposed on public companies. If they do, crowdfunding will not be viable.

We would like to see Congress also address a number of small business capital access issues that the JOBS Act does not address. To address the issues of finders to match capital with issuers, we would like Congress to look at permanently and substantially reducing the regulatory burden.

We appreciate the opportunity to make these remarks. Thank you.

[Prepared statement of Mr. Van Winkle follows:]



**Testimony of Jeffrey J. Van Winkle  
on behalf of the  
National Small Business Association  
regarding  
JOBS Act Implementation  
before a Joint Hearing of the  
Subcommittee on TARP, Financial Services and Bailouts of Public and  
Private Programs of the Committee on Oversight and Government Reform  
and the  
Subcommittee on Capital Markets and Government Sponsored Enterprises of  
the Committee on Financial Services**

**September 13, 2012**

My name is Jeff Van Winkle<sup>1</sup> and I appreciate the opportunity to be here today to present the views of the National Small Business Association (NSBA). I am the volunteer Treasurer of the NSBA and former President of the Small Business Association of Michigan. I am a member of the law firm Clark Hill. The focus of my practice is assisting small and medium size business, particularly in raising capital.

The National Small Business Association (NSBA) was founded in 1937 to advocate for the interests of small businesses in the U.S. It is the oldest small business organization in the U.S. The NSBA represents more than 65,000 small businesses throughout the country in virtually all industries and of widely varying sizes.

The JOBS Act<sup>2</sup> has the potential to dramatically and positively transform the ability of small firms to access the capital they need to grow, to innovate and to create jobs. The passage of the JOBS Act demonstrates a broad bi-partisan understanding that existing securities laws pose an unreasonable burden on the ability of small firms to access the capital markets, harming economic growth and job creation.

We are deeply concerned that either the SEC or FINRA or both will impose such a high regulatory burden on issuers and crowdfunding portals that important aspects of the JOBS Act

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<sup>1</sup> Biographical information and the "Truth in Testimony" disclosure is set forth at the end of this written testimony.

<sup>2</sup> The Jumpstart Our Business Startups Act (JOBS Act), Public Law 112-106.

***Celebrating 75 Years - 1937 - 2012***

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may become a dead letter. This would frustrate the intent of Congress and the President. It would have a severely adverse impact on the ability of small firms to raise the capital necessary to create jobs and to play a major role in improving the U.S. economy. Moreover, there are important indications that the SEC and FINRA are moving too slowly to implement the JOBS Act.

Our testimony also addresses a number of important issues that the JOBS Act did not address that we regard as important “unfinished business” in the area of securities regulation. In particular, we believe that the rules regarding peer to peer lending, finders and business brokers need to be reformed to remove impediments to small firms’ ability to raise needed capital.

#### *The JOBS Act*

On Apr. 5, 2012, the President signed into law the JOBS Act. The NSBA strongly supported this legislation. This bi-partisan legislation is designed to substantially reduce the regulatory impediments to small firms’ access to capital markets. Properly implemented by the SEC and FINRA, it will dramatically improve small companies’ access to capital and reduce their cost of capital. It will reduce the legal, accounting and other administrative cost of small businesses and reduce the need to pay substantial fees to investment bankers and other broker-dealers to access capital markets. The passage of the JOBS Act demonstrates a broad bi-partisan understanding that existing securities laws pose an unreasonable burden on the ability of small firms to access the capital markets, harming economic growth and job creation.

#### *Title I — Reopening American Capital Markets to Emerging Growth Companies*

Title I temporarily reduces the regulatory burden on new public companies classified as “emerging growth companies.”<sup>3</sup> Specifically, (1) certain executive compensation disclosure requirements are deferred, (2) only two years of audited financial statements are required in a registration statement, (3) the Sarbanes-Oxley section 404(b) internal control audit requirements are deferred, and (4) certain otherwise prohibited broker research reports and other communications are permitted. In addition, the Commission is directed to study how Regulation S-K may be changed to reduce the costs for emerging growth companies. Emerging growth companies are generally defined by the Act as a company with less than \$1 billion in revenues that has had registered common stock for five years or less.

NSBA supports reducing the expense and administrative burden of going public and remaining a public company. However, much of the relief in Title I is temporary in nature rather than permanent. It is also limited in scope. Thus, going public still entails assuming complex and expensive compliance responsibilities. Title I will make it somewhat easier and less expensive to go public and, for up to five years, will make it less expensive to remain public. Therefore, it

<sup>3</sup> The Act’s definition of emerging growth company undoubtedly includes firms that are not small businesses.

is likely to encourage more IPOs, improving access to public securities markets for small, dynamic firms. Because, however, the relief is temporary and limited in scope, the economic impact of Title I is also likely to be limited.

More needs to be done to reduce the regulatory burden on small public companies. We believe that Congress should begin by substantially reducing regulatory costs for companies with less than \$100 million in revenues or a market capitalizations of less than \$250 million. We look forward to working with Congress to develop such an initiative.

NSBA's comments regarding the regulatory framework for Title I are relatively limited.

Materials used to communicate with potential institutional or accredited investors to determine investor interest in accordance with section 105(c) of the Act should not have to be filed with the Commission.

Obviously, § 229.301 (Selected Financial Data) of Regulation S-K will have to be amended to conform with section 102(b) of the Act since the Act only requires two years of audited financial statements.

*Title II — Access to Capital for Job Creators*

The importance of Title II of the Act is often underrated. Typical small business owners know a limited number of accredited investors (i.e. very affluent people). They are thus effectively forced by the securities laws' pre-existing relationship requirements to pay broker-dealers large fees to make introductions. This aspect of the law will allow them, should they choose, to try to directly seek accredited investors. It is a very important step towards breaking the effective Wall Street cartel on raising small businesses capital from other than friends or family.

Specifically, Title II of the Act provides that the prohibition against general solicitation or general advertising contained in 17 CFR 230.502(c) shall not apply to offers and sales of securities made pursuant to 17 CFR 230.506, provided that all purchasers of the securities are accredited investors. It further requires the issuer "to take reasonable steps to verify" that purchasers of the securities are accredited investors, using such methods as determined by the Commission. The Act also provides, subject to various requirements, that no person shall be subject to registration as a broker or dealer solely because "that person maintains a platform or mechanism that permits the offer, sale, purchase, or negotiation of or with respect to securities, or permits general solicitations, general advertisements, or similar or related activities by issuers of such securities, whether online, in person, or through any other means."

We discuss below our general perspective on Title II and the proposed rule released by the SEC on August 29.

*Rule 506 Generally*

Our primary concern with respect to Title II is that the Commission resist the temptation to alter Rule 506 in a way that increases the burden on, or risk to, those using the exemption. No additional requirements should be added.

In our judgment, the Act is clear:

...the prohibition against general solicitation or general advertising contained in section 230.502(c) of such title shall not apply to offers and sales of securities made pursuant to section 230.506, provided that all purchasers of the securities are accredited investors.

The Act does not require or encourage other revisions to Rule 506. Moreover, contrary to the assertions of some, Congress did not intend that the SEC impose a complex new regulatory regime on Rule 506 issuers requiring them to engage in complex and burdensome investigations of their investors. The reason, we believe, that Congress gave the SEC only 60 days to implement this requirement is clear. They simply expected the SEC to delete the provisions in Regulation D that prohibited general solicitation and general advertising and had no expectation that the SEC would create a complex and burdensome regime regarding accredited investor verification.

Let us be clear. This is not about protecting innocent little old ladies from fraudulent issuers. Title II leaves all anti-fraud laws in place. Those advocating a complex regime regarding verification of accredited investor status are seeking to protect those who are willing to lie to issuers about their income or net worth. In order to protect those investors who are willing to fraudulently fill out investor suitability questionnaires and fraudulently attest to a false income or a false net worth, proponents of such a regime are willing to prevent countless job creating small businesses from raising the capital necessary to launch or grow their business. That is not what Congress had in mind when it passed Title II of the JOBS Act.

The verification language in the final Act is identical to the relevant language in the House bill. The relevant legislative history is the House report. There was no Senate report. The House report language states:

To ensure that only accredited investors purchase the securities, H.R. 2940 requires the SEC to write rules on how an issuer would verify that the purchasers of securities are accredited investors.<sup>4</sup>

This is simply a paraphrasing of the underlying statutory language. Since the law requires a modification to the underlying regulation, namely Regulation D, it is utterly unremarkable that the Committee in its report noted that the SEC would have to write rules implementing the

<sup>4</sup> Access To Capital For Job Creators Act, Report from the Committee On Financial Services October 31, 2011, p. 2 and p. 5.

requirements of the Act. There is no indication that the Congress contemplated a complex and burdensome regulatory regime governing the verification of accredited investor status that would effectively defeat the underlying purposes of the Act.

The comments of individual members of Congress are not true legislative history except, arguably, in the case of floor managers or the relevant committee chairpersons.<sup>5</sup> They reflect only the opinions of one member. Nevertheless, the only discussion of the verification issue on the Senate floor during the JOBS Act debate appears to be a discussion by Sen. Levin in support of the Reed-Landrieu-Levin amendment (SA 1833) that was **not** adopted by the Senate.<sup>6</sup> Sen. Levin stated:

The Reed-Landrieu-Levin amendment would direct the SEC to revise its rules to allow companies to offer and sell shares to a credited investor (sic), but it then directs the SEC to make sure those who offer or sell these securities take reasonable steps to verify that the purchasers are actually accredited investors. It requires the SEC to revise its rules to make sure these sales tactics are appropriate. There are not going to be, under our language, billboards or cold calls to senior living centers. I wish I could say the same about the House bill.<sup>7</sup>

This clearly implies that Sen. Levin thought the House bill (which is the language that was signed into law) did not require all of these things.

It is clear that imposing additional burdens on Rule 506 issuers who engage in general solicitation or general advertising would make it more difficult for small firms to raise capital. It would raise their cost of raising capital. It would make it less likely they will find needed investment. It would make it less likely that investors will invest in small firms since the cost of doing so will be higher. This is clearly contrary to the general purposes of the Act.

<sup>5</sup> This, of course, is even more true of the comments of a single member in committee. Moreover, committee debate transcripts are rarely available to attorneys or courts since they are neither published in *U.S. Congressional and Administrative News* nor the *Congressional Record* nor by the Government Printing Office. Only committee hearings and reports are usually published. See, e.g., "Legislative History Research: A Basic Guide." Julia Taylor, Congressional Research Service, June 15, 2011. *Ergo*, the comments of a single member in committee is accorded virtually no weight as legislative history even by proponents of using legislative history as an aid in statutory interpretation. Justice Stephen Bryer, for example, is one of the foremost proponents of using legislative history as an aid in interpreting statutes. Even he, however, mentions only "congressional floor debates, committee reports, hearing testimony, and presidential messages," none of which support the proposition that the JOBS Act provision at issue was meant to inaugurate a complex verification regime. See, "On The Uses Of Legislative History In Interpreting Statutes," 65 S. Cal. L. Rev. 845 (1992). Many other leading jurists and scholars oppose using legislative history for purposes of interpreting statutes at all. See, e.g., *Reading Law: The Interpretation of Legal Texts*, Justice Antonin Scalia and Bryan A. Garner, West, 2012.

<sup>6</sup> Cloture on amendment SA 1833 (the Reed-Landrieu-Levin amendment) was not invoked in Senate by Yea-Nay Vote. 54 - 45. See Record Vote Number 51.

<sup>7</sup> March 15, 2012, Congressional Record — Senate, S1727.

Such a regime would also increase the risk to issuers of lawsuits or disqualification of their offering if they sell to an investor who lied to them about their accredited investor status. This risk would very dramatically reduce the willingness of issuers to take advantage of Title II of the JOBS Act. This also is clearly contrary to the general purposes of the Act.

*The Proposed Rule*

The Commission was required to have issued a final rule by July 5. On August 29, the Commission agreed to a proposed rule. That rule effectively parrots the underlying statutory language by eliminating the ban on general solicitation and requiring that “[t]he issuer shall take reasonable steps to verify that purchasers of securities sold in any offering under this § 230.506(c) are accredited investors.”

Clearly, the Commission was feeling pressure to issue a rule as required by the JOBS Act. Equally clearly, as demonstrated by the public comment record and press reports, the Commission was feeling pressure from state regulators, self-styled consumer groups, labor unions and others who opposed the JOBS Act to use the statutory verification requirement as an excuse to implement a complex and expensive regulatory regime that would effectively nullify Title II.

It is not clear whether the Commission will adopt something similar to the proposed rule, go down the road of mandating a series of steps by issuers or creating a safe-harbor composed of specific steps similar to those outlined on pages 18 and 19 of the proposed regulation.<sup>8</sup>

From a small business perspective, there are risks associated with any of these three approaches. If specific mandates are made, those mandates may well involve such expense or serve as such a disincentive to investors that Title II becomes of little value. If it costs thousands of dollars for investors to comply with the rules, then they are going to find other ways to make relatively small investments.<sup>9</sup> If a safe-harbor approach is adopted, then it is likely that attorneys will treat the safe-harbor requirements as effectively mandatory in order to avoid legal risks. Yet if the current approach adopted by the proposed rule is adopted, we will not really know the legal contours of Title II for years as SEC enforcement actions and litigation outcomes provide the basis for knowing what is and is not required of issuers in connection with verification of accredited investor status.

<sup>8</sup> These include use of publicly available information (such as proxy statements or IRS Form 990s), tax return information or third party verification (by, for example, a broker dealer, accountant or attorney).

<sup>9</sup> If third party verification of net worth is required, then due diligence by accountants or others will be expensive (particular with respect to determining liabilities). Moreover, third parties are likely to impose a surcharge to compensate for their potential liability in connection with net worth certifications made in connection with securities offerings.

On balance, after careful consideration of the likely outcome given the current situation, NSBA has decided to support the proposed rule in its current form. Although the proposed rule could be better, it is unlikely to improve. It is better to let practitioners, experience and courts work out the contours of the verification requirement over time. Perhaps the issue can be revisited after some years of experience with the proposed rule.

#### *Rule 506 Bifurcation*

We are concerned that the SEC not modify Regulation D in such a way as to actually impede rather than enhance the ability of small firms to raise capital. This would certainly be the case if a new burdensome regulatory regime was created and applied to all Rule 506 offerings (including those that made no general solicitation). It would also be diametrically opposed to the intent of Congress.

Thus, we strongly urge that if the SEC imposes additional requirements on Rule 506 issuers who engage in general solicitation or general advertising, that it bifurcate the Rule so that these new requirements do not apply to issuers that do not engage in general solicitation or general advertising. In other words, issuers that do not engage in general solicitation or general advertising should be in no worse a situation than they were prior to passage of the JOBS Act. The existing rules should apply to them no matter what verification procedures the SEC adopts with respect to Rule 506 offerings involving general solicitation or advertising as authorized by the JOBS Act.

So far, the SEC has not gone down this road. The proposed rule does not affect Rule 506 offerings that do not involve a public offering.

#### *Reasonable Belief Standard*

The reasonable belief standard regarding accredited investor status should be retained. The traditional and almost universal current practice of using investor suitability questionnaires combined with investor self-certification to establish accredited investor status should continue to be allowed and be deemed to constitute taking "reasonable steps to verify that purchasers of the securities are accredited investors" as required by the JOBS Act. There is neither legislative history supporting nor any other reason to believe the proposition that Congress intended to undermine the laudable policy goals of the Act by changing the current long-standing practice with respect to verifying accredited investor status.

We believe that the current practice of investor suitability questionnaires combined with investor self-certification should be explicitly acknowledged and permitted by the final regulation.<sup>10</sup>

<sup>10</sup> If the Commission feels compelled to change existing practice, then a certification by the investor's attorney, CPA, certified financial advisor or other professional should be sufficient. This, of course, will add expense to the entire process and have a negative impact on investor returns and willingness to invest in Regulation D offerings. The expense will be particularly great for those relying on the net worth test. Requiring that investors certify that their income or net worth meets the accredited investor standards under penalty of perjury under 28 USC §1746

*Title III — Crowdfunding*

Title III of the Act provides a crowdfunding exception to the registration requirements of the Securities Act of 1933. The crowdfunding exception will allow issuers to raise, subject to substantial regulation, up to \$1 million a year in small increments from ordinary investors through a registered funding portal. State Blue Sky laws regarding registration and qualification are preempted.<sup>11</sup> This aspect of the Act has the potential to transform small firms' access to capital provided that the regulatory framework adopted by the Commission (or FINRA) does not unnecessarily impede either issuers or funding portals.

The Act requires that the rules necessary to implement crowdfunding be promulgated by December 31 of this year. There is every indication that the SEC and FINRA are moving so slowly that they are doing to miss this deadline by a very wide margin.

*Peer to Peer Lending*

Typically crowdfunding is discussed as if it only pertains to equity offerings. The law is clear, however, that it also applies to debt offerings. A brief foray into the history of the SEC and Peer to Peer (P2P) Lending is appropriate.<sup>12</sup> P2P lending is when consumers lend small amounts of money to a wide variety of small borrowers through the medium of a P2P web site. P2P lending allows borrowers to borrow less expensively than they would be able to with convention lenders and small investors to achieve higher rates of return than they would be able to by convention interest bearing investments. The P2P web site becomes the means of financial intermediation rather than traditional financial institutions or capital markets. The two leading U.S. P2P lenders are Prosper and Lending Club. P2P lending is more advanced in the United Kingdom and a number of U.K. companies have left the U.S. P2P market due to the adverse U.S. regulatory environment.

In November 2008, SEC entered a cease-and-desist order against Prosper in which the SEC alleged that Prosper was engaging in unregistered offerings of securities. Prosper reached a settlement with the SEC and resumed selling notes to lenders when its registration statement became effective in July 2009. Lending Club suspended its sales of notes to lenders from April

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would also be acceptable and create legal downside to investors inclined to lie to issuers. See "Supplemental Comments on Regulatory Initiatives to Implement the JOBS Act," August 2, 2012, David R. Burton, General Counsel, National Small Business Association for details on all of these matters.

<sup>11</sup> If this were not the case, then the cost of complying with all 51 Blue Sky laws would make many, perhaps most, crowdfunding offerings uneconomic. Since issuers would not know from what states their internet investors were coming and since an internet or national newspaper solicitation is likely to be deemed subject to regulation by many state authorities, compliance with all or most Blue Sky laws would probably be necessary in the absence of the preemption provision.

<sup>12</sup> For background see, "Peer-to-Peer Lending in the United States: Surviving After Dodd-Frank," Jack R. Magee, 15 North Carolina Banking Institute 139 (2011) and "Person-To-Person Lending: New Regulatory Challenges Could Emerge as the Industry Grows," United States Government Accountability Office, July 2011 (GAO-11-613).

to October 2008 to register with SEC. It too filed a registration statement with the SEC. Both registration statements are amended and refiled on nearly a weekly basis.

As a result of this SEC action, neither Prosper nor Lending Club now lend to small businesses. They permit only lending to individuals.

Title III of the JOBS Act will effectively permit P2P lending to small firms under the rubric of crowdfunding. There is a need, however, to fix the underlying law so that P2P lending is more generally available to small firms. It is ridiculous that a small business seeking a loan from small investors is regulated so heavily that the regulatory costs substantially exceed the loan amount being sought.

#### *\$1 million Limitation*

New section 4(6) permits offerings under the crowdfunding exemption up to an aggregate of \$1 million in a twelve-month period. The statutory language is not a model of clarity regarding whether the \$1 million limitation pertains only to offerings under Section 4(6) of the Act or includes all exempt offerings. NSBA supports the \$1 million limitation applying only to crowdfunding offerings. The Commission should clarify its position and, if necessary, Congress should clarify the statute.

#### *Self-Regulatory Organizations and Registration as a Broker*

New section 4A(a)(2) requires funding portals to register with any applicable self-regulatory organization (as defined in section 3(a)(26) of the Securities Exchange Act of 1934). Section 304(a) of the Act provides that [t]he Commission shall, by rule, exempt, conditionally or unconditionally, a registered funding portal from the requirement to register as a broker or dealer.

The Commission must designate with which SRO a funding portal should register. It is not clear what the funding portal should register as, however. The Act makes it clear that a funding portal is distinct from a broker or dealer from a regulatory standpoint. The difficulty is that the current stance of the Commission is, effectively, that almost anyone no matter how tangentially involved in a securities transaction may be a dealer (see, e.g., the SEC's Guide to Broker-Dealer Registration <http://www.sec.gov/divisions/marketreg/bdguide.htm#II>). It is clear that the state of SEC "guidance" in this area is not clear.

For example, the SEC "Guide to Broker-Dealer Registration" states that (1) "[f]inding investors for "issuers" (entities issuing securities), even in a "consultant" capacity," (2) "[e]ngaging in, or finding investors for, venture capital or "angel" financings, including private placements" or (3) "persons that operate or control electronic or other platforms to trade securities" can trigger registration. That, of course, is what funding portals will be doing and what both Congress and the President intend for them to do.

Given the highly expansive interpretation of current SEC guidance, any funding portal would presumably be required to register as a dealer. Yet this clearly is not consistent with Congressional intent and would impose an unreasonable burden on funding portals. In fact, it would defeat the primary purpose of the legislation, to wit, to allow investors to invest and small issuers to raise capital without being required to cut Wall Street in for a large piece of the company.

NSBA does not believe that registration as a dealer should generally be required of organizations that are only funding portals for crowdfunding and/or Regulation D offerings. It is imperative that the Commission and, presumably, FINRA, adopt this position and make this clear.<sup>13</sup> It is important that the Commission make it clear that funding portal fees set, in whole or in part, as a percentage of the amount raised do not trigger dealer registration requirements.

#### *Disclosure*

New section 4A(a)(3) requires an issuer “to provide such disclosures, including disclosures related to risks and other investor education materials, as the Commission shall, by rule, determine appropriate.” To eliminate uncertainty and ensure that the information deemed by the Commission to be necessary is conveyed to prospective investors, we strongly urge the Commission to provide model language that it wants in the disclosures and educational materials or, as necessary, to provide detailed templates.

#### *Background Checks*

New section 4A(a)(5) requires an issuer to “take such measures to reduce the risk of fraud with respect to such transactions, as established by the Commission, by rule, including obtaining a background and securities enforcement regulatory history check on each officer, director, and person holding more than 20 percent of the outstanding equity of every issuer whose securities are offered by such person.”

We would urge the Commission to indicate what behavior uncovered by a background check is disqualifying, what needs to be disclosed and what does not. For example, is a 15 year old DUI or marijuana possession felony conviction disqualifying? Does it need to be disclosed? Are the requirements limited to crimes of moral turpitude? Is the background check requirement limited to a *criminal* background check and, if not, what other types of background check will be required? For example, is it mandatory to disclose tax liens, judgments, bad debts or similar issues and if so, how is such a background check to be conducted? Liens and judgments, for example, are often not on a central database. Guidance on the parameters of this requirement is very important.

<sup>13</sup> It appears that the SRO will be FINRA and, if so, the SEC should make this decision sooner rather than later so FINRA can get its rules adopted and begin registering funding portals.

Section 15(b)(4) of the Securities Exchange Act could be used as the template for a rule regarding disqualification but would not necessarily be appropriate for a mandatory disclosure standard.

We would also bring to your attention the recent EEOC revised “Enforcement Guidance on the Consideration of Arrest and Conviction Records in Employment Decisions under Title VII of the Civil Rights Act of 1964.” It is clear that the EEOC and SEC are pursuing very different policy agendas in this area. The EEOC regards virtually all background checks as legally suspect and potentially subject to enforcement action. We would ask that SEC and EEOC guidance be consistent since our membership cannot comply with conflicting legal requirements issued by two different agencies.

#### *Aggregation*

New section 4A(a)(8) of the Act requires intermediaries to ensure that no investor in a twelve-month period has purchased crowdfunding securities that, in the aggregate, from all issuers, exceed the Section 4(6) investment limits. Obviously, an investor may make investments through more than one portal. Unless the SEC maintains a central clearing house of some kind, it is unclear how an intermediary will be able to verify whether an investor had exceeded these limits unless it is entitled to rely upon the representation of an investor regarding prior investments in such securities.

#### *Rescission*

New section 4A(b)(1)(G) requires an issuer to offer investors a reasonable opportunity to rescind the commitment to purchase the securities. Dovetailing this provision with the Truth in Lending Act (TILA) provisions contained in 15 USC §1635 and many state consumer protection statutes seems appropriate since the policy goals are substantially similar and it is less likely to lead to consumer confusion. The TILA statute provides consumers the “right to rescind the transaction until midnight of the third business day following the consummation of the transaction or the delivery of the information and rescission forms required under this section together with a statement containing the material disclosures required under this subchapter, whichever is later.” The period should commence upon the investor entering into a binding initial commitment.

It should also recommence if the issuer makes a change in the investment terms or provides a new material adverse disclosure before the offer is closed (and should not terminate until substantially after the issuer provides actual notice of the change or adverse disclosure). In our judgment, in these two cases, the period should be much longer than three days. In fact, we would not object to a requirement (consistent with the principles of traditional contract law) that the issuer be required to receive a specific ratification by the investor of the revised terms or of the existing terms in light of the revised facts after a new material adverse disclosure.

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#### Offering Notices or Announcements

New section 4A(b)(2) provides that an issuer shall “not advertise the terms of the offering, except for notices which direct investors to the funding portal or broker.” The Commission should provide guidance as to what information is permitted in the notice. At a minimum, the issuer should be allowed to provide the following information in the notice:

- (1) The name of the issuer;
- (2) The name and web site of the funding portal or portals;
- (3) The type of security being offering;
- (4) The offering amount;
- (5) The opening and closing date of the offering; and
- (6) The line of business that the issuer is in (or will be in if the offering will fund a new line of business).

#### *Issuer and Intermediary Liability*

New section 4A(c) provides a cause of action to an investor in a crowdfunding offering against the issuer, a director or partner of the issuer, the principal executive officer or officers of the issuer, or the principal financial officer, controller or principal accounting officer of the issuer to recover damages for material misstatements and omissions by the issuer. Although it is Congressional intent that the issuer and its executives be legally responsible for material misstatements and omissions in the offering documents, the Commission should provide guidance as to whether an intermediary will be required to confirm any information presented by the issuer during the course of the offering (and if so, which information and to what extent) or will be subject to liability for any violations by the issuer of its Section 4(6) obligations.<sup>14</sup> The Commission should provide guidance as to whether intermediaries will be permitted to request issuers to provide greater disclosure of information to the public than required by the Act and whether this additional disclosure would result in any liability to the intermediary in the event of fraud or negligent misrepresentation by the issuer.

Given the combination of a large number of potential investors making small investments and potentially risky investments, class action or shareholder derivative lawsuits (both warranted and unwarranted) are likely to be reasonably common. In order for this risk not to pose a major barrier to those wishing to maintain funding portals, it is important that the scope of intermediary duties be set forth with reasonable specificity. Moreover, it is our belief that a funding portal attempting to impose stricter standards than the minimum required by the Commission should not give rise to liability.<sup>15</sup> Finally, a funding portal that complies with Commission requirements should not be co-liable for material misstatements and omissions by an issuer – otherwise, they are, in effect, being asked to become an insurer and the costs and risk of maintaining a portal will become prohibitive.

<sup>14</sup> Alternatively, of course, Congress could clarify the statute.

<sup>15</sup> *Ibid.*

*Investment Advice*

Section 3(a) of the Securities Exchange Act as amended by new subsection 80 defining a “funding portal” prohibits an intermediary from offering investment advice or recommendations. However, the Act does not provide a definition of what constitutes investment advice or a recommendation. The commission should clarify whether the following actions would constitute either investment advice or a recommendation: (1) removing an offering before its offering period has expired for lack of sufficient investor commitments; (2) preventing an issuer from offering its securities on the funding portal’s website because of failure to provide documents responsive to a the portal due diligence/disclosure standard; (3) establishing disclosure standards or qualification standards (e.g. prohibiting felons from being in issuer management) that are higher than the standards specified by the Commission (4) assuming a funding portal allows investors to comment or submit questions to an issuer on the funding portal’s website, deleting a third party’s statements that are false, obscene, defamatory or irrelevant; (5) defining the layout, format or positioning of the offering on the funding portal’s website; (6) providing market and news updates; and (7) declining to post an offering due to the offering not fitting into the type of offering that the funding portal seeks to limit itself to offering (e.g. small businesses, businesses in a specific geographical area, prohibiting certain lines of business (e.g. gambling establishments), etc.).<sup>16</sup>

*Customer Funds*

A funding portal may not “hold, manage, possess, or otherwise handle investor funds or securities” (new section 3(a)(80)) but must ensure that ensure that all offering proceeds are only provided to the issuer when the aggregate capital raised from all investors is equal to or greater than a target offering amount, and allow all investors to cancel their commitments to invest, as the Commission shall, by rule, determine appropriate; (new section (4A(a)(7)). Thus, a funding portal must effectively ensure that funds are held in escrow but may not do so itself. The Commission should provide guidance as to what sort of institutions may provide this service, what the funding portal’s responsibilities regarding this requirement are, who should bear the cost of this service, who should bear the risks associated with providing this service and what the escrow agent’s duties are and to whom.

*Title IV — Small Company Capital Formation (Regulation A)*

Regulation A and the small issue exemption has effectively become a dead letter. It is used sometimes as little as once annually by the small issuer community.<sup>17</sup> Increasing the aggregate 12 month offering exemption amount to \$50 million has the potential to make it relevant again for larger small firms and medium-sized firms seeking to raise capital. We do not currently have specific recommendations regarding substantive changes to Regulation A.

<sup>16</sup> Ibid.

<sup>17</sup> Prior to the enactment of the JOBS Act, Regulation A offerings could not exceed \$5 million. In 2011, only one Regulation A offering was completed. See “Factors That May Affect Trends in Regulation A Offerings,” United States Government Accountability Office (GAO-12-839), July 2012, a study mandated by the JOBS Act.

Congress intends for this exemption to be used. Thus, if this change does not result in any appreciable Regulation A filings then the Commission should seriously assess whether the regulatory burdens on issuers imposed by Regulation A should be reduced so as not to frustrate Congressional intent.

Alternatively, it may prove advisable for Congress to rethink the small issue exemption so that a less burdensome approach may be found.

*Accredited Investor*

Section 413 (b) of Title IV of the Dodd-Frank Act provides that “[t]he Commission may undertake a review of the definition of the term “accredited investor”, as such term applies to natural persons, to determine whether the requirements of the definition, excluding the requirement relating to the net worth standard described in subsection (a), should be adjusted or modified for the protection of investors, in the public interest, and in light of the economy.”

NSBA strongly opposes increasing accredited investor threshold. In “light of the economy,” the last thing regulators should do is make it more difficult for small, dynamic companies seeking investors to raise capital. There is no evidence that the threshold is too low. And it is not in the public interest to deny investors access to the investments that will create jobs, enhance productivity and foster innovation.

We would recommend that Congress revisit this section of the Dodd-Frank Act and instead permanently set the accredited investor thresholds where they are presently (perhaps indexed for inflation).

*Title VII — Outreach on Changes to the Law*

Section 701 of the Act provides that:

The Securities and Exchange Commission shall provide online information and conduct outreach to inform small and medium sized businesses, women owned businesses, veteran owned businesses, and minority owned businesses of the changes made by this Act.

NSBA has offered to assist the Commission in conducting outreach and providing small businesses with information about the opportunities created by the Act.

*FINRA*

FINRA will presumably be the regulatory authority for crowdfunding portals. If FINRA treats portals as broker-dealers light, then the regulatory cost of operating a portal will be so high that only broker-dealers will be able to offer portals. This will frustrate one of the main purposes of

the JOBS Act. Congress needs to provide oversight of, and input to, FINRA as well as the SEC.<sup>18</sup>

#### *Money Laundering*

FINRA, its July Regulatory Notice 12-34, specifically requested comments on money laundering and crowdfunding portals. The burden imposed on financial institutions because of various “Know Your Customer” requirements and other anti-money laundering provisions is huge (well over \$5 billion annually).<sup>19</sup> To impose the full panoply of these requirements on web portals would, quite probably, prevent crowdfunding portals from being operated by anyone other than broker-dealers.

Of course, for purposes of the money laundering laws financial institutions are not necessarily actual financial institutions. Most would be surprised to find that travel agencies, jewelers, pawnbroker, car dealers, and persons involved in real estate closings and settlements are “financial institutions.”<sup>20</sup> Broker-dealers are, of course, subject to these laws. In addition, “any business or agency which engages in any activity which the Secretary of the Treasury determines, by regulation, to be an activity which is similar to, related to, or a substitute for any activity in which any business described in this paragraph is authorized to engage” may be subject to these rules.

Handling large sums of money is the one thing all of the subject business have in common. As noted above, portals are **prohibited** from holding customer funds. Thus, anti-money laundering provisions should simply not apply to portals and the law does not require it.

#### *Fraud*

The JOBS Act does not change federal fraud laws and does not preempt state fraud laws. You would never know this from the various pronouncements being made by state regulators and other opponents of the JOBS Act.

The law imposes a myriad of requirements on funding portals. It also gives the SEC and FINRA tremendous authority to impose additional requirements. We do not believe that imposing additional requirements beyond those actually required by the JOBS Act are warranted. It is highly unlikely that such additional requirements would materially reduce fraud. It is highly likely that additional requirements will impede the ability of small companies to use crowdfunding to raise needed capital and to create jobs. If it becomes evident in the future that some particular revision to the regulations governing crowdfunding is appropriate, then those revisions can be made by the Commission or FINRA to address the problem.

<sup>18</sup> See August 30, 2012, Comments to FINRA by David R. Burton, General Counsel, National Small Business Association for details.

<sup>19</sup> See, e.g., “Trends in Anti-Money Laundering 2011,” July 2011, Celent.

<sup>20</sup> 31 USC 5312(a)(2).

*Finders and Business Brokers*

A finder is a person that assists a small business in raising capital in exchange for a fee. Often, they are business colleagues or acquaintances. The SEC withdrew all guidance permitting finders and SEC officials gave a series of speeches implying that they would start pursuing enforcement actions against finders who collected their fees based on success (i.e. as a percentage of the funds raised) as unregistered broker dealers. This would also endanger the status of an issuer's offering as lawful. This has thrown into question and largely shut down a very important avenue for small firms trying to raise capital. Finders represent a very cost-effective way for small issuers to reach accredited investors.

The American Bar Association, which is not typically deeply concerned about small firms' capital access, has identified this as a major problem that needs to be resolved.<sup>21</sup> The Annual SEC Government-Business Forum on Small Business Capital Formation has also consistently identified this as a serious problem.

As discussed in the context of web portals, the difficulty is that the current stance of the Commission is, effectively, that almost anyone no matter how tangentially involved in a securities transaction may be a dealer. For example, the SEC "Guide to Broker-Dealer Registration" states that (1) "[f]inding investors for "issuers" (entities issuing securities), even in a "consultant" capacity," (2) "[e]ngaging in, or finding investors for, venture capital or "angel" financings, including private placements" ... That, of course, is what finders do.

Congress needs to amend the Securities Act to provide a safe harbor from the broker-dealer registration requirement for finders that conduct a limited number of transactions annually and limit their activities to assisting private placement issuers to find investors. There is a similar need to protect business brokers who assist those wishing to purchase or sell small business.

*Conclusion*

The JOBS Act is a very important piece of bi-partisan legislation. It is the first piece of legislation to make material improvements in small firms' capital access in a very long time. Yet we have a very serious concern that the SEC and FINRA may erect a wide variety of regulatory barriers that may nullify or substantially frustrate the laudable policy goals of the Act. The SEC has already missed the first deadline set by the law and there is every indication that the SEC (and FINRA) will fail to meet other deadlines in the law (most notably regarding crowdfunding implementation).

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<sup>21</sup> See, "Report and Recommendations of the Task Force on Private Placement Broker-Dealers," American Bar Association (Section of Business Law, Committee on Small Business, Committee on Federal Regulation of Securities, Committee on Negotiated Acquisitions, Committee on State Regulation of Securities), June 7, 2005.

Mr. MCHENRY. Thank you, Mr. Van Winkle.  
Mr. Thompson?

**STATEMENT OF ROBERT B. THOMPSON**

Mr. THOMPSON. Chairman McHenry, Chairman Garrett, Ranking Member Quigley, Ranking Member Waters, members of both Committees, thanks for the opportunity to talk about JOBS, its affect on the economy, the obstacles faced by entrepreneurs in raising capital.

JOBS produced far-reaching legislative reforms in this area. It added two new exemptions, which was, frankly, unheard of over the 80-year history of the Securities Act, plus it substantially expanded a third exemption, so there is a whole new area that we haven't had before, big space. It also increased the deregulatory space of the 1934 act, and the on ramp creates lessened burdens for emerging growth companies.

In implementing and passing this legislation, Congress followed an established template for securities regulations which basically, as I told my students this morning before this hearing, involves four essential pillars: disclosure, SEC review, increased regulations when there is intense selling efforts versus others, and liability to cultivate due diligence.

The JOBS Act followed this template. The crowdfunding bill includes disclosure, includes focus on intermediaries, and it includes a 12(a)(2)-like liability. A-plus follows this template, with a focus on 12(a)(2) liability, intermediaries, and disclosure. Implementation should follow the same template.

To talk about a couple of specifics, crowdfunding in bills introduced by Chairman McHenry and passed by one of these Committees, reflects an innovative path of raising securities. The challenge in this area though is that if you are trying to raise \$1 million or less, any regulatory cost will quickly eat into what you are going to raise, and any issuer is going to look at the relative cost and benefits of different exemptions. I mentioned the several that are being applied.

We heard from two members of our panel already who use 506 and probably they would keep using 506 to reach accredited investors after the crowdfunding regulation occurs. That remains a dilemma for implementing that section of the Act.

I think the focus on portals may be the way to go to try to get some innovative approach there.

Similarly, A-plus has a problem in terms of relative use. Regulation A, which is the base for the smaller amount, has fallen into almost never being used. Now, once we increase it by ten-fold, from five to fifty, it may be used more, but it is going to be the same comparative dilemma. 506 is going to be more attractive to many people who might use A-plus.

So that takes us to 506, which I think will be the most far-reaching affect of the JOBS Act. Empirical data from the SEC for the period 2010 and early 2011 shows that more money was raised in private offerings, particularly in 506, than in IPOs. It is already the biggest form of public raising, and once the general solicitation ban is removed, which will be not too far in the future, it will grow even more.

I think that that will be the focus in the near-term for accessing capital.

Now, the problem I have with 506 is that the focus is on accredited investors, which was an innovative addition back in 1982 when the SEC promulgated it. A lot has changed since then in the sense that an accredited investor is carrying a lot more of the weight than it did in 1982. Why? Business in 1982 the amount hasn't changed—\$200,000 in income, \$1 million in net worth, same as it was three decades ago. You all know what inflation has occurred in those three decades. I actually looked up Congressional salaries, but I won't talk about that. The number that got my attention is that the number of investors who qualify as accredited, in 1982 it was .17 or .18 of all individual taxpayers. Today that number, the cohort that qualifies to be an accredited investor is 20 times bigger. The focus should be on that more than anything else.

I will refer you to my testimony for my other points.

Thank you very much, Mr. Chairman.

[Prepared statement of Mr. Thompson follows:]

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Statement of Professor Robert B. Thompson  
Peter P. Weidenbruch Jr. Professor of Business Law  
Georgetown University Law Center

at

Hearings Before the Subcommittee on TARP, Financial Services and Bailouts of Public and  
Private Programs of the House Committee on Oversight and Government Reform and the  
Subcommittee on Capital Markets and Government Sponsored Enterprises of the House  
Committee on Financial Services

The JOBS Act

September 13, 2012  
Washington, D.C.

Chairman McHenry, Chairman Garrett, Ranking Member Quigley, Ranking Member Waters, and Members of the Subcommittees:

Thank you for the opportunity to testify about the JOBS Act, its effect on capital formation, and obstacles faces by entrepreneurs and emerging businesses. JOBS provides far-reaching legislative reforms in what it means to be a public company or to make a public offering. It provides two new exemptions to the registration requirements of the Securities Act of 1933 (the '33 Act) (an act for which new exemptions have rarely been created over its almost 80 year history) and substantially expands the reach of a third exemption, Rule 506, which is already the most heavily used exemption under the Act. In addition the JOBS Act broadens the space outside the regulatory reach of the Securities Exchange Act of 1934 ('34 Act) by raising the threshold that triggers '34 Act reporting obligations from 500 shareholders of record to 2000 (if most are accredited investors) and has facilitated IPOs (Initial Public Offerings) by permitting a new category of companies, Emerging Growth Companies, to avoid various regulatory requirements for up to five years after they go public.

In these various formulations, Congress acted to facilitate access to capital while at the same time protecting investors. More specifically, the paths chosen by Congress in the JOBS Act are well within the familiar template of securities regulation strategies: mandatory disclosure; agency review; a greater regulatory focus when sales pressure is more intense; and liability to spur due diligence by intermediaries and others. For example, crowdfunding includes a focus on intermediaries and section 12(a)(2)-like liability. Regulation A+ makes use of traditional disclosure, agency review, and Section 12(a)(2) liability. Efforts to evaluate the steps being taken to implement the Act ought to reflect this template.

### I. Crowdfunding

Crowdfunding, as reflected in the bill produced by Chairman McHenry and this subcommittee reflects the innovative premise of seeking to harness the “wisdom of crowds” to separate the good business plans from the deficient. The bill as passed by Congress caps the amount an issuer can raise at \$ 1 million over a twelve month period and has limits on what individual investors can invest. The challenge in this area is that when you are raising \$ 1 million or less, any fund raising and regulatory cost will quickly capture a large share of the amount to be raised. If regulatory bars are lowered to what seems like a cost-effective number, entrepreneurs will be able to seek out small investors who share their entrepreneurial (if sometimes risky) dream, but in this early-stage setting where firms don’t have an operating history, the chances of fraud also increase. The JOBS Act takes both of these concerns into account, but the economic reality of the overlap between the two seems to leave little room for robust use of this exemption. As the SEC looks for the path that would satisfy these concerns, perhaps the best focus would be encouraging a small number of registered portals who will be able to satisfy the SEC they have a sufficient plan for dealing with the inevitable temptations for abuse including possible fraud, exploitation of investor ignorance, and violation of issuer and investor caps. Such portals may be able to achieve some economics of scale in processes to deal with those concerns. To the extent these portals have a social welfare function and an interest in this area they may have additional incentives or resources to develop solutions to this challenge.

**II. Regulation A+**

The JOBS Act directs the SEC to promulgate a new set of rules under section 3(b) for offerings up to \$50 million, building on the current “mini-registration” process under Regulation A (17 C.F.R. §230.251 et seq.). As with crowdfunding it is important to focus on the economic realities that will hinder robust use of this exemption. The existing Regulation A (limited to \$5 million offerings) has shrunk to a point where it is seldom used today. For issuers it is a balance of the amount that can be raised, the costs to raise it, and the alternative routes to obtaining the same capital and the costs of those alternatives. The disclosure and other requirements of Regulation A are scaled to the smaller size, but issuers are also subject to state registration requirements which adds additional costs. The tenfold increase in the amount that can be raised in the new exemption, as compared to existing Regulation A, will permit more economies of scale than in the present regulation and may change the cost/benefit calculus for issuers thinking about using this exemption, at least at the upper reaches, but the comparison will always be made (and probably adversely) to either raising capital through 506 (newly expanded as discussed below) or a registered public offering.

**III. Expanded Use of Rule 506 with the Removal of the Ban on General Solicitation**

The largest impact of capital raising from the JOBS Act is likely to be in the expanded use of offerings under Rule 506. Offerings under this exemption have grown substantially even before the JOBS Act changes. Empirical data from SEC economists shows that for 2010 and the first part of 2011 issuers raised more money through private offerings of various types than

through registered public offerings.<sup>1</sup> Regulation D, and more particularly Rule 506 under Regulation D, was the largest component of the private offering realm. The JOBS Act makes this route even more attractive, directing the SEC to remove ban on general solicitation for Rule 506 offerings to accredited investors (and the great majority of all Regulation D offers today are made only to accredited investors). With the demise of this ban, we can expect more aggressive selling than we have had in the past, including more selling via the internet. I will focus on two points about this new 506 world: first, how a series of relaxations of the requirements for private offerings have occurred since the promulgation of Rule 506 and Regulation D in 1982 even while the threshold of accredited investors continues to have the same dollar threshold as three decades ago so that there is reason to ask if the concept of accredited investor has been stretched too far. Second this expanded space for 506 has an unexpected downstream effect in facilitating a growing resale market for such securities free of any investor protections from the '33 or '34 Act.

*A. The Private Offering Exemption now reaches a much broader section of the investor population than in 1933 or 1982 with fewer investor protections*

Private placements have been a part of the '33 Act from its enactment. James Landis, a principal drafter of the '33 Act and the SEC's second chair, explained the Section 4(2) exemption by reference to "sale of an issue to insurance companies or to a limited group of experienced

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<sup>1</sup> See VLAD IVANOV & SCOTT BAUGUESS, CAPITAL RAISING IN THE U.S.: THE SIGNIFICANCE OF UNREGISTERED OFFERINGS USING THE REGULATION D EXEMPTION (February 2012) available at [http://www.sec.gov/info/smallbus/acsec/acsec103111\\_analysis-reg-d-offering.pdf](http://www.sec.gov/info/smallbus/acsec/acsec103111_analysis-reg-d-offering.pdf)

investors."<sup>2</sup> There could only be a small number of offerees (25 in the earliest period), and they had to be linked to the issuer by access or relationship that would practically preclude an offering to a large number of investors. A ban on general solicitation of offerees was implicit in the approach to private placements from the beginning. Offers made to the public could not fit within an exemption specifically defined as non-public.

This early reading of the Section 4(2) exemption meant that such deals were negotiated, not sold. When a concentrated group of sophisticated purchasers negotiate with the issuer, they are in a position to bargain for information and its credibility, through the use of representations and warranties. But this early conception of what constituted an exempt private offering was ambiguous as well as limiting to entrepreneurs. In the 1970s and early 1980s, SEC rule-making provided a safe-harbor that effectively widened the exemption. The SEC's dramatic step came through a definition of "accredited investors" to create a class of persons whose wealth alone would satisfy this standard. The term included banks and institutional investors, but also individual investors with what were then distinctly upper class incomes (\$200,000 per year) or net worth (\$1,000,000).

Capital raising transactions under Rule 506, if directed solely at accredited investors, did not mandate disclosure, did not require sophistication or an offeree representative, and could be directed at an unlimited number of potential purchasers, without any upper dollar limit. Not only did this shift to wealth as a metric lessen the likely sophistication that purchasers would bring to the transactions, but it made salesmanship an attractive possibility. However, there were limitations that blunted the impact of this shift at the time of its adoption, limitations that

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<sup>2</sup> James M. Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 37 (1959-60).

have since eroded or fallen away. First was the dollar figure in the definition of accredited investor: in 1982, an income of \$200,000 or millionaire status in terms of net worth covered a relatively limited number of very well-off people, and did not affect all that many retail investors. That dollar amount hasn't changed in the three decades since even though inflation has brought more and more individuals within its definition, effectively extending its reach deeper into the cohort of those with smaller real incomes. Indeed measured as a percentage of the pool of individual taxpayers, the number of individuals whose income is above \$200,000 is now 20 times larger than at the time of enactment of Regulation D.<sup>3</sup>

A second change in the post 506 universe was the Supreme Court's 1995 decision in *Gustafson v. Alloyd Co.* (513 U.S. 561) that excluded private offerings from the reach of Section 12(a)(2) under the '33 Act, a change that relegated those transactions to a fraud-only regime under Rule 10b-5 or common law fraud. Such a liability regime could well be justified in a negotiated transaction with a small group of concentrated investors, but less so in a world where there is aggressive selling to a large number of unconnected investors. In addition, as discussed more below, Rule 506 offerings were restricted as to resale for a fairly lengthy period, meaning that those inclined to trade their securities would not be much interested in these kinds of transactions. At the time of Rule 506's promulgation, there was the possibility that state blue sky regulation would apply, which has since been preempted by federal law. Finally

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<sup>3</sup> Justin Bryan, High-Income Tax Returns for 2009 Stat. Income Bull, spring 2012 available at <http://www.irs.gov/pub/irs-soi/12insprbulhignincome.pdf> (reporting that \$200,000 in 1981 dollars would be \$319,508 in 2009 and that individual income tax returns at or above \$200,000 made up 0.145% of filed returns in 1981 versus 2.793% of returns in 2009. Thus the \$200,000 level corresponds to a percentage of individual income tax returns that is about twenty times higher than it was when the number was put into Regulation D in 1981.

there was the ban on general solicitations, removed by the JOBS Act as to offerings made only to accredited investors.

Certainly the concept of accredited investor has taken on more weight than it carried when it was put into Regulation D in 1982 and there is reason to ask if carries more weight than it should. Although the SEC's proposed rule-making in August stays close to the narrow charge from the JOBS Act to remove the ban on general solicitation, the cumulative effect of this change on the overall reach of Rule 506 illustrates the important need for the SEC to revisit its current numerical thresholds of the definition.

*B. The Resale Market for Private Offerings*

The removal of the ban on general solicitation also contributes to an as yet unrecognized impact on the growth of the resale market for securities initially issued in private offerings. Historically, shares issued via a private offering were difficult to resell so an investor bought them expecting to hold. This reflected market conditions as to the difficulty of matching buyers and sellers in a small and sometimes unique market, but it also reflected regulation. A resale could destroy the issuer's original exemption thus threatening the economic benefit of the exemption. The SEC did create a safe harbor in the early 1970s via Rule 144, but the holding period required to get into this safe harbor for stock that was not listed on a stock exchange or regularly traded was long enough (three years) to realistically discourage an initial investor buying with an intent to resell. However, things have changed, one market-driven and the other regulatory. Twice in the last 15 years, the SEC has reduced the holding period—from three years to two and then from two years to one- so that today an investor who buys in a Rule 506 offering need only hold the shares for 12 months before being

able to resell free of traditional '33 Act restrictions. Second, a market has developed for these securities. The demand for shares in Facebook prior to its IPO earlier this year brought attention to platforms like SecondMarket and SharesPost that provided a resale opportunity for Facebook shareholders and owners of other shares acquired in private offerings. The combination of market innovations and regulatory changes has meant that many more shares now change hands in a venue without mandatory disclosure or other investor protection. While this comes under the domain of the '34 Act discussed below, the expansion of Rule 506 after the lifting of the ban on general solicitation, will likewise expand the size of this resale market.

**IV. Changes to Section 12(g) of the '34 Act increasing the space for resales of securities outside of the '34 Act regulatory space.**

The three changes I have discussed so far turn on when issuers have to take on the obligations of the '33 Act, a threshold measured by whether they have made a registered public offering or instead come within the various exemptions provided by the '33 Act. In contrast, the obligations of the 1934 turn on being a reporting company, a status that has a more complex structure. Crossing any one of three thresholds requires a company to take on the obligations of the '34 Act. First being listed on a securities exchange, such as the New York Stock Exchange or Nasdaq, makes one a reporting company. Second, a company that makes a registered public offering, (even if it were not to then listed on an exchange) must meet most of the obligations of the Act. Third, a non-exchange, non-IPO company must still meet these obligations if it crosses the threshold as to size and number of shareholders. From 1964 until

the JOBS act, the number was 500 shareholders of record. The JOBS Act bumps that number by a factor of four to 2000, as long as not more than 499 are non-accredited. The result is that a company can grow much bigger without having to submit to the regulatory structures of the '34 Act. The practical effect of this change in 2012 is limited. Because of the three separate ways into the Act, only companies that choose not to list on the stock exchange or not to make a registered public offering can take advantage of this new unregulated space and most companies of that size still prefer the capital that can be raised from an IPO and the liquidity for shareholders that comes from an exchange listing. But as observers of changes in capital markets know, those financial facts are in a state of flux. Private equity and venture capital now provides a greater share of capital needs. And as the previous part of my remarks illustrate, the use of these sources via 506 is likely to accelerate. Similarly the platforms mentioned earlier, like SecondMarket and SharesPost can provide liquidity outside of an exchange listing, so that these two definitions will be less of a binding constraint going forward. We are looking at having an increased volume of shares traded in the resale market without the disclosure and other protections of the '34 Act.

There is also the greater possibility of evasion. The statutory standard since 1964, and even after JOBS, remains shareholders of record. This is the number of shareholders reflected on the corporation's share records. Since the back office crisis of the late 60s, there has been a massive switch to how securities are held with the shares in publicly held corporations almost always held in street name of a few large depository companies who in turn hold the shares for brokerage houses or banks, with the true beneficial owners never reflected in this count. It is also possible to use a corporation or trust as an entity to aggregate a larger number of owners,

an issue that got a flurry of attention as to Facebook in the year before its IPO. The JOBS Act contains a provision calling for a SEC study, but the increase to 2000 may well push this study off anyone radar screen for the foreseeable future. The likely result is an increase of companies that have a sufficiently large footprint as to affect the overall economy and have a large number of shares being traded in the resale market, but for which there is no mandatory disclosure. The discussion about capital raising while important to our economy, should not block a focus on the resale market and the value to capital raising that comes from a strong transparent resale market in shares.

Mr. MCHENRY. Thank you, Mr. Thompson.  
Mr. Ravikant.

#### STATEMENT OF NAVAL RAVIKANT

Mr. RAVIKANT. Thank you, Chairman McHenry and Garrett, Ranking Members Quigley and Waters, and the rest of the Committee members, I appreciate your having me here to speak.

I am the Founder and CEO of AngelList. We are the world's largest service for connecting technology startups and sophisticated investors. In less than two-and-a-half years we have helped 1,500 companies to meet VCs and angels for successful funding rounds, and our alumni have gone on to raise over \$1.1 billion on and off AngelList.

If you look at the map up there, there's 80,000 companies on AngelList today spread out over the entire United States, and we have connected companies in Colorado, here in D.C., Texas, Seattle, everywhere, to investors in Silicon Valley and New York.

There was some discussion here about the timing of the general solicitation and crowdfunding provisions, but I want you to know that the JOBS Act has already had a huge impact on us in our ecosystem.

If you go to the next slide, you will see that we recently launched AngelList Docs, which is regulatory compliance and financing closings online. This process puts \$20,000 into the pocket of every startup, and it reduces the burden of closing from a month to three days, and major law firms have signed up to do these closings for free. I mean, when is the last time your lawyer did anything for free?

Thanks to the JOBS Act, we had 250 companies sign up for this in two weeks, and that represents a net savings of \$5 million if they all use this product. That is in two weeks.

So obviously there is a discussion about general solicitation and crowdfunding coming up. Given our learnings, helping thousands of companies, we have just a little bit of advice on what people should keep in mind as we think about implementation.

On general solicitation, we think it is important that the verification of accredited investors be doable by third parties, whether it's people like ourselves or broker dealers or lawyers, so that an investor only has to go through the process once, and then the third party clearinghouse can help with the verification in the future and keep the cost low for issuers.

Crowdfunding is obviously a very complicated issue. On the one hand there has to be sufficient investor protection to prevent fraud, and, like I said, we have helped 1,500 companies raise money. To date we have had no reports of fraud.

On the other hand, if you make the burdens too high or the regulatory compliance too high, then the good companies will opt out of crowdfunding and they will raise money under 506 or other exemptions, and at that point you end up with a huge adverse selection problem. At least in our part of the world, a very small number of companies account for all the returns for investors. If those companies were to not use crowdfunding, crowdfunding would be dead on arrival.

So we think it is important that the SEC and the regulators help make crowdfunding more viable. Ways to do that are to allow the crowdfunding platforms to explicitly curate what deals they show. Kickstarter, for example, which is a celebrated poster child for crowdfunding, curates heavily. The SEC should provide clarity on liability issues and what qualifies as errors and omissions that may generate liability for the issuers. Otherwise, again, the good companies will avoid crowdfunding.

Finally, it is very important to keep this exemption, the crowdfunding exemption, compatible with raising from accredited investors. One of the best ways to protect the crowd in a crowdfunding situation is to also have sophisticated individual investors or VCs investing alongside on the same terms. So someone has done the due diligence.

Finally, I want to thank you for the JOBS Act. It is a very rare kind of accomplishment because the constituents that you are really helping with the JOBS Act are companies that don't yet exist, which is pretty rare. Normally there is a strong constituency already asking for whatever you work on; but in this case most of the constituents are yet to be created. I hope they will also create jobs that don't yet exist and pay taxes that don't yet exist.

We take a long view on this because we think that today's startups are tomorrow's Fortune 500 companies, and I think you have enabled a lot more of those given due time.

Thank you very much.

[Prepared statement of Mr. Ravikant follows:]

The House Financial Services Committee  
The House Oversight And Government Reform Committee  
Joint Subcommittee Hearing on JOBS Act Implementation  
September 13, 2012

Written comments for the record  
Naval Ravikant  
CEO, AngelList  
San Francisco, California

Chairman McHenry and Garrett, and Ranking Members Quigley and Waters, and the rest of the Committee Members, thank you for this opportunity to speak.

I am the founder and CEO of AngelList, the largest service in the world for connecting technology startups and sophisticated investors. With support from backers like the Kauffman Foundation, AngelList has connected over 1,500 new companies with thousands of angel investors and Venture Capital firms that backed them. Our alumni companies have gone on to raise over \$1.1 Billion to hire people and build self-sustaining businesses. Companies that used AngelList, like Uber, Pinterest, and BranchOut are well on their way to becoming household names.

We also regularly feature startups outside of Silicon Valley and New York that may otherwise escape investor attention. For example, Veenome and FastCustomer, based right here in DC, Precog, based in Boulder, Colorado, Ordoro, based in Texas, and dozens of other companies located outside of major funding hubs have recently found investors via AngelList.

A few months ago, we launched AngelList Talent to place job-seekers into these fast-growing young companies. In less than six months, we have arranged around 14,000 interviews between hiring startups and people looking for work. Kickstarter, Khan Academy, Votizen, blogging giant Wordpress, and 1,300 other fast-growing companies are meeting potential employees on AngelList. Today's small startups are tomorrow's Fortune 500 employers. According to the Kauffman Foundation, companies less than 10 years old are responsible for all net job growth in the US, and we want to make that easier and faster to accomplish.

We are grateful for The JOBS Act as it updates regulations designed for a pre-Internet era, and allows us to roll out new services that help young companies. For example, enabled by provisions in the JOBS Act, we launched "AngelList Docs." This product automates the financing and regulatory compliance process for new startups. We have reduced the time and burden for legal closings of financing rounds from months to days, and from tens of thousands of dollars to zero. Law firms like Wilson Sonsini Goodrich & Rosati have lent their support by offering to close the financings for free if their clients use AngelList Docs. When was the last time your lawyer did anything for free?

Companies using AngelList Docs are saving \$20,000 of dead-weight loss in a financing where as little as \$100,000 might be raised - money better used to hire, and time better used to innovate.

Of course, most of the impact on the startup community is yet to come.

First up, General Solicitation. We support the SEC's reasons for proposing tighter verification of accredited status when a company discusses their financing publicly. We also appreciate that the SEC left the existing rules in place for companies that do not. Under the SEC's latest proposal, the existing "reasonable belief" standard will continue to apply when the offerings remain private, as they do today when conducted through AngelList.

However, when implementing the tighter verification standard when general solicitation is employed, we respectfully ask that the SEC consider that the tens of thousands of new companies using AngelList are tiny and under-resourced. Rules that seem obvious to us may confuse and distract entrepreneurs. Just as we maintain workflow processes and terms of service to track and simplify compliance with the current rule against general solicitation, we will attempt to automate the new standards that evolve under the heightened verification requirement. If platforms like AngelList can take the burden off entrepreneurs by providing 3<sup>rd</sup> party verification of investor accredited status, we can help startups remain compliant.

Second, Crowdfunding. We realize that the SEC has a very difficult task ahead of it. Critics have argued loose rules may invite fraud. Rules that are too tight, however, may repel the good companies - the ones who drive all of the economic returns for investors. We should avoid a perverse outcome in which crowdfunding becomes associated with desperate companies guaranteed to be bad investments. We should not create a mechanism in which a company must choose either crowdfunding or sophisticated, accredited funding. One of the best mechanisms to protect the crowd is to ensure that a self-interested, sophisticated investor has purchased the same security on similar terms.

Tim Rowe's congressional testimony cited AngelList as a model for how Funding Portals envisioned in the JOBS Act could avoid fraud. We respectfully offer several suggestions based on our experience:

1. Discourage fraud by allowing Funding Portals to "curate" – decide what gets featured and what gets buried on the site and in communications. Non-equity crowdfunding sites such as Kickstarter, curate heavily to avoid becoming hotbeds of fraud. Clearly, funding portals should not receive separate compensation tied to such curation.

2. Provide clarity on what qualifies as errors and omissions. The different liability rules for crowdfunding and accredited investments means that companies may be pushed to choose between them rather than doing both.
3. Keep crowdfunding compatible with fundraising from accredited investors. We **must** encourage sophisticated, accredited investors and the crowd to invest in the same security. Otherwise there is nobody to thoroughly vet the companies and negotiate the terms for the crowd.

We support the SEC in its rulemaking here, and encourage the Self-Regulating Organization efforts. However, AngelList will not offer crowdfunding unless we are sure the regulations will allow us to attract and curate good companies, and allow those companies to raise without creating undue liability for themselves.

A final thought - I encourage the SEC to move with all due speed and clarity. In our fast-moving tech startup world, we are witnessing the premature launch of businesses that provide crowdfunding-like services of questionable legality, putting both investors and companies at risk. This puts competitive pressure on the others – by our count there are over a hundred companies waiting in the wings to try this and may be tempted to jump the gun. Delays in enforcement or clarity about when regulations are enacted will feed this fire.

Finally, we want to say Thank You to Washington. The JOBS Act is a rare bipartisan success, and helps one of the least connected but most important constituents - companies that don't yet exist. The startup community isn't accustomed to this attention and help from both sides of the aisle, and we deeply appreciate it. Thank you for helping these future companies. They will create the jobs that don't yet exist, pay the taxes that aren't yet paid, and create the incredible products and services that we cannot yet imagine.

Mr. MCHENRY. Thank you so much for your testimony. It is very exciting to hear what the panel is doing. And I would say before I begin my questions is that, you know, we are focused on both capital formation and ensuring investor protection. Investor protection is not forgotten in either the JOBS Act nor SEC regulation nor crowdfunding portals as they currently exist or angel investing networks. Capital formation is inhibited when you have fraud. It is bad for market participants, bad for startups, and obviously bad for those that are victims of this. So robust investor protection is highly important, and I obviously care deeply about that.

With that I would recognize myself for five minutes for purposes of questions.

Mr. Ravikant and Mr. Eakin, if I could ask you, do you believe that non-accredited investors are harmed by seeing advertisements that are directed towards accredited investors?

Mr. RAVIKANT. Well, that is a fair question. I don't think there is any harm in actually seeing it, as long as they don't make those investments.

Mr. EAKIN. Agreed.

Mr. MCHENRY. Okay. Well, we will start there with some commonality here.

Ms. Verduyck, you outlined you spent a significant amount of your time trying to raise capital. Do these regulatory restrictions on your ability to raise capital, did that inhibit your ability to grow your business and create jobs?

Ms. VERCRUYSSSE. Yes. I feel that it does because not only you have to find those people that are willing, it is a lot harder to find people that are willing to invest in your company, and that is why it takes so much time. Whereas if I could just go to my loyal customer base that already believe in what I am doing, because we were actually told even on Facebook a customer said, I love your bars. How can I invest in your company? Well, I said right now you can go out and buy a bar and that is how you are investing in our company, because the current law forbid me from engaging him.

Mr. MCHENRY. And to that point, lifting the ban on general solicitation, the SEC just a few weeks ago, instead of making a final rule or interim final rule, they basically put forward a proposal on lifting the ban on general solicitation. Mr. Eakin, what affect does that have on linking up capital and creating jobs?

Mr. EAKIN. Lifting the ban will have a tremendous positive affect on helping more businesses reach out to more investors. We believe that the platforms like CircleUp provide an efficient way to start the conversation. Investors maintain the ability to conduct their diligence, to thoughtfully review investment opportunities, but it allows a spark to start conversation.

Mr. MCHENRY. So not putting forward a rule that can be used now inhibits job growth and the flow of capital? Is that what you are saying?

Mr. EAKIN. We are looking forward to the implementation of title two of the JOBS Act.

Mr. MCHENRY. Okay. All right. So Mr. Thompson, you outlined a couple of things dealing with crowdfunding that are of particular interest to me. I have an idea, as something I have put forward to the Commission, that they have enormous latitude for how they

implement and write the rules dealing with crowdfunding. What I put forward is this idea that we can start just by having as much freedom as possible to raise capital up to \$100,000 as sort of a first step for raising up to a million dollars. Would you think that that is workable, that the Commission open up first a lower space, see how that forms, and learn some best principles, best practices out of that, then keep raising it?

Mr. THOMPSON. I think scaled enforcement has been a core part of securities regulation for decades, and that means lower burdens for lower amounts, and what benefits can be achieved, and so I think focusing at a smaller amount, \$100,000 as a good try, and see what works there, and if we can figure out something that works there with some prerequisites, it might well work.

Mr. MCHENRY. Okay. And Mr. Van Winkle and Mr. Ravikant, you both outlined that you are concerned about crowdfunding as how it is implemented and whether or not you can actually have a robust marketplace in core participation, and, lacking that, it will be, I would say to Mr. Van Winkle's comment, it was dead on the vine, I think is how you termed it.

Mr. VAN WINKLE. A dead letter.

Mr. MCHENRY. Dead letter?

Mr. VAN WINKLE. Yes.

Mr. MCHENRY. Thank you.

Mr. VAN WINKLE. If issuers need to go through too much of a process, a disclosure process, as Mr. Thompson indicated, they are going to look at other exemptions for the amount that is available through a crowdfunding portal. If you took too much of your money in trying that you might raise in compliance, it is not a good exemption.

Mr. MCHENRY. Mr. Ravikant?

Mr. RAVIKANT. Yes. I would add that we don't want to create a situation where only the desperate companies use crowdfunding. It should be used by top tier companies and that means that the regulations have to be streamlined and comprehensible.

Mr. MCHENRY. To that, Mr. Ravikant, you outlined what AngelList is currently doing. How is AngelList using the JOBS Act right now to link up capital and help small businesses?

Mr. RAVIKANT. Right now we only connect accredited investors and obviously don't engage in general solicitation, so it is somewhat limited in its nature, and it will be opened up more after the full implementation of the JOBS Act.

Mr. MCHENRY. Okay. So a lot more to come after full implementation?

Mr. RAVIKANT. We always like to lead with a product as soon as the law allows it.

Mr. MCHENRY. All right. Excellent.

Thank you so much for your testimony. Thank you for being here. And thank you for what you are doing to help create jobs.

With that, Mr. Quigley is recognized for five minutes.

Mr. QUIGLEY. Thank you, Mr. Chairman.

I supported both these measures very strongly, and I know the Administration did, and I don't see any reason why I or the Administration want to win the race. I am not pulling for one of these

acts over the other to cross the finish line, but they are both complicated.

Mr. Thompson, you talked about what seems to me the real challenge and the real intense dichotomy of trying to address this issue of crowdfunding is the smaller amounts. Any kind of regulation eats up what you are actually trying to collect, but, on the other hand, when you are dealing with small amounts in the manner in which we are talking, we are talking about less-sophisticated investors.

If you could give a few specific ways to try to address that if you were advising the SEC.

Mr. THOMPSON. I think one way is to try to bring in a third party to carry some of the load. And if the portals, as Mr. Ravikant suggested in one of his slides, can carry some of the load of verification or regularization, then the costs go down, and so I think the SEC might well want to look at focusing on a subset of portals who have the capacity and the affinity to want to support capital raising and are willing to commit some of their resources toward developing the platform that will reduce the amount of fraud, as opposed to making it all on the sellers who have sometimes overly addressed an incentive to sell and get the balance wrong.

So I think the portal focus has potential in dealing with this small amount.

Mr. QUIGLEY. Mr. Ravikant, you talked in your testimony, I think it is along the same lines: the sophisticated investors alongside the unsophisticated. Is that the manner in which you described what Mr. Thompson is saying?

Mr. RAVIKANT. Yes. I would say it is a couple of things. As Mr. Thompson said, the portals can help in the prevention of fraud, but the SEC has to enable that. The examples I would give are, number one, we can help curate the deals. We have lots and lots and lots of data on these deals, as well as competitive companies and so forth, so by curation we can help the investors get some data.

We can build in tools for transparency. We don't want the reputation of being a hotbed for fraud, obviously, or the investors won't come, and since we deal with a lot of sophisticated investors we would put in a lot of protections.

One other protection which I talked about which you just referred to is having the sophisticated investors invest alongside the crowd on the same terms, but that may be uniquely possible for us for tech startups. It may not be possible for other local businesses or consumer goods startups where you don't have a large native base of sophisticated investors.

Mr. QUIGLEY. And Mr. Van Winkle, you understand—and I know you agree—that this is an extraordinary opportunity for investment for small businesses, but we want to get it right, as to the point that you don't want this to be viewed in a few years as a reservoir for people who are out to milk unsophisticated investors.

Mr. VAN WINKLE. I would agree with that.

Mr. QUIGLEY. What is your thought on how to balance this?

Mr. VAN WINKLE. I think the elimination of the public advertising and solicitation ban has been talked about by practitioners for a long time, that as the markets have matured, investors are selective, whether a small investor or a larger. We heard described

by a panel, they had to go out and seek many people who turned them down at times because they would have to keep going. I expect that will continue on, that we are not going to see a sea change of the investing public because the laws change. What this will do is it will create many more opportunities to connect folks, and the existing anti-fraud protections will continue to protect those investors.

I think it will enhance the opportunity to raise capital without injuring investors.

Mr. QUIGLEY. Ms. Verduyck, your personal experience in that vein, you would also agree that these are sometimes very small investors for the first time, and the reputation of this type of investments is just as important as your ability to get them, is key to it?

Ms. VERDUYCK. I agree. Was there a question there?

Mr. QUIGLEY. No, I just wanted to see your personal experience, particularly with smaller investors, their concerns about something along the lines. They are typically used to investing in Quaker, as you said. You are a little different. So the reputation of a pool like this is as important as anything you do.

Ms. VERDUYCK. I think this speaks to what you are talking about, but what I like to do is be really transparent about where we are as a company, and it is actually a lot easier for them to embrace a company of our size. The financials are very simple, you know, and our expenses are very easy. We have marketing costs and payroll and a little bit of research and development, but it is very easily understood by a non-savvy investor by just having a couple of conversations with them.

And then by seeing the financials they can see where their money is going, and then also by seeing us out in the community actually selling products they can see that we are actually selling a viable product.

Mr. QUIGLEY. Great. Thank you.

Mr. GARRETT [presiding]. Thank you. The gentleman yields back, and I will recognize myself for five minutes.

Again I thank the panel, and I also thank the panel specifically for their entrepreneurial spirit, which is what makes America great.

This morning, before I came here, the professor was teaching classes, and I was on C-Span doing a TV interview. The questions that were coming to us, Why isn't there more bipartisanship in Congress and why doesn't both sides of the aisle just put controversies aside and work together? And I could actually point to this piece of legislation, and I mentioned actually Ms. Waters name on there, and actually there is legislation that we have worked together on, and we have worked together to be able to pass it through our subcommittee, full committee, and right on through the process. I said, don't always believe everything you read in the newspaper as far as all the antagonism.

The JOBS Act is an example of true bipartisanship, but that is what happened here in Congress, and then it gets out to what we always like to call the bureaucrats. In this case, the bureaucrats fall into the category of the regulators or the SEC who put—what

I am hearing from the panel, effectively an impediment to the will of Congress.

I know the gentleman from Connecticut was here earlier—I guess he is not here right now—and he talked about how in the military there is a process called a stand-down, when they see that something is going wrong first they stand down and see what is wrong and then go forward from that. If that had occurred in the situation in the last session of Congress when we had the financial meltdown of 2008, and then there was a stand-down into a thoughtful analysis of actually what the problems were that led up to that, and we then passed a piece of legislation that resolved that problem, that would be an appropriate stand-down in resolve and reform, but we didn't have that. We had a 2,000 page Dodd-Frank that came from it addressing all sorts of areas that were not the cause of the problem, and then not addressing areas such as this one that could actually help us get out of the morass that we are in.

So with that, I throw this to the panel, and maybe Mr. Eakin or any other members might want to talk about this. We have already heard somewhat of the effect of the SEC's standing in the way of the will of Congress and what the impediment will be to the cost of industry.

If we look at Commissioner Agilar's statement, it appears he wants to create a whole new set of regulations to impede capital formation, and, as I said, that runs directly counter to the initial intent of the JOBS Act. And his dissent is entitled, actually, "Increasing the Vulnerability of Investors."

So starting with you, Mr. Eakin, I don't know whether you read that dissent or not, but the caption, "Increasing the Vulnerability of Investors," is that what Congress was doing when we passed the JOBS Act? Was that our intention? Were we increasing the vulnerability of investors who might want to invest in this granola bar company next to you?

Mr. EAKIN. That would be the interpretation of Commissioner Agilar's words to himself on that one.

Mr. GARRETT. Okay.

Mr. EAKIN. We support the full implementation of the JOBS Act as written and believe increased transparency and accountability in the marketplace is in the funding portals under the oversight of a strong SRO, and the SEC will improve the capital formation in the Country.

Mr. GARRETT. Anyone else on that? Mr. Van Winkle?

Mr. VAN WINKLE. I would simply say that there are people standing on the sidelines waiting to see how, for example, crowdfunding regulations are going to look and what is going to be required. They are prepared to move forward, put their offering of their business out there and connect that capital with the business. We think that will be very beneficial. I believe that is what Congress and the President wanted with the passage of this act.

Mr. GARRETT. Can you also just explain, since you are speaking, in your testimony you talk about how existing security laws pose an unreasonable burden on the ability of small firms to access the capital markets, harming economic growth and job creation? Those are some of your words?

Mr. VAN WINKLE. That is correct. So the framework before—  
Mr. GARRETT. Yes.

Mr. VAN WINKLE.—the JOBS Act was such that it is very difficult for the small issuer that is out there that is looking for capital to connect. Those networks aren't there. They need to be able to have more opportunities to be able to connect.

The ban on solicitation, the removal of that will be very helpful in connecting those folks. These investors often will still pass on the ideal. They may not understand it. Maybe it is not as simple or straightforward as they thought, so they will walk away. But there will be transparency, as Mr. Eakin indicated, and we think that will be very helpful.

Mr. GARRETT. I think Mr. Quigley raises a good point. Mr. Thompson and Mr. Ravikant, can you address it a little more fully? If I'm the investor going forward with the JOBS Act as Congress wanted it to be implemented, why should I feel assured that I, as an investor, maybe not a sophisticated investor, would have adequate protection under congressional intent with the JOBS Act?

Mr. THOMPSON. The act, itself, it is not just a blank sheet. It contains a large number of guidelines for implementation. It says SEC do it, and here is what you should do: disclosure, intermediaries, liability. All of that is in there.

Mr. GARRETT. Mr. Ravikant?

Mr. RAVIKANT. Yes, I would say the portals, like ourselves and Mr. Eakin's portal, will bend over backwards to try and prevent fraud. There is no such thing as a completely fool-proof system, but our reputations and businesses are on the line.

Mr. GARRETT. Gotcha. And with that, I see that I am over time, so I thank you very much for the panel.

The gentlelady from California.

Ms. WATERS. Thank you very much. Mr. Chairman, I would like to thank all of our participants in our panels here today, but I am especially pleased about Ms. Verduyck for your appearance here today.

When I talk about business, small business and entrepreneurs, I really like to talk to people who do it, who have their hands on, who have to meet that payroll, who understand what it really means to have to go out and find investors and money. Consultants and lawyers and all that are fine, but I really appreciate your being here today and the way that you have described the development of your business.

I also know that oftentimes you must seek capital from various sources, and I am very pleased to see that you were able to get that micro loan of \$25,000. That was part of the American Recovery and Investment Act, so that makes me feel good that what we did is real, and that is certainly had a positive impact on businesses such as yours.

So again I appreciate your being here. As a matter of fact, I worry a little bit about the time that you are spending on this, because I know you must spend that time in your business, a small business like that where you are hands on. You don't need to be sitting up here in Congress for hours talking about whether or not they are moving fast enough.

The JOBS Act is real and it is going to happen, and I want to tell you, even with Dodd-Frank, what we have been doing, and oftentimes in a bipartisan way. We are looking at the soft spots, the gray areas, and we have had remarkable cooperation from both sides of the aisle on straightening out some of these things in Dodd-Frank, and I think that the JOBS Act, between SEC and all of us who care about this, we will do that, so I am very confident.

I would like to, if I may, Mr. Chairman, I would like unanimous consent to insert into the record a letter that was written to us by many of those consumers and organizations that are paying attention to this particular legislation.

This letter was sent to the Securities and Exchange Commission related to the rulemaking on general solicitation and advertising under JOBS Act by a group of consumer and investor advocates, including Americans for Financial Reform, Public Citizen and Consumer Federation of America, among others.

First, this comment letter from the group says that they would have opposed the SEC going straight to an interim final rule on general solicitation and advertising because they believe there were a number of issues that were in their public comment period.

I would like to know, Mr. Thompson, do you think that it is reasonable that the SEC propose a rule on this issue rather than going straight to an interim final rule, given that the ban on general solicitation and advertising that the JOBS Act lists has been in place for decades? Should the implementation of its repeal be open to a robust dialogue?

Mr. THOMPSON. The SEC rulemaking is never the end of the story, and certainly in recent years what happens after rulemaking is litigation, with a focus on cost/benefit analysis. That has been a grave concern of members of this Committee. So the SEC has to worry about will its rulemaking stand up to challenge that is likely to come, and that suggests paying attention to notice and comment, having a period of notice of comment, reflecting on what is commented, and then making the final rule.

So by not doing that, I think the SEC was increasing the risk of litigation and increasing the risk of the rule not being implemented as quickly as it might otherwise.

Ms. WATERS. Thank you very much.

Just quickly to Mr. Ravikant, I want you to know that some of the comments of members of this panel about our small businesses not having to spend their limited capital trying to be in compliance is something that I certainly am concerned about and I support, and the idea of a portal or portals that could help with that I think is extremely attractive. But, having said that, as someone who works in the world of rules, do you think it is fair to say that the SEC should move slowly and deliberately with the way it lifts the general solicitation ban?

Mr. RAVIKANT. Yes. It honestly impacts us less because of the nature of the companies that we work with already have access to sophisticated investors. That said, the strange part is that a lot of companies accidentally or not knowingly violate the general solicitation ban on a regular basis, so in that sense it does need to be modernized quickly.

To give you an example, this morning my fiance forwarded me a video on You Tube pitching me to invest in a startup, me personally, so this company had gone and made a rap video singing about me and hoping I would invest in their company. Now clearly that is a violation of the general solicitation ban. I don't think they will be harmed by it because it was addressed to me, but it shouldn't be sitting on You Tube. So things do need to be modernized.

Ms. WATERS. Thank you. Mr. Chairman, I yield back the balance of time I don't have.

Mr. SCHWEIKERT. [Presiding]. Thank you, though I am still trying to get my head around rap solicitation.

Dr. Hayworth?

Ms. WATSON. Sounds good to me.

Ms. HAYWORTH. Thank you, Mr. Chairman.

Mr. Ravikant, you rap star fan base aside—that is really big, actually—but I was interested in your comments about the cost of regulation and, of course, the entire panel has alluded to them, as well, but I think the big theme that we face in this Congress and in this Committee, of course, is that we are trying to balance consumer protections, investor protections, with the cost of, as Ms. Vercruyse has described so eloquently, with the cost of trying to navigate that system.

We can keep layering on requirement after requirement, sort of suspenders, duct tape, you name it. But, as you have pointed out, eventually it stifles growth, in fact, relatively quickly.

Could you comment a bit further in particular about the liability issues that are also incurred, because I think one of the subtexts of the regulatory burdens is not only the cost of compliance per se but also the anticipated cost potentially of liability. Could you talk a bit more about that?

Mr. RAVIKANT. Yes. I am really not an expert in this area, but my understanding is that, as part of the JOBS Act crowdfunding provision, that the directors and officers of the companies are directly liability for any material errors and omissions, so what we are basically asking there for is some kind of a checklist for the SEC as to what disclosures a company should go through, and then know that it is not subject to potential liability in ex post facto manner, and that will help issuers have some comfort on using crowdfunding.

Part of the problem is those liability provisions do not exist on the 506 exemption side, so a company going into crowdfunding is going to have that additional burden, so the more streamlined that process can be, the more transparent, a checklist or a set of guidelines would definitely help a lot.

Dr. HAYWORTH. Thank you, Mr. Ravikant.

Mr. Thompson, can you speak to that issue, as well?

Mr. THOMPSON. Sure. As Mr. Ravikant said, 506 doesn't have liability because of the Gutherson v. Alloy case from 15 years ago, but crowdfunding does. And it is 12(a)(2) like, which I'm not sure what that means, but someone who drafted it must know what it means, but there is some liability there. And so that is why I think many investors will be using 506 instead of crowdfunding.

Is there a way to give some safe harbor? I think the rulemaking for that hasn't come yet. It is not due yet. I think you will see some attention paid to that.

It is hard to do, so I can't predict it, but I don't know exactly how it is going to look.

Dr. HAYWORTH. Would any of our other panelists care to comment? Ms. Vercruysse, does that play on your mind when you think about how you interact with potential investors?

Ms. VERCRUYSSSE. The part about the liability?

Dr. HAYWORTH. About being held liable.

Ms. VERCRUYSSSE. Well, I just have to speak to my own personal experience, and that is that I was just asked by one of my business partners, actually, and he is a major investor in my company, whether I had D and O insurance to protect against that. That is how we would do it.

But I, as an entrepreneur, didn't know before about the existence of D and O insurance, than that leaves my husband and I completely liable if we don't have that.

Dr. HAYWORTH. Right. Mr. Eakin, is that—

Mr. EAKIN. I very much agree with Mr. Ravikant's sentiments in having a healthy, attractive ecosystem of companies wanting to use this provision, and one way to do that is providing clear guidance to those issuers of how they can protect themselves from the liability perspective.

Dr. HAYWORTH. Right. Thank you very much.

I yield back, Mr. Chairman.

Mr. SCHWEIKERT. Thank you.

Ms. Maloney?

Ms. MALONEY. Thank you, Mr. Chairman. Thank you for holding this hearing. I welcome all of you.

First, I would like to say that I supported the JOBS Act and I worked with my colleague, Mr. McHenry, on the crowdfunding provision of the bill because I believe that we should be able to have all kinds of tools, investors and companies, at their disposal to grow and create jobs.

I appreciate Mr. McHenry accepting one of my amendments to make SEC oversight of these sites more robust and to combat against bad actors.

The JOBS Act just became law in April, and we have had 90 days, and said it should be done in 90 days, and no question we are past that time, but I don't think any of us feel that we don't need to get it right, especially since the SEC's job is to protect investors and guard against the bad actors.

I would like to ask Mr. Thompson, despite the well-established need for financial regulation reform—we are still recovering from this great recession—the majority has made considerable efforts to delay implementation of the Dodd-Frank financial reform bill, while supporting, in contrast, an expedited implementation of the JOBS Act. I, for one, think we should finish the rules on Dodd-Frank first. But I am concerned that the majority's attempt to rush the JOBS Act could severely weaken investors' protections and the integrity of American capital markets.

In your written testimony, Mr. Thompson, you stated—and I would like to quote your words back to you—the largest impact of

raising capital from the JOBS Act is likely to be in the expanded use of offerings under Rule 506.” That is offerings issued after the removal of the ban on general solicitation; is that correct? And if that is correct, the implementation of Section 201 is no small matter; would you agree?

Mr. THOMPSON. It will be the biggest impact because it is already the largest source of capital raising, and once general solicitation is removed it will be get even bigger. And so it is appropriate that it is first on the list. But the SEC has got a lot of balls in the air. They have to do them all. There were 90 sections of Dodd-Frank that required them to do something. I mentioned there were two new exemptions under JOBS. They are doing them all.

I think 506 needs to be a focus. They have still got a 506 regulation from Dodd-Frank to remove the bad boy, to add a bad boy exemption to 506. That was proposed a year ago. I think, given the use of 506, that rule needs to keep moving.

Ms. MALONEY. I agree.

Mr. THOMPSON. So I think all these 506 rules ought to be on the table first.

Ms. MALONEY. I agree. And Chairwoman Shapiro stated that she is giving serious consideration to all of these rulemaking approaches, and she says—and I will quote from her letter—“Due to the high level investor interest and strong desire for a comment period expressed by a number of commentators in the public; however, upon further reflection and analysis I now believe that the more appropriate approach in this matter is to proceed per our normal notice and comment process.” This was in response to Mr. McHenry’s letter that she should bypass the normal notice and comment process.

I think something that is so serious, to protect investors, and the fact that the public has notified the SEC that they want to comment on it, I just want to know, if you agree that the approach the Commission has decided to use for 201 to allow for the comment period is important. Do you agree, Mr. Thompson?

Mr. THOMPSON. I agree, and I think it also assists looking ahead toward litigation because the shorter the interim final has the potential to increase the challenge to the rules that are implemented.

Ms. MALONEY. And Mr. McHenry goes on in his letter to request internal documents and communications related to “potential Commission action to implement section 201 of the JOBS Act.” And this Committee has a legitimate role to conduct oversight, but in this case the agency is simply following the normal rulemaking process, and I would argue that their demands and documentations is just adding to the time when she is following the normal rulemaking process which allows a comment period.

I would say that their actions are somewhat disingenuous, particularly when they have voted to underfund the SEC. They wanted a cost/benefit analysis, and tried to pass that. Believe me, if you pass the cost/benefit analysis, we never would have gotten to any rules. And their real action to sort of stonewall and stop the implementation of Dodd-Frank.

And I would like to respond to Mr. Van Winkle that you are saying the money is on the sidelines because we have to come forward with the rules, but if you look at all the analyses that are coming

out from the economists, whether it is Zandy or with McCain's economists or Krugman from the Times or any of them, they are all saying that money is on the sidelines waiting for the election, that is the real reason. I have read about five different reports on that, not the fact that the rule isn't in place. And I would say that the JOBS Act went into effect, and I think it is very important that the SEC get it right when it comes to protecting investors.

My time has expired and I yield back and I thank the Chairman.

Mr. SCHWEIKERT. You caught me not paying close enough attention.

Mr. Canseco?

Mr. CANSECO. Thank you, Mr. Chairman.

One of the biggest concerns I have with the SEC's proposed rule is the verification of accredited investors. It seems the proposed rule would disincentivize the issuance of new securities for fear of legal retribution.

Mr. Van Winkle, you allude in your testimony to issuers currently being able to rely on written statements from investors that they are accredited. Could you explain why the new standards set by the SEC in its proposed rule is a problem and how it could minimize the positive effect of the JOBS Act?

Mr. VAN WINKLE. The proposed rule, I don't think it minimizes that. Under its current structure, what I described, it is 40 years of tradition of inquiring of an investor, Are you accredited, Do you meet these standards, and telling the issuer. The issuer typically has some basis of knowing that or has had some connection with that person. The proposed rule gives room for the issuer to continue to sort out what makes sense, and will be able to verify that.

So if the proposed rule is implemented as it is currently written, I think it will create the right playing field for the JOBS Act implementation to move forward.

Mr. CANSECO. Do you think that the proposed rules are a little too subjective?

Mr. VAN WINKLE. I don't think, based on what I know now, that they are too subjective. We may know more two years from now, but there's plenty of protection in place to keep issuers honest. Quite honestly, what we heard today is that issuers want to tell about what is going on in their companies. That has been my experience in my practice, that issuers want to disclose that information. That is what is going to keep the honesty going in the system.

Mr. CANSECO. As I understand it, if the SEC rule were to become final there would be a double standard for investor accreditation. Issuers using new solicitation exemption would be held to a different standard than other issuers. Now, Mr. Van Winkle, do you believe that could create a problem?

Mr. VAN WINKLE. I am certain someone could find a problem, but I think we are concerned that we want to make sure that the existing exemption, if you are clearly not using general solicitation, that you can continue to follow that pattern; whereas the issuers who are seeking to find a broader expanse of investors may have a slightly different standard to apply and they will sort through that.

Mr. CANSECO. So if an investor were to put in writing and under a contract that they need certain net worth or income requirements

to purchase private issued security, do you think that is sufficient information for an issuer to rely on?

Mr. VAN WINKLE. Yes.

Mr. CANSECO. Even under the current proposed rules?

Mr. VAN WINKLE. Under circumstances, that may be very correct, but as you allude to, the subjective nature of it, the flexibility means that the issuer will look at, Is this the appropriate investigation for this level? And we do that all today in practice. We make sure that there is a relationship that is established and there has been appropriate verification.

Mr. CANSECO. So in your opinion did the SEC go far beyond what Congress asked it to do with its proposed rule on solicitation?

Mr. VAN WINKLE. The proposed rule seems to be aligned with what I understand Congress' intent was with the JOBS Act.

Mr. CANSECO. Okay. So one other question, Mr. Van Winkle. The JOBS Act received a fair amount of criticism from certain groups who argued it could lead to increased fraud or that it somehow relaxed standards and increased risk to investors.

You mentioned in your testimony, but could you explain why fraud protections are not weakened by the JOBS Act, and do you believe that the SEC erred on the side of over-caution, thus damaging the intent of the JOBS Act?

Mr. VAN WINKLE. The JOBS Act, title two of it, greatly expands the opportunity in the potential investor pool. That may or may not lead to higher probability of fraud. I don't know. What I do know is that the concern is that there are more issuers that would be causing fraud by not disclosing, so the disclosure regime is still going to remain for issuers under rule 506. They still need to disclose what they are supposed to disclose.

I can't predict whether or not we have more potential investors, whether there will be more fraud. I think the fear is that there will be people just coming out of the woodwork who are advertising fake businesses. I mean, that is what I—my experience has been that issuers are very concerned about making sure that they have a reliable and viable business before they bring in investors.

Mr. CANSECO. Thank you, Mr. Van Winkle. I see that my time has expired.

Mr. SCHWEIKERT. Yes. This time I was paying attention to the time. Thanks, Mr. Canseco.

Mr. Lynch?

Mr. LYNCH. Thank you, Mr. Chairman.

Let's stay right on that point about the fear of investor fraud. Many observers believe that the most significant provision of the JOBS Act is, in fact, at least from an investor fraud standpoint, the elimination of the ban on general solicitation and advertising for section 506 offerings. Indeed, I recall a statement by Chairman Shapiro. Actually, I will quote her. This is right before the JOBS Act passed. She said, "We must balance our responsibility to facilitate capital formation with our obligation to protect investors in our markets." And she goes on to say, "I am concerned that we lack a clear understanding of the impact that this legislation and its exemptions would have on investor protection."

And sort of echoing what you just said, Mr. Van Winkle, the New York Times editorial board, which I don't normally quote—this is

a first—said, this is two days after the SEC issued its proposed rule, said “Soon retirees and other investors will be barraged with advertisements for private stock offerings. Such advertising that used to be banned under Federal securities law will make it easier for hucksters and ripoff artists to lure people into unsuitable investment and outright frauds because private offerings are not subject to the disclosure requirements and other investor protections that apply to publicly held companies.”

What do you think about the concerns raised there? I mean, given the fact that a lot of people, even before this relaxation, had trouble really discerning the disclosures to begin with, and those were more sophisticated investors. Now we are going to have general solicitations. Do you think that presents a danger to the market and to average investors?

Mr. VAN WINKLE. There are a number of pieces to that question. I can just observe these comments in response. Maybe it is helpful. It is assumed that there are going to be many more issuers that are going to be promoting businesses that are fraudulent. I guess that is—

Mr. LYNCH. Well, there is more opportunity for fraud.

Mr. VAN WINKLE. Because we have more investors potentially?

Mr. LYNCH. No, no, but because we have less protections against fraud.

Mr. VAN WINKLE. The sole protection against fraud is really on the issuers. It is the obligation of the issuers to be honest, to disclose what they need to disclose, and what they communicate to those potential investors to be truthful. I mean, I am distilling that down. The fact that—

Mr. LYNCH. No. Also you have a general population that is more vulnerable. Therein lies the opportunity for fraud. You have a general population that now can be solicited openly, and without—and they don’t have the protections, the ability to protect themselves. That is what creates the opportunity. I am not as concerned about companies that are out there now and operating under the previous rules; I am worrying about opportunities that will present themselves where investors won’t have that protection. That is the danger.

Mr. VAN WINKLE. So we have to have an issuer that is fraudulent that is now going out into the marketplace and advertising and seeking to bring in those investors that aren’t going to ask those questions. We certainly don’t know what that looks like. I mean, that is one of the concerns people have. That is why there is this concern about the change.

I will simply say my experience has been from the very small investors—and I have worked with very small companies that have raised small investments—that almost every single potential investor looks at issues and asks questions. I have seen that from what I consider to be very unsophisticated financially but smart business people, or the smart retiree who is very concerned. That retiree has to actually have cash to put into the business in order to be an investor. So that, as a practical level, is going to be an element of protection.

Mr. LYNCH. Let me attack this from a different direction then. Even though lifting the ban was required under the Act, the SEC

still had an ability in the rulemaking process, I think, to provide some level of protection still for the investor. Did the SEC miss that opportunity, in your opinion?

Mr. VAN WINKLE. I don't believe the SEC has missed it. If, based upon experience, two years from now they observe that they missed the mark a little bit, they may move that. But just based on what we know now, based on what the SEC knows now in its best judgment I think it issued the proposed rule which said the issuer is going to have to make those determinations. As was previously said, there is a subjectivity to that.

Mr. LYNCH. Okay. Fair enough. Thank you.

I yield back.

Mr. SCHWEIKERT. Thank you, Mr. Lynch.

Mr. Pearce?

Mr. PEARCE. Thank you, Mr. Chairman. Fascinating discussion. I appreciate the testimony of every single one of you here, those of you sitting out there, not those of us sitting up here, that give me hope for the future. I really appreciate the depth.

Mr. Ravikant, I really appreciated your presentation, the sophistication of a small business owner. I could have used help like yours way back when.

Ms. Vercruysse, again your struggle starting with one or two people are things that are very familiar to me, so I appreciate that.

I found it a fascinating discussion because there is a definite split in opinions from this side of the table that somehow we are going to protect the general public. We don't seek to protect the general public from people who want to read your palms. You can advertise that. Walking down here in Arlington I can find palm readers that are going to hook me up with a different generation that passed away several decades ago, and I don't get protected from that. I go out to Las Vegas, I slap my money on the roulette wheel where I know the odds are far less than investing with any single one of you all, and there's no protection for that.

And yet somehow we want to protect the general public with the same people who watched M.F. Global from inside. We have 100-something protectors, protectors of the general public, protectors of the investors sitting in the room watching what was going on. Sometimes the very highest level protectors, and somehow they didn't catch that we are about to defraud the investors, some guy named J.P. Morgan, Lehman Brothers, when that guy up there named Madoff, \$50 billion they believe, and they are watching very closely, and yet we are going to tell Ms. Vercruysse that she can't advertise on Facebook. If you want to stick \$100 in my company you might not get it back, but I think you will. We are going to stop that.

I just can't imagine where we are coming from in this Country right now. We want to unleash the power and innovation. People are responsible. If they stick \$100 in Ms. Vercruysse's 18 Rabbits, maybe they only get 16 rabbits back. I don't know.

And then we hear that the economists all are in absolute declaration that investors are sitting on the sidelines waiting for the election. Now, the President himself said a couple of years ago that people are hoarding their money and corporations are hoarding their money. They shouldn't be doing it. They are hoarding their

money because they are uncertain. The money is on the sidelines because of uncertainty, not some election.

Mr. Ravikant, I agreed with almost everything you said, but I do want to dig a little bit deeper on one thing. I think you said in your testimony or in your answer to a question that you don't want crowdfunding for the smaller companies, that you would want to reserve it for the larger ones? If I misunderstood, that is the reason I am asking, because I am thinking directly of the 18 Rabbits. I can see where, if she could just advertise on Facebook page, she probably would have enough to expand. So give me some clarification.

Mr. RAVIKANT. Okay. That was a misinterpretation.

Mr. PEARCE. Okay.

Mr. RAVIKANT. Yes. Actually, I think it would work better for smaller companies.

Mr. PEARCE. Okay. All right.

Mr. RAVIKANT. Absolutely. Less at risk, smaller amounts, smaller denominations.

Mr. PEARCE. Okay.

Mr. RAVIKANT. Obviously, depends on the regulatory cost.

Mr. PEARCE. I was afraid that I had misunderstood.

Mr. Thompson, one of the things that you had talked about several times is sophisticated investors, people who are knowledgeable. Again, keeping the backdrop of the gentlelady sitting straight down the table from me there with a small investment could grow significantly with a few people pitching in a little bit of money, \$500 apiece. Tell me a little bit about the sophisticated investor. I heard you use the term and I am not diminishing the requirement, but also I am thinking about her situation.

Mr. THOMPSON. Accredited investors includes \$1 million in assets, which includes your pension, your retirement. Whatever you save for retirement counts for that million dollars or \$200,000 in income. That is a large group that has disposable investment income.

Mr. PEARCE. If I could interrupt, because I am running out of time, just apply it to her request. Why can't we make it available to her to advertise on Facebook for people who maybe don't even make \$20,000 a year to stick \$100 in it?

Mr. THOMPSON. I think after the ban is lifted you will be able to do that, for accredited investors.

Mr. PEARCE. But you don't think there is some great risk there.

Mr. THOMPSON. There's a risk, because I think we dip too deep into the pool, but it will expand who she can advertise too. But that is different than what is on the other exemptions.

Mr. PEARCE. Okay. And I see my time is lapsed. If we go to a second round I have got a couple more points.

Thank you, Mr. Chairman.

Mr. SCHWEIKERT. Thank you, Mr. Pearce.

Mr. Hurt?

Mr. HURT. Thank you, Mr. Chairman.

I want to thank each of you all for appearing today. I come from Virginia and we have a rural south side District where we have unemployment that is much higher than the national average in many places. We have some places in Virginia's Fifth District that have unemployment as high as 16 percent. So the jobs issue is

very, very important, and very, very real to us in terms of sustaining families, sustaining businesses, and sustaining farms.

So this is all very good to hear that this JOBS Act that was adopted with bipartisan leadership seems to be making some headway. A lot of the conversation today has been focused on the SEC, and a lot of the financial regulation, which I think we all would agree, despite the fact that there is polarizing, it seems, and one side accuses the other or each other of various offenses, I think we all agree, certainly on our side, that there are regulations that are very, very important to making sure that we have an efficient market and a market that protects consumers.

I don't think there is anyone on our side who doesn't believe that, but I think that what we see is that regulations have costs, they have impacts, and we need to be sensitive to that because the consequences are very real. It means no jobs, or fewer jobs at a time when, again, I have places in my District with 16 percent unemployment, and I have to answer to those people, and I should answer to those people.

I guess my questions are much more general in nature and I would ask you to back out of the SEC, the granular look at that level, but my question is really for Mr. Eakin and Ms. Vercruysse, and then Mr. Ravikant. If I could just have you all talk, generally speaking, about the regulatory burdens or regulatory issues that you see that are a part, necessarily, from the financial regulation and from the JOBS Act.

Could you talk about the atmosphere for job creation in terms of regulations, whether it is an oppressive tax code, whether it is environmental regulations, perhaps all well intentioned, but environmental regulations that affect business? And then finally labor issues. These are all things that we have control of here in Washington. I should say we don't have control, we have responsibility to those very important issues. How do they affect job creation?

If we could just go down the line, 30 seconds, 45 seconds apiece. How is that?

Mr. EAKIN. Congressman, I appreciate the opportunity. I think it is a little bit beyond my expertise, focusing on marrying credit investors to startups through CircleUp has been our primary focus in the JOBS Act, so I think I will pass to another.

Ms. VERCRUYSSSE. The regulations as far as the jobs, providing more jobs?

Mr. HURT. Yes. I would just love to hear your input in terms of access to capital, in terms of a regulatory climate that encourages job growth as to one that suppresses it. If you have any general comments?

Ms. VERCRUYSSSE. Well, I think that general comment would be that I do like how there are some micro lending organizations out there right now that very much are into job creation. I sit on the board of Working Solutions, and we provide micro loans to small businesses in San Francisco and the Bay Area. They all have to come to the table with proposal about how many jobs that they are going to create and what sectors they are going to affect and how their jobs are going to help their businesses grow and thrive. So I think that is something that is definitely working.

The regulations don't really, at my stage of business they don't really burden me at all. This was a new thing going from a LLC to a corporation. I had some things to learn, but luckily CircleUp helps with that.

Mr. HURT. Right. Do you have anything to add, Mr. Ravikant?

Mr. RAVIKANT. Yes. it is a great question. I think that all of us here probably have a smart phone in our pocket right now, and so because of that what is happening is a lot of technology companies that before would have stayed just in the technology space are entering other adjacent spaces, and they are running into regulations.

An example would be Uber Cab, with its various disputes with the taxi companies and taxi commissions, B&B, with the hotels and so on. So the marketization of local services has been running into a lot of regulatory issues. That would be an interesting area to keep an eye on.

To give you an idea of some of the craziness going on, San Francisco Bay area now has two services that have peer-to-peer taxis where he can roll up in his car and pick me up and I have to give him a donation based on distance travel. So these kinds of things are very innovative on the regulatory side.

Mr. HURT. Thank you. That is very helpful.

I yield back the balance of my time.

Mr. SCHWEIKERT. Thank you, Mr. Hurt.

Mr. Fincher?

Mr. FINCHER. Thank you. I thank you, Mr. Chairman.

I am going to pick up just for a second where Mr. Pearce left off about how so many times I am not—I am a freshman Member. I haven't been up here as long as some of my colleagues, so I am not an expert politician. I am just a businessperson, a farmer from Tennessee.

But are we really here to protect? Usually Congress, in my opinion, when I go home and talk to people in my District when it comes to jobs, when it comes to work, how the government is in the way, that we are not helping, we are making things worse. And bad characters do need to be punished when they step out of line, but so many times the more rules, the more regs that we impose on business owners only hurt the ability to grow the economy, to lower unemployment, and to get the private sector back in the driver's seat.

A few minutes ago, when one of my colleagues on the other side of the aisle was trying to talk about the JOBS Act versus Dodd-Frank, I mean, really it is a big difference there in Dodd-Frank and the JOBS Act.

We somehow must get back to the place of there's personal responsibility, and people are out there making decisions. They can think for themselves. We are not here to make sure that the world can go on and everything needs to travel through the House of Representatives or the Senate or the White House, that people can make decisions for themselves.

Your testimony today has been great.

Mr. Ravikant on the end, can you comment for me just for a second on the JOBS Act, I was looking at a couple of questions about how many dollars of capital, how many jobs it would create. If this had not been put in place, do you think the SEC would have been

able to clarify or make decisions making it easier for companies to go public without the JOBS Act?

Mr. RAVIKANT. I actually don't know anything about the public side of it, unfortunately, I deal in much earlier stage. But I will say that thanks to the JOBS Act there will be more capital for small businesses. Some of it, in fact a lot of it, will come from the 506 exemptions, some of it will come from crowdfunding, and so eventually there will be more public companies. We just have to give it time. It is a 30-year cycle. We just have to look a little forward.

Mr. FINCHER. Absolutely.

Mr. RAVIKANT. But, to give you an idea, Chairman McHenry's amendment to the JOBS Act which allowed us to offer that online documentation, we can save companies \$5 million in the first two weeks. That is \$5 million that is better used hiring people and building product.

Mr. FINCHER. Absolutely. Any more comments? Mr. Eakin?

Mr. EAKIN. Sir, we believe that the JOBS Act is a great stimulus in helping small businesses raise more capital more efficiently, and through portals like Mr. Ravikant as well as CircleUp we are excited for full implementation.

Mr. FINCHER. And let me finish up by saying this. I was thinking last night; I couldn't sleep. I sleep about three hours a night now in this job. This is not about any past political arguments or things that one party or another party has been doing to each other. I don't know what happened in the past. This is about going forward, and we have got to get this right if America is going to be able to get back on top, and if we don't get the private sector growing again by allowing us to get out of the way, then it is going to be hard to do.

So that is what we are trying to do up here, and hopefully both sides can work together to make that happen.

Thank you for your testimony. I yield back.

Mr. SCHWEIKERT. Thank you, Mr. Fincher.

The Chair is going to yield to himself. I guess I can yield myself all the time I want, right? I like this. No. We are not going to do a second round of questions, but I will do sort of a lightning round.

Two things I want to touch on. One, we were hearing in some of the questions the comment general population. I want to make an additional clarification. It is not general population. These are accredited investors. That was a part of that discussion.

And there is also sort of a philosophical split here, and I may be an outlier in this. I have an intense concern that often in our attempt to protect everyone we take part of our population that hasn't made that threshold of being accredited and take away their opportunity to find a golden egg, to invest in something that really over their lifetime gives them that opportunity.

My great fear is we often end up in these debates of the have's and have-not's, but if we made the barrier so, You are accredited. You get to play. You are a small investor. We are going to add barrier and barrier where no one wants you to really even knock on our door, but we never give them the opportunity to start that process of taking risk and ultimately accumulating wealth.

Mr. Ravikant, you are doing some things that I find fascinating in building a portal that allows a small business to be able to use

your standardized documentation. Walk me through that as sort of quickly as you can of how that benefits a small upstart.

Mr. RAVIKANT. Today if you are a small business and you find investors, whether through AngelList or CircleUp or wherever, you have to then negotiate a term sheet, negotiate the investment. Before the JOBS Act, if you wanted help on that regard you would have to go hire a lawyer or work through a broker dealer, both of which are very expensive.

The JOBS Act allows us to offer optional closing documents, soup to nuts, online. We created a beautiful, visual process, well designed, Internet based, lays out all the standard terms. Your lawyer can even work with it, it works very quickly. It takes the process that used to take a month of back-and-forth negotiation and generating huge documents and redlines and all that, and it is instant. It is basically instant. And we made it free, not just for the company that raised money through AngelList, but for any company.

Mr. SCHWEIKERT. And that is for the business side. How about if I am the person that absolutely loves Ms. Vercruysse's product and I sent her a note over Facebook and she says, I can't talk to you over Facebook because I would go to jail, but you could go take a look at this website.

Mr. RAVIKANT. Correct.

Mr. SCHWEIKERT. And if I actually ultimately would establish, can I invest in her through you?

Mr. RAVIKANT. Well, we can make the introduction after we establish the investor's accreditation and their sophistication. We actually go one level beyond accreditation.

Mr. SCHWEIKERT. Mr. Van Winkle, you practice in this area of helping folks. Give me the range of type of investor class you ultimately will represent or deal with or help.

Mr. VAN WINKLE. The investors that we are typically working with, and usually we come across them because we are representing the businesses that are using their network. That is really their only method today, and they are going on and talking to their friends and other business acquaintances, and they are talking to people who are their business owners. Sometimes they are talking to family members. Many of them have been owners of some other business, so they have some sense of how to do that. Or they have been just a person who has paid attention to things over the years.

It is a wide, wide range, but today it is a relatively small group because it is based on personal connections, and so someone who might know about an idea has no idea how to go about investing in it. I think what we are hoping to unlock is the ability to create a connection and then, within the regulatory framework, enable them to make that investment lawfully.

Mr. SCHWEIKERT. You actually just nailed where I was trying to go here. My wife and I, on occasion we find a product we absolutely love, and I assume other people have this experience saying, We have a little money saved up. Do we go out and buy a boat, or do we actually put some money some place—if you put it in a savings account or other things today you get almost no yield in this world.

But maybe I should take a little risk because I love organic, I live on your type of product. You said, even though it is going to be the kid version at Costco, I will look for it. But how do we take that next subclass of investor and make it more egalitarian so they can invest? Do you see as with the approach we are trying to hopefully get the SEC to move with the JOBS Act to provide those opportunities?

Mr. VAN WINKLE. I think that is what the title two is trying to do and say that there are a lot of accredited investors who perhaps are suitable investors and they are unable to connect with issuers, so they will be able to do that.

The issuers will be able to announce we are looking for investors, and it will go about—I think there will be new ways of communicating, and it will connect those folks.

Mr. SCHWEIKERT. But somewhere here—and this may be JOBS Act 3.0 eventually if we ever get to that, and I know I am heading over time, but you are involved in a micro lender, but ultimately I would love to see a world where it is micro equity, where I can take a few hundred dollars or a few thousand dollars, and I know for many folks that was a vision within the crowdfunding, and take a risk, but actually start to be someone who gets to participate in the rewards of taking that risk.

This is the end of this panel. Thank you for participating with us. All of you, if you have any other ideas or suggestion of how we can do things better, please share that with us.

We have a letter from the ICBA that will be put into the record.

Mr. SCHWEIKERT. Without any objection, this Committee is closed.

[Whereupon, at 12:01 p.m., the hearing was adjourned.]



September 13, 2012

## Key JOBS Act Provision Must Be Addressed to Benefit Thrifts

On behalf of its nearly 5,000 community bank members, ICBA is pleased to submit this statement for the record for the joint hearing of the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises and the Oversight and Government Reform Subcommittee on TARP, Financial Services, and Bailouts of Public and Private Programs titled: "The JOBS Act: The Importance of Prompt Implementation for Entrepreneurs, Capital Formation, and Job Creation." We appreciate the opportunity to share the community bank perspective on this issue. ICBA seeks Congress's assistance in correcting an oversight in the drafting of the JOBS Act that is denying thrift holding companies the intended benefits of a key provision of the Act.

Title VI of the JOBS Act raised the threshold number of bank shareholders that trigger SEC registration from 500 to 2,000. It also raised the deregistration threshold from 300 shareholders to 1,200 for banks and bank holding companies. ICBA was a consistent and leading supporter of this provision and we are confident that it will promote economic activity and job creation by helping community banks raise capital without triggering costly SEC registration requirements. Many ICBA members have already deregistered and others are considering deregistration. Private banks and holding companies have taken advantage of the higher registration threshold by raising capital from additional investors without going public and registering with the SEC. We thank Congress for enacting this pro-growth legislative relief.

However, due to an oversight in the drafting of the statute, the deregistration thresholds do not apply to thrift holding companies. While the banking agencies have so far interpreted the deregistration provisions of the JOBS Act to cover thrifts, the SEC still has not clarified whether thrift holding companies are covered. Thrifts and thrift holding companies are subject to the same oversight and supervision as banks and bank holding companies and are subject to the same financial reporting requirements. The enhanced oversight and regulation of banks is the rationale for affording them a higher shareholder registration and deregistration thresholds under the JOBS Act. That being the case, there is no policy reason for denying thrift holding companies, subject to the same oversight and regulation, the benefits of the higher thresholds.

A second concern we have with the SEC's implementation of this provision is that bank holding companies must continue to file periodic reports for 90 days after they have deregistered by filing Form 15. This includes all reports required under Exchange Act Sections 13(a), 14, and 16. While Exchange Act Rule 12g-4 permits immediate suspension of Section 13(a) reporting obligations upon a filing of Form 15, because that rule has not yet been amended to incorporate the new 1200 shareholder deregistration threshold, bank holding companies cannot yet take advantage of it.

**ICBA urges the SEC to issue an amendment as soon as possible to Rule 12g-4 to reflect the**

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**new statutory deregistration threshold.** Until then, bank holding companies will be forced unnecessarily to continue filing periodic reports for a considerable period of time after they have terminated their registration under Section 12. Bank holding companies are already heavily regulated and required to file financial statements with the banking agencies. It is burdensome and costly for them to continue to file SEC reports once they are no longer regulated by the SEC.

ICBA deeply appreciates this joint hearing on the implementation of the JOBS Act, which will raise awareness of our concerns. The benefits of the updated shareholder registration and deregistration thresholds cannot be fully realized, as intended by Congress, until the above noted changes are made to the SEC's implementing rules.

Thank you for convening this hearing and for the opportunity to submit this statement for the record.

One Mission. Community Banks.

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August 16, 2012

FILED ELECTRONICALLY

Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F St., N.E.  
Washington, DC 20549-1090

Re: JOBS Act Rulemaking: Title II

Dear Ms. Murphy,

We are writing to comment on the Commission's pending rulemaking under Section 201(a)(1) of the Jumpstart Our Business Startups Act of 2012 ("JOBS Act"), which requires that the Commission remove the ban on general solicitation and advertising ("GS&A") for private offerings conducted pursuant to Securities Act Rule 506.

In summary, we believe that the Commission will need to make substantial additional amendments to Rule 506<sup>1</sup> to satisfy its obligation to ensure that the Rule is consistent with the protection of investors and integrity of our securities markets. The Commission has previously recognized significant deficiencies in current Rule 506 that for too long have been left unaddressed. The elimination of the GS&A ban, along with other JOBS Act provisions, will further weaken Rule 506. We urge the Commission to consider fully the potential harm to investors and securities markets that eliminating the GS&A ban will cause in order to ensure that the benefits of an amended Rule 506 exceed the significant costs of this radical reform.

While we recognize that the JOBS Act requires a repeal of the ban on GS&A, that leaves open a number of questions about how best that should be accomplished in order to minimize the harm to investors and market integrity. Consideration of these factors will require an extensive analysis. This is one reason that adopting an interim or temporary rule,<sup>2</sup> as the financial press recently reported is under consideration, would be improper. Consideration of the comments of all affected parties on any proposals that the Commission is considering is a necessary – and legally required – part of the rulemaking process. As discussed further below, we strongly oppose the adoption of any interim rule implementing Section 201(a)(1).

#### **I. Interim Rule**

We believe that the adoption of an interim rule pursuant to Section 201(a)(1) of the JOBS Act would be impracticable, inconsistent with the protection of investors, and in violation of the letter and spirit of the rules of administrative procedure, as also discussed in our letter of August 13<sup>th</sup>. An interim

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<sup>1</sup> As a technical matter, many of these amendments would be to other rules under Regulation D, but we refer herein only to Rule 506 for clarity.

<sup>2</sup> We use these terms to describe an interim rule, temporary rule, interim final rule, interim final temporary rule, and any other rulemaking that has the legal effect, even if not permanent, of amending Regulation D. See, e.g., *Extension of Interim Final Temporary Rule on Retail Foreign Exchange Transactions*, Exchange Act Rel. No. 67405 (July 2012) available at <http://www.sec.gov/rules/interim/2012/34-67405.pdf>.

rule would be impracticable because considering public comments submitted *after* the Commission had already permitted GS&A activities would be, in effect, a proverbial closing of the barn door after the horses have escaped. It would be extremely difficult for the Commission to backtrack in an area where the politics of securities regulation seem to have overtaken rational policymaking. Indeed, an interim rule would appear to be an attempt merely to assuage Congressional critics while offering no redeeming social benefits.

An interim rule also would be inconsistent with the protection of investors and securities markets because the Commission has not had sufficient time, much less sufficient public input, to conduct an adequate analysis of the cost of amending Rule 506. As discussed further in this letter, existing inadequacies in Rule 506, recent market developments and other provisions of the JOBS Act present a set of major factors that must be taken into account pursuant to rulemaking – a challenge that is heightened by competition for SEC resources from pending Dodd-Frank Act rulemakings that are subject to much earlier deadlines. We question whether even *proposing* amendments on August 22 could be consistent with the SEC's obligation to complete rulemaking required by the Dodd-Frank Act with long-passed deadlines. The Commission does not have the authority to cherry-pick mandatory rulemakings based on currently prevailing political winds.

We also believe that an interim rule would violate the spirit and letter of the Administrative Procedures Act. As the Commission is aware, proposed rules must be published for thirty days to allow for public notice and comment. The Commission may adopt an interim rule without prior notice only if it “for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.”<sup>3</sup> We believe that there is no conceivable basis on which the Commission could show good cause to disregard notice and comment requirements. The ban on GS&A in Rule 506 offerings has been in place for decades; it would be absurd to argue that some emergency or special circumstances it must be suspended during the 30-day (or longer) pendency of the comment period.<sup>4</sup> If Congress had wanted to obviate compliance with the APA, it could have accomplished its goal through legislation. Instead, it chose to submit the GS&A provision to the rulemaking process, which its members undoubtedly expect to be conducted consistent with applicable law.<sup>5</sup> Nor do we believe that one could reasonably argue that Section 201(a)(1) constitutes adequate “notice” under the APA. As discussed below, abandoning the GS&A ban raises a myriad of issues that belie any reasonable claim that affected parties are on constructive notice as to what the resulting rule will entail.

<sup>3</sup> Administrative Procedures Act Section 553(b)(3)(B). See *Mack Trucks, Inc. v. EPA*, 682 F.3d 87 (C.A.D.C. 2012) (vacating interim rule adopted to relieve company of regulatory burdens on ground that EPA did not show good cause). See also *Western Oil & Gas Ass'n v. EPA*, 633 F.2d 803, 810 - 11 (1980) (pressing statutory deadlines are not sufficient to constitute good cause).

<sup>4</sup> See *Riverbend Farms, Inc v Madigan*, 958 F.2d 1479, 1484 & n.2 (9th Cir 1992) (“Congress intended to let agencies depart from normal APA procedures where compliance would jeopardize their assigned missions. . . . Emergencies, though not the only situations constituting good cause, are the most common.”). We believe the complexity of the issues to be addressed in this rulemaking argue for a comment period longer than the 30-day minimum. See Administrative Procedures Act Section 553(b)(3)(B) (requiring comment period of “not less” than 30 days).

<sup>5</sup> Almost all of the comment letters submitted to date have ignored this fact and assumed that the Commission has been given the authority to adopt a rule under 506 that conflicts with Section 4(2). However, Congress chose not to take that approach, preferring instead to allow GS&A within the constraints of administrative rulemaking process.

The SEC's recent record in APA challenges where affected parties *had* the benefit of notice and comment certainly counsels against adopting rules *without providing any notice period at all*.<sup>6</sup> Nor have so-called "temporary" rules with sunset provisions addressed the problem. For example, in 2007 the Commission adopted a "temporary" rule with a sunset provision that exempted broker-dealers from a requirement in the Investment Advisers Act.<sup>7</sup> The "temporary" rule was set to expire at the end 2009, but the Commission subsequently extended it until the end of 2010,<sup>8</sup> and then again until the end of 2012.<sup>9</sup> The eternally "temporary" nature of the rule has been revealed to be nothing more than a way to end-run the agency's obligation to consider and resolve issues raised during the public comment period. Ironically, the need for this "temporary" rule was triggered by another failed attempt to circumvent notice and comment procedures. In 1999, the Commission took a "temporary" no-action position when it proposed to exempt a large swath of broker-dealers from the Investment Advisers Act. It was not until five years later, and only because it was sued by an aggrieved party, that the Commission took final action on the rule – only to see it summarily vacated by a federal court.<sup>10</sup> These examples illustrate how "interim" and "temporary" rules often are, in effect, neither interim nor temporary and why they can be problematic.

## II. The Costs of the GS&A Ban

In fact, we believe that the Commission would be hard-pressed to adopt a rule this year, much less at the end of this month. Although Congress required that Rule 506 be amended to permit GS&A, that mandate does not diminish the SEC's obligation to consider the effect of the rulemaking. Congress did not amend Section 4(2) to carve out GS&A activities. Nor did it mandate that the Commission amend Rule 506 to permit GS&A without making any other rule changes. Rather, Congress chose, by only mandating a discrete amendment to Rule 506, to delegate to the Commission the manner and scope under which GS&A activities would be permitted. Congress decided that GS&A activities did not necessarily defeat reliance on the Section 4(2)<sup>11</sup> private offering exemption, *and nothing more*. Congress left to the Commission the responsibility to ensure that Rule 506 *as a whole* continued to operate consistent with its statutory wellspring. The Commission therefore must evaluate fully the effects of the rulemaking and adopt a rule *only* if it is consistent with the protection of investors and the integrity of our securities

<sup>6</sup> The "no action" position that was adopted while the fee-based brokerage account rule was under consideration was intended to be temporary, but it lasted for years. See *Financial Planning Association v. SEC*, 482 F.3d 481 (D.C. Cir. 2007) (vacating exemptive rule for fee-based brokerage accounts); *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Rel. No. 3128 (Dec. 28, 2010) (extending period of "temporary" rule to *more than five years* from its initial effective date) available at <http://www.sec.gov/rules/final/2007/ia-2653fr.pdf>.

<sup>7</sup> *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. (Sep. 24, 2007) available at <http://sec.gov/rules/final/2007/ia-2653.pdf>.

<sup>8</sup> *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 2965 (Dec. 23, 2009) available at <http://sec.gov/rules/final/2007/ia-2653.pdf>.

<sup>9</sup> *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 3118 (Dec. 1, 2010) available at <http://sec.gov/rules/proposed/2010/ia-3118.pdf>.

<sup>10</sup> See *Financial Planning Association v. SEC*, 482 F.3d 481 (D.C. Cir. 2007) (vacating exemptive rule for fee-based brokerage accounts).

<sup>11</sup> The correct reference is now "Section 4(a)(2)," but we have used the common terminology for clarity.

markets. The bipartisan support for the JOBS Act was assuredly premised on the SEC's fulfilling its legal obligations in promulgating amendments to Rule 506.

The SEC staff has itself recently articulated the agency's obligation to consider the full range of cost and benefits in rulemaking.<sup>12</sup> While we do not agree with the scope of the obligations implied by the staff's recent memorandum, and are particularly concerned that it overweights quantifiable costs to industry (e.g., compliance costs) in comparison with benefits to investors and the securities markets,<sup>13</sup> we agree with the staff's position that Congressional policy mandates do not repeal rulemaking procedures.<sup>14</sup> As the staff stated:

where a statute directs rulemaking, rulewriting staff should consider the overall economic impacts, including *both* those attributable to Congressional mandates *and* those that result from an exercise of the Commission's discretion.<sup>15</sup>

There is no question that the mandate in Section 201(a)(1) of the JOBS Act may have a substantial negative economic impact on investors and the securities markets. Indeed, it is for this reason that the Commission has always conditioned the Rule 506 exemption on a complete abstention from GS&A. We are not aware of any indication that the SEC's view of the costs and benefits of that judgment have changed.

There is also no question that the Commission has substantial discretion to mitigate the adverse effects of Section 201(a)(1) using the same kinds of investor protection strategies that are already reflected in Rule 506. It therefore must consider the economic impact of the exercise of such discretion. In fact, we believe any reasonable cost-benefit analysis would necessarily conclude, as discussed further below, that Section 201(a)(1) will require considerable mitigating additional amendments to Rule 506 in addition the mandatory enhancement of accreditation verification procedures.

The potential adverse effects on investors of permitting GS&A in private offerings have long been recognized by the Commission. The reason that Rule 506 is contingent on the absence of GS&A activities is that such activities substantially increase the risks of nonaccredited investors making purchases in private offerings. The Securities Act relies primarily on the regulation of offering activities by prohibiting all offers prior to the filing of a registration statement and strictly regulating all written offers once the registration statement has been filed. General solicitation and advertising activities therefore are generally permitted only if a registration statement has been filed, which provides a strong practical constraint on the ease with which fraudulent offers can mislead investors.

<sup>12</sup> *Current Guidance on Economic Analysis in SEC Rulemakings*, Memorandum from RSFI and OGC to the Staff of the Rulewriting Divisions and Offices (Mar. 16, 2012) ("Rulewriting Memorandum") available at [http://www.sec.gov/divisions/riskfin/rsfi\\_guidance\\_econ\\_analy\\_secrulemaking.pdf](http://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf).

<sup>13</sup> See *The SEC's Aversion to Cost-Benefit Analysis*, Hearing before the Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs, Committee on Oversight and Government Reform, U.S. House of Representatives (Apr. 17, 2012) (testimony of Mercer Bullard) (discussing the problem of adopting "investor protection rules based on a reasonable belief that the unquantifiable benefits of preventing and deterring fraud and misleading sales practices exceed the often quantifiable costs of compliance with the rules") available at <http://oversight.house.gov/wp-content/uploads/2012/04/4-17-12-Bullard-Testimony.pdf>.

<sup>14</sup> We urge the Commission to instruct the staff to revise the memorandum to reflect a more balanced view of the full range of costs and benefits that securities regulations create.

<sup>15</sup> Rulewriting Memorandum at 8 (emphasis in original).

Removing the GS&A ban from Regulation D eliminates this constraint by allowing the broad dissemination of securities offers with no requirement that any information, much less a standardized registration statement, be made available to investors. Regulators will no longer be able to implement the Securities Act's approach of regulating public offers through the simple, efficient mechanism of taking immediate action with respect to any public offers of unregistered securities. Because public offering activities as to unregistered securities will no longer be an automatic, actionable red flag for regulators, that monitoring mechanism will have been eliminated. The ability of fraudsters to attract nonaccredited investors will be increased exponentially.

Nonaccredited investors are not the only beneficiaries of the ban on GS&A; it operates to protect accredited investors as well. General solicitations and advertising – without the regulating effect that a publicly available, standardized disclosure document provides – increase the risk of abusive and misleading sales practices as to accredited and nonaccredited investors alike. For this reason, the additional amendments necessary to adapt Rule 506 to the removal of the ban on GS&A must address both the accredited and nonaccredited investor markets.

### III. “Reasonable Steps” Requirement

Congress has identified at least one amendment to Rule 506 that the Commission is required to make. Section 201(a)(1) of the JOBS Act requires the Commission to identify “reasonable steps” that issuers that engage in GS&A activities are required to follow to ensure that only accredited investors are purchasers. Notwithstanding industry requests that the Commission ignore this express mandate,<sup>16</sup> we believe that the Commission has no discretion in this respect and must comply with Congress’s command to enhance the standards under which issuers confirm purchasers’ accredited status. We also believe that the Commission must provide persons who are likely to be most concerned about the “reasonable steps” requirement an opportunity to comment on the many forms that it might assume. Adopting an interim rule would not allow sufficient opportunity for comment.

Section 201(a)(1) requires that rules promulgated under Rule 506 be amended to provide that the prohibition against GS&A in Rule 506 not apply to offers and sales “provided that all purchasers of the securities are accredited investors.”<sup>17</sup> The next sentence in that provision the Act states:

Such rules shall require the issuer to take reasonable steps to verify that purchasers of the securities are accredited investors, using such methods as determined by the Commission.

This provision unambiguously mandates rulemaking that requires that issuers take reasonable steps to confirm that purchasers of securities are accredited investors. Although the broker-dealer industry argues, as a policy matter, that it is not necessary to mandate specific “steps” in this respect, Congress decided

<sup>16</sup> Letter from Sean Davy, Managing Director, SIFMA, to Elizabeth Murphy, Secretary, SEC (Apr. 27, 2012) (“SIFMA Letter”) available at <http://sec.gov/comments/jobs-title-i/general/general-18.pdf>. We note that the industry’s letter shows its agreement that Section 201(a)(1) could not reasonably be viewed as providing adequate notice as to the substance of any rulemaking thereunder.

<sup>17</sup> Accredited investors generally include, among others, individuals with annual income in excess of \$200,000 (\$300,000 for married couples) or net worth in excess of \$1 million, and a variety of institutions. See Rule 501(a). Purchases by up to 35 non-accredited, financially sophisticated investors are permitted as well, provided that additional written disclosure is provided. See Rule 506(b)(2)(i).

otherwise.<sup>18</sup> The industry position that the Commission need not take any action in light of this direct Congressional mandate directly contradicts the plain text of the statute.

There can be no doubt that Congress intended what it prescribed: that the Commission tighten the standards for determining whether an investor is accredited. The House Report is explicit on this question:

H.R. 2940 requires the SEC to write rules on how an issuer would verify that the purchasers of securities are accredited investors.<sup>19</sup>

As the Commission is well aware, Rule 501(a) already provides that the term “accredited investor” includes persons whom the “issuer reasonably believes” come within any of the rule’s enumerated categories. The rule does not identify any specific steps that issuers must take to satisfy this standard. The JOBS Act’s new requirement is exactly that – a *new* requirement that the Commission is required to incorporate into Rule 506. Congress expressly required steps to “verify” accredited status, which term can only be satisfied by requiring third party evidence of an investor’s income or wealth.<sup>20</sup>

This reading of the reasonable-steps rulemaking provision is also required by analysis of Section 201(a) as a whole. Less than 100 words after expressly requiring “reasonable steps” to ensure that Rule 506 purchasers are accredited investors, Section 201 again refers to the “reasonable belief” standard for a different offering exemption – but pointedly says nothing about any “reasonable steps” requirement. Section 201(a)(2) requires that GS&A be permitted for offerings under Rule 144A where all purchasers are eligible under that Rule, just as Section 201(a)(1) authorizes GS&A in Rule 506 offerings. Section 201(a)(2) also requires that sellers “reasonably believe” that Rule 144A purchasers are eligible investors, but it notably does *not* require that issuers or sellers take “reasonable steps” to confirm investors’ status.

The purpose of this difference between otherwise parallel amendments to private offering rules could not be clearer. Congress appreciated that Rule 506 offerings create a much greater risk of participation by unsophisticated investors than Rule 144A offerings and accordingly raised the standard that applies to sales under Rule 506. Rule 144A is limited to qualified institutional buyers, which are generally institutional investors with at least \$100 million in investments, whereas Rule 506 permits not only accredited investors with only \$200,000 in income (\$300,000 for married couples) or \$1 million in net worth (minus the value of the primary residence) but also up to 35 non-accredited investors who are subject to no wealth requirements at all. Congress decided not to impose a “reasonable steps” requirement on Rule 144A offerings because sales to qualified institutional buyers simply do not raise the level of investor protection concerns that exist for Rule 506 offerings. Congress’s intent that the Commission raise the “reasonable belief” standard for Rule 506 offerings in light of the removal of the GS&A ban could not be clearer.

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<sup>18</sup> See *supra* note 16.

<sup>19</sup> *Access To Capital For Job Creators Act*, House Report 112-263, 112<sup>th</sup> Cong. 1<sup>st</sup> Sess. (Oct. 31, 2012) available at <http://www.gpo.gov/fdsys/pkg/CRPT-112hrpt263/html/CRPT-112hrpt263.htm>.

<sup>20</sup> See Letter from Jack Herstein, President, North American Securities Administrators Association to Elizabeth Murphy, Secretary, SEC, at 2 (July 3, 2012). While some claim that third party verification protects only those “who are willing to lie to issuers.” Letter from National Small Business Association to SEC (Aug. 2, 2012), we note that the recent prevalence of liars loans in the mortgage context was largely attributable to agents who aggressively encouraged false reporting by borrowers, which supports our view that third party verification is intended to deter the fraudulent sales practices of issuers and broker-dealers. Third-party verification is a standard practice in the lending industry.

In contrast, the broker-dealer industry perceives no difference between Rule 506 and Rule 144A offerings and offers no explanation for the different positions in Section 201(a)(1) and (2).<sup>21</sup> Rather, it argues that it is “generally accepted that certification by an offeree as to its status as an accredited investor or a qualified institutional buyer provides a basis for a reasonable belief and believe that such certification should constitute reasonable steps for purposes of Section 201(a) of the JOBS Act.”<sup>22</sup> The conflation of the standards that should apply under Rules 506 and 144A is flatly inconsistent with the current provisions of those rules, the express distinction made in the text of Section 201(a), and any semblance of rational public policy. Nor is it clear to us how a *purchaser*’s having taken steps in the form of providing a certification could satisfy a requirement for the *issuer* to take steps, as Section 201(a)(1) specifically requires.

The necessity of raising the “reasonable belief” standard for Rule 506 offerings is as much a matter of good public policy as it is nondiscretionary compliance with an express Congressional mandate. Permitting GS&A activities in connection with private offerings will substantially increase the likelihood that unsophisticated investors will be lured into fraudulent or unsuitable investments. It therefore is necessary to adopt stronger measures to ensure that only accredited investors make purchases.

Indeed, Congress had good reason to lack confidence in the current legal standards regarding investors’ accredited status. In a 2007 release, the Commission stated that its “experience indicates that some issuers may not have taken appropriate measures to satisfy their obligation under Rule 501(a) to form a reasonable belief that a prospective purchaser satisfied the definition of accredited investor.”<sup>23</sup> Thus, Congress was rightfully concerned that such noncompliance with the “reasonable belief” standard warranted stronger measures in light of the JOBS Act’s elimination of the GS&A ban. We may comment on specific “reasonable steps” that the Commission should consider once notice of a proposal has been issued.

#### **IV. Context of Rulemaking: The Need for Additional Investor Protections**

The removal of the ban on GS&A must be accompanied by other changes to Rule 506 designed to ensure that investors are adequately protected. The Commission has already taken positions on the inadequacy of Rule 506 as currently drafted that must be considered in light of any GS&A amendment. In other words, even with the current GS&A ban there are recognized deficiencies in Rule 506 that must be corrected before the Commission can even reach the question of what additional reforms are necessitated by the ban’s elimination. We believe that these existing problems, all of which have previously been acknowledged by the Commission, must be fully addressed for any rulemaking under Section 201(a)(1) to proceed consistent with the rules of administrative procedure.

##### **A. Accreditation Standard**

The Commission has recognized that, even under the current GS&A ban, the accredited investor net worth and income tests are inadequate to ensure that investors are financially sophisticated or have sufficient wealth to bear large losses. In 2007, the Commission proposed increasing the accredited investor net worth/income minimums from \$1 million/\$200,000 to \$2.5 million, noting that the current

<sup>21</sup> See SIFMA letter, *supra* note 16.

<sup>22</sup> *Id.* at 6–7.

<sup>23</sup> *Revisions of Limited Offering Exemptions in Regulation, Securities Act Rel. No. 8828 at 38 (2007)* (“Revisions of Limited Offering Exemption”) available at <http://www.sec.gov/rules/proposed/2007/33-8828.pdf>.

standards, if adjusted for inflation, were dramatically lower than the amounts considered appropriate when they were initially adopted.<sup>24</sup>

Moreover, in 2007 the Commission went on record as viewing a higher accredited investor standard as a condition of relaxing of the Rule 506 GS&A ban.<sup>25</sup> The Commission proposed to permit limited advertising of offerings that were sold only to “large accredited investors.” Such investors who were natural persons were required to have at least \$2.5 million in investments or \$400,000 in annual income. If the Commission believes that such an increase would be necessary for a *limited relaxation* of the GS&A ban, then it logically must take the position that an increase of at least that scale would be necessary for the *wholesale elimination* of the GS&A ban that the JOBS Act contemplates.

Furthermore, net worth and income limits elsewhere in the JOBS act strongly support an increase in the accredited investor standard. While the crowdfunding exemption would permit an investor with \$1 million in investments to invest only \$100,000 in all crowdfunding offerings combined, accredited investors can invest *100% of their net worth* in a single private offering. To impose more stringent limits on crowdfunding offerings where GS&A is *not* permitted than are imposed on private offerings where GS&A *is* permitted defies reason. Such an inconsistency between the crowdfunding requirements and Rule 506 could not be consistent with Congressional intent as expressed in the JOBS Act.

At a minimum, the Commission cannot reconcile its longstanding positions on the inadequacy of accredited investor minimums and the relationship between those limits and the scope of permitted GS&A activities, as discussed above, with Rule 506 amendments that do not include increases in the natural person accredited investor minimums. The Commission has found that the current minimums are inadequate – especially in the context of a relaxed GS&A ban. It cannot now find that the minimums are adequate where the GS&A has been entirely eliminated consistent with maintaining that Rule 506 as whole continues to be a rational interpretation of Section 4(2)’s public offering prohibition. To reconcile this inconsistency and to ensure adequate protection for investors, the accredited investor income/net worth minimums should be increased at least to \$400,000/\$2.5 million and these minimums should be automatically adjusted to reflect inflation.

#### **B. Financial Complexity**

Another factor that the Commission has recognized as having heightened risks for investors and markets is the increasing complexity of financial products and financial planning. Financial products sold to retail investors have grown increasingly complex, often resulting in abusive sales practices and large investor losses, especially in the context of hedge funds (to include private equity funds). The replacement of defined benefit plans with defined contribution plans, along with the shift of retirement assets from employer-supervised employee-benefit plans to broker-advised Individual Retirement Accounts, has required investors to assume greater responsibility for their financial security in retirement. Permitting GS&A activities under Rule 506 will undoubtedly prompt aggressive marketing campaigns encouraging workers to rollover large 401(k) balances into unregulated hedge funds in IRAs, and many will be retirees who are inappropriately treated as accredited investors not because they are either financially sophisticated or wealthy, but because they have accumulated a considerable nest egg that they

<sup>24</sup> See *id.*; *Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles: Accredited Investors in Certain Private Investment Vehicles*, Securities Act Rel. No. 8766 (Dec. 27, 2006) (noting that 1982 accredited investor standards have made investors eligible today who would not have previously been eligible and the increasing complexity of investments) available at <http://www.sec.gov/rules/proposed/2006/33-8766.pdf>.

<sup>25</sup> Revisions of Limited Offering Exemption, *supra*.

must rely on for income throughout the remainder of their lives. The increased complexity of financial products and financial planning argues for strengthening Rule 506 – regardless of whether GS&A activities are permitted.

### C. Internet and Social Media

At the same time that the Commission must authorize some degree of GS&A activities in private offerings, the Internet continues to expand the potential for such activities to facilitate fraud in the securities markets. In restoring the Rule 504 GS&A prohibition (see below), the Commission specifically noted that “market innovations and technological changes – most notably, the Internet – have created the possibility of nationwide markets for these exempt securities that were once thought to be sold only locally.”<sup>26</sup> Since the Commission expressed this view, the Internet – and its power to disseminate false information – has grown many times over. The evolution of social media has increased the likelihood of affinity fraud in cyberspace, where the potential reach and thus the potential harm is multiplied exponentially.

### D. Private Markets

The development of markets in unregistered securities has exploded, with the very public trading of millions of shares of Facebook prior to its IPO making a mockery of the concept of “private” markets.<sup>27</sup> These markets may permit participation based on only the thinnest of representations by investors. More than 20,000 investors have “certified themselves as accredited investors” on SecondMarket’s platform with no apparent third-party verification. The increased publicity surrounding and popularity of private markets heightens investor protection concerns and create a natural magnet for nonaccredited investors. The financial incentives of issuers significantly expand the risk that, absent appropriate safeguards, “liar’s loan” practices will be introduced into the private offering market.

### E. Hedge Funds

Hedge funds (to include private equity funds) make up a disproportionate percentage of Rule 506 offerings. They also represent, as demonstrated by the extensive and detailed regulation of mutual funds, the kind of structure that poses special risks for investors. To the extent that GS&A involves investment performance figures, there is good reason to believe that fraudulent hedge fund advertising will be the single greatest source of abuse under amended Rule 506. Hedge fund compensation structures promote risk-taking, and these funds, unlike mutual funds, can hold unlimited amounts of illiquid securities, with respect to which valuation fraud has been rampant. We believe that, while Section 4(2) cannot be deemed to be unavailable solely on the basis of GS&A, the Section 3(c)(1) and (7) exemptions in the Investment Company Act can and should be deemed to be unavailable on the basis of GS&A because of the special concerns attendant upon investment pools.

Alternatively, the Commission should consider restrictions on hedge fund offerings that address the special investor protection concerns that these investments raise. For example, the Commission should consider applying mutual fund advertising and valuation rules to hedge funds that engage in GS&A (and,

<sup>26</sup> *Id.*

<sup>27</sup> That problem is made significantly worse by the JOBS Act provision increasing the shareholder threshold for becoming a publicly reporting company from 500 to 2,000 shareholders. *See generally* Mercer Bullard, *Facebook Fiasco Reveals Flaws in Private Offerings*, Morningstar.com (Jan. 10, 2011) (discussing active trading of Facebook shares in private market) available at <http://news.morningstar.com/articlenet/article.aspx?id=369342>.

in any case, require standardized performance and fee reporting for all hedge funds), and require explicit, large-font disclaimers that hedge funds are not mutual funds and present special risks.

The worsening obsolescence of the accredited investor standard; the growth of the Internet; the increasing complexity of financial products and financial planning, and the development of private trading markets are all factors that support substantially strengthening Rule 506 *regardless of any JOBS Act mandate*. The regulatory risks created by hedge funds warrant adopting a GS&A ban under the Investment Company Act. The GS&A mandate will only make an unacceptable situation worse if the Commission does not take steps to ensure that Rule 506 continues to be consistent with investor protection and efficient capital markets.

#### V. Context of Rulemaking: Experience with GS&A under Rule 504

Not only has the Commission previously recognized existing deficiencies in current Rule 506; it also has specifically recognized the harmful effects of permitting GS&A in the context of unregistered offerings. The SEC's experience with Rule 504 amendments in the 1990s illustrates the potential for increased fraud that eliminating the GS&A ban will create.<sup>28</sup> In 1992, the Commission eliminated the GS&A prohibition for offerings under Rule 504, which permits offerings of up to \$1 million. It subsequently found that the elimination of the GS&A ban contributed to an increase in microcap fraud. The Commission restored the GS&A prohibition, in part because it was concerned that "small businesses could be unfairly impacted by the taint that might attach to Rule 504 offerings."<sup>29</sup> Like the inadequacies of Rule 506 previously identified by the Commission, the agency's experience with Rule 504 must be fully vetted as part of any Rule 506 amendment that would similarly liberalize GS&A activities. This experience reflects the adverse effects on both investor protection *and* access to capital for small businesses.

#### VI. Context of Rulemaking: New Concerns Created by the JOBS Act

Amendments to Rule 506 cannot be considered in isolation. In many respects, there are new concerns created by the JOBS Act that also must be addressed in any Rule 506 rulemaking. Some have been created by the elimination of the GS&A ban. Others would be concerns requiring amendments to Rule 506 even without the ban's elimination. All of the following problems must be considered as part of the context of Rule 506 rulemaking under Section 201(a)(1).

- Number of Shareholders Triggering Public Company Status. The JOBS Act increased the number of shareholders that a company can have before being subject to reporting under the Exchange Act. This provision will allow more companies to avoid public company status and thereby increase the number that can raise capital under Rule 506 without disclosure of basic information about their business and finances or compliance with other public company regulations. At the same time, permitting GS&A activities will exponentially increase the dissemination and availability of unregulated information. Rule 506 amendments therefore must address the new problem – which exists even without the exacerbating effect of permitting GS&A – of an entirely

<sup>28</sup> *Revision of Rule 504 of Regulation D, the "Seed Capital" Exemption*, Securities Act Rel. No. 7541 (May 21, 1998) ("If the microcap market, or offerings under Rule 504, become stigmatized as unsavory, legitimate small businesses may become less able to raise money as investors lose confidence in the market and in the integrity of those making such offerings.") available at <http://www.sec.gov/rules/proposed/33-7541.htm>.

<sup>29</sup> *Id.*

new category of larger companies with significantly larger shareholder bases operating in the shadows of the private markets.

- Crossover with Crowdfunding. Crowdfunding will create a parallel market where GS&A is not permitted but securities can be sold to anyone. This creates the risk that GS&A activities will be made under cover of Rule 506 that are actually intended to condition the market for crowdfunding offerings. Rule 506 amendments therefore must address the problem of GS&A under Rule 506 where GS&A is being used to engage in illegal marketing of crowdfunding offerings.
- Stimulated Resale Markets. The GS&A activities that accompany a private offering will create substantially greater interest in the securities in the resale market. However, current resale restrictions assume that securities issued in private offerings have *not* been subject to such broad, market-conditioning activities. Current resale rules must be revisited because they are inadequate to address the increased resale activity that GS&A will promote.
- Nonaccredited Investors. Rule 506 currently permits sales to nonaccredited investors. It will become substantially more difficult to determine whether sales to such investors were permissible, because this determination will require tracing each sale to a nonaccredited investor back to *all* of the relevant sales activities to determine whether they included GS&A. Rule 506 does not require integration across separate Rule 506 offerings; the rule should, at a minimum, prohibit *all* Rule 506 sales to nonaccredited investors by issuers that have made GS&A under Rule 506. The Commission must also consider whether sales to nonaccredited investors under Rule 506 continue to be viable under any circumstances.<sup>30</sup>
- Broker-Dealer Exemption. Section 201(c) of the JOBS Act exempts broker-dealers that provide a platform used for Rule 506 offers and sales from registration under the Exchange Act. This exemption dramatically alters the context for private offering regulation by removing intermediary regulation that is crucial for the protection of investors and the integrity of markets. This change alone would militate for substantial revisions to Rule 506 even without the GS&A mandate. The GS&A mandate now requires an even more thorough effort to ensure that the important investor and market protections under broker-dealer regulation that are lost as a result of this exemption are replaced in an amended Rule 506.

These are only some of the considerations that must attend any changes to Rule 506. We urge the Commission to conduct a ground-up review of the full regulatory context in which private offerings occur to ensure that amendments to Rule 506 fully reflect the impact that removing the ban on GS&A will have on investors and the securities markets.

## VII. Potential Reforms

As a general matter, we will reserve any detailed comments on amendments to Rule 506 pending notice of the SEC's proposed rulemaking. However, we consider two specific amendments to be nondiscretionary, in addition to the requirement that the GS&A ban be removed. First, the Commission

<sup>30</sup> Eliminating non-accredited investors from Rule 506 eligibility also might reduce issuers' net compliance costs. Issuers and intermediaries may prefer not to have the option of selling to non-accredited investors (*e.g.*, friends and family of accredited investors) because of the increased compliance risk and costs [*e.g.*, the Rule 502(b) disclosure document] that such sales pose. Many issuers and intermediaries therefore might prefer to have their hands tied in this respect.

must enhance verification procedures for accredited investor status for GS&A offerings, as expressly required by Section 201(a)(1). Second, the Commission must raise the standards for natural persons to qualify as accredited investors, standards that the Commission has acknowledged are grossly inadequate.

In addition, we believe that the Commission must take additional steps to address the substantial risk of investor harm and damaged market confidence that allowing GS&A in unregistered offerings will create. While we do not propose a particular mix of reforms at this time, we do believe that the Commission must consider, among other options, the following reforms and explain why, if they are not adopted, why they are not necessary or appropriate in light of the SEC's longstanding view, reflected in the current Rule 506, that GS&A create significant potential for abuse.

- Form D. Require the filing of Form D at least 30 days before any sale in a Rule 506 offering in which there is GS&A. Expand Form D to require additional information regarding such GS&A offerings.
- Pre-Filing of General Solicitations and Advertising Materials. Require pre-filing of all GS&A under Rule 506 with FINRA, regardless of whether any broker-dealer involved is exempt from registration under the Exchange Act. FINRA already pre-reviews broker-dealer advertising; the same requirement should apply to GS&A in light of the significant potential for abuse. Develop content requirements for GS&A, such as explicit warnings regarding the risks of investing in unregistered securities.
- Issuer Disclosure. Require that Rule 506 issuers and their agents that engage in GS&A activities file with the Commission and deliver to all persons who contact them regarding the offering a disclosure document that sets forth basic information (*e.g.*, the disclosure document required under Rule 502(b)(2)).
- Resale Restrictions. Impose stricter requirements on the resale of Rule 506 securities with respect to which the issuer has engaged in GS&A activities.
- Integration with Crowdfunding. Substantially narrow the 6-month safe harbor for integration with crowdfunding offerings, non-GS&A Rule 506 offerings and all other offerings of unregistered securities that do not permit GS&A.
- Broker-Dealer Exemption. Identify the most significant gaps in broker-dealer regulation that the broker-dealer exemption will create and take steps to remedy this weakening in investor protection.
- Exclude Nonaccredited Investors from Rule 506. Amend Rule 506 to exclude nonaccredited investors as eligible purchasers, or narrow that category of persons to key executives of the issuer who are in a position to obtain the information necessary to make an informed investment decision. Alternatively, prohibit sales to nonaccredited investors by issuers that have made a GS&A offering.
- Bad Actor Disqualification. The Commission has proposed to amend Rule 506 to prohibit certain bad actors from relying on the rule's safe harbor, as required by Section 926 of the Dodd-Frank Act.<sup>31</sup> The one-year deadline imposed under Section 926 has long since passed. We urge the

<sup>31</sup> *Disqualification of Felons and Other "Bad Actors" From Rule 506 Offerings*, Securities Act Rel. No. 9211 (May 25, 2011). The Commission made a similar proposal in 2007, on which it also has not taken final action.

Commission to adopt final amendments no later than the elimination of the GS&A ban under Section 201(a)(1).

- Recordkeeping. Create/Enhance recordkeeping requirements regarding information on, among other things, accredited investor status, content and use of GS&A, and size and qualifications of shareholder base.
- Hedge Funds. Prohibit GS&A by funds relying on the exemptions under Section 3(c)(1) and (7) of the Investment Company Act. Alternatively, apply mutual fund advertising and valuation rules to hedge funds that engage in GS&A (and, in any case, require standardized performance and fee reporting for all hedge funds), and require explicit, large-font disclaimers that hedge funds are not mutual funds and present special risks.

In summary, for decades the Commission has imposed a ban on GS&A under Rule 506 for good reason: general solicitation and advertising activities create special risks for investors and the integrity of markets. Congress recognized this concern by delegating to the Commission the authority to find a way to permit GS&A consistent with the SEC’s exercise of authority under Section 4(2). We believe that it is only possible to accommodate GS&A under Rule 506 offerings if extensive reforms such as those set forth above are adopted to address the abuses that GS&A will unleash.

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In conclusion, we appreciate this opportunity to comment on rulemaking under Section 201(a)(1) of the JOBS Act. We hope that the Commission will recognize that an interim or temporary rule under this provision would be inappropriate and improper, especially in light of the considerable revisions to Rule 506 that eliminating the GS&A ban will necessitate. The Commission must consider pre-existing deficiencies in Rule 506 as well as new problems that Section 201(a)(1) and other JOBS Act provisions have created. It is important to note that, while Congress has instructed the Commission to craft a rule under Section 4(2) that permits GS&A, it did not limit in any way the SEC’s obligation to ensure that Rule 506 as a whole is consistent with the Section 4(2) exemption’s requirement – its only requirement – that the exempted transactions be “nonpublic.”<sup>32</sup>

We look forward to providing further comments once notice of a proposed rule has been issued. Thank you for your consideration of our comments.

Sincerely,

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Fund Democracy, Inc.

Barbara Roper  
Director of Investor Protection  
Consumer Federation of America

Lisa Donner  
Executive Director  
Americans for Financial Reform

Lynn E. Turner  
Former SEC Chief Accountant

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<sup>32</sup> Section 4(2) states as follows: “The provisions of section 5 shall not apply to . . . (2) transactions by an issuer not involving any public offering.” Section 201(a)(1) of the JOBS Act provides that Rule 506 shall not be unavailable solely “as a result of general advertising or general solicitation.”

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