

HELPING ANGELS LEAD OUR STARTUPS ACT

APRIL 19, 2016.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. HENSARLING, from the Committee on Financial Services, submitted the following

R E P O R T

together with

MINORITY VIEWS

[To accompany H.R. 4498]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 4498) to clarify the definition of general solicitation under Federal securities law, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE AND SUMMARY

Introduced on February 9, 2016, by Representatives Chabot, Hurt, Sinema and Takai, H.R. 4498 the, “Helping Angels Lead Our Startups” (HALOS) Act builds on the success of the bipartisan Jumpstart Our Business Startups (JOBS) Act (Pub. L. No. 112–106). The HALOS Act furthers the JOBS Act’s mission to promote access to investment capital for small companies and ensure that startups can continue to connect with angel investors. H.R. 4498 defines an angel investor for purposes of the Federal securities laws and clarifies the definition of general solicitation contained in the Securities Act of 1933 (Securities Act) to ensure that startups have the opportunity and ability to discuss their products and business plans at certain events, known as “demo days” where there is no specific investment offering.

## BACKGROUND AND NEED FOR LEGISLATION

Title II of the JOBS Act makes it easier for startup enterprises to market their securities to a larger pool of investors. The Securities Act requires that offers to sell securities must either be registered with the Securities and Exchange Commission (SEC) or specifically exempted from such registration. One such exemption is Rule 506 of Regulation D, which allows companies to offer securities for sale to up to 35 non-accredited investors and an unlimited number of accredited investors (with accredited investors self-verifying their status) as long as the company does not market its securities through general solicitations or advertising. Title II of the JOBS Act extended this exemption to securities marketed through a general solicitation or advertising so long as the issuer takes steps to verify that all purchasers of the securities are “accredited investors.”

When the SEC implemented Title II of the JOBS Act, the final rule classified events held by angel investors as general solicitations, thus requiring entrepreneurs and startups to verify accredited investor status. This process can be burdensome and jeopardizes educational and economic development events like “demo days”—where startups may interact with angel investors and venture capitalists.

Angel investors are wealthy individuals who often are actively involved in the startups they back, and who typically are not professional investors. According to the Angel Capital Association (ACA), angel investors deployed \$24.1 billion in capital in 2014 which is an increase from \$17.6 billion in 2009. As a result, angel investors have now surpassed venture capitalists as the largest funding source for startup enterprises in the United States. Angel investors, like venture capitalists, fund early-stage entrepreneurs and serve as mentors or outside directors of startups.

Access to such potential investors is important; in 2014, as previously noted, angels invested approximately \$24.1 billion in over 73,000 startups, and companies such as Amazon, Costco, Facebook, Google, and Starbucks were all initially funded by angel investors. “Demo days” existed prior to the JOBS Act as investors self-certified their accredited investor status, but steps taken by the SEC to implement the Act have created uncertainty as to whether this preexisting practice may continue. H.R. 4498 ensures that angel funding remains available to startups by defining the term “angel investor group” and exempting angel investor events from being considered a general solicitation.

On February 15, 2016, the ACA’s Executive Director noted in a blog post that, “Demo Days have been an important part of the entrepreneurial financing process for literally decades, often with lead sponsorship by federal, state and local government entities for the purpose of economic development. Thousands of these events have been held annually.” The ACA further noted in the same blog post that the HALOS Act removes the uncertainty of the SEC’s actions to implement Title II of the JOBS Act as “requiring verification of accredited investors for these events creates a new burden for participating entrepreneurs and makes investors less likely to invest in participating companies because they are concerned about the requirements of the SEC rule.”

Specifically, H.R. 4498 defines an “angel investor group” and clarifies that the Securities Act’s general solicitation limitations do not apply to a presentation, communication, or event conducted on behalf of an issuer at an event sponsored by certain organizations; where any advertising for the event does not reference any specific offering of securities by the issuer; or where no specific information regarding an offering of securities by the issuer is communicated or distributed by or on behalf of the issuer.

On December 2, 2015, Chris Mathieu, the Chief Financial Officer of Horizon Technology Finance, testified before the Subcommittee on Capital Markets and Government Sponsored Enterprises in support of H.R. 4498 and noted that:

The HALOS Act provides essential protection for trade associations that facilitate such meetings between investors and fund managers, and would be greatly helpful in cultivating small business capital formation. More importantly, it provides protection for fund managers engaged in meeting potential investors at these events.

#### HEARINGS

The Committee on Financial Services’ Subcommittee on Capital Markets and Government Sponsored Enterprises held a hearing examining matters relating to H.R. 4498 on December 2, 2015.

#### COMMITTEE CONSIDERATION

The Committee on Financial Services met in open session on March 2, 2016, and ordered H.R. 4498 to be reported favorably to the House without amendment by a recorded vote of 44 yeas to 13 nays (record vote no. FC–100), a quorum being present.

#### COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. The sole record vote in Committee was a motion by Chairman Hensarling to report the bill favorably to the House without amendment. That motion was agreed to by a recorded vote of 44 yeas to 13 nays (record vote no. FC–100), a quorum being present.

## Record vote no. FC-100

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Hensarling .....	X			Ms. Waters (CA) .....		X	
Mr. King (NY) .....	X			Mrs. Maloney (NY) .....		X	
Mr. Royce .....	X			Ms. Velázquez .....		X	
Mr. Lucas .....	X			Mr. Sherman .....		X	
Mr. Garrett .....	X			Mr. Meeks .....	X		
Mr. Neugebauer .....	X			Mr. Capuano .....		X	
Mr. McHenry .....	X			Mr. Hinojosa .....			
Mr. Pearce .....	X			Mr. Clay .....		X	
Mr. Posey .....	X			Mr. Lynch .....		X	
Mr. Fitzpatrick .....	X			Mr. David Scott (GA) .....		X	
Mr. Westmoreland .....				Mr. Al Green (TX) .....		X	
Mr. Luetkemeyer .....	X			Mr. Cleaver .....	X		
Mr. Huizenga (MI) .....	X			Ms. Moore .....		X	
Mr. Duffy .....	X			Mr. Ellison .....		X	
Mr. Hurt (VA) .....	X			Mr. Perlmutter .....	X		
Mr. Stivers .....	X			Mr. Himes .....	X		
Mr. Fincher .....	X			Mr. Carney .....	X		
Mr. Stutzman .....	X			Ms. Sewell (AL) .....	X		
Mr. Mulvaney .....				Mr. Foster .....	X		
Mr. Hultgren .....	X			Mr. Kildee .....		X	
Mr. Ross .....	X			Mr. Murphy (FL) .....	X		
Mr. Pittenger .....	X			Mr. Delaney .....	X		
Mrs. Wagner .....	X			Ms. Sinema .....	X		
Mr. Barr .....	X			Mrs. Beatty .....	X		
Mr. Rothfus .....	X			Mr. Heck (WA) .....		X	
Mr. Messer .....	X			Mr. Vargas .....	X		
Mr. Schweikert .....	X						
Mr. Guinta .....	X						
Mr. Tipton .....	X						
Mr. Williams .....	X						
Mr. Poliquin .....	X						
Mrs. Love .....	X						
Mr. Hill .....	X						
Mr. Emmer .....	X						

## COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the findings and recommendations of the Committee based on oversight activities under clause 2(b)(1) of rule X of the Rules of the House of Representatives, are incorporated in the descriptive portions of this report.

## PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee states that H.R. 4498 will provide business start-ups with greater access to capital by ensuring that they are not prohibited from participating in “demo days” sponsored by certain entities.

## NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the estimate of new budget authority, entitlement authority, or tax expenditures or revenues contained in the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

## COMMITTEE COST ESTIMATE

The Committee adopts as its own the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

## CONGRESSIONAL BUDGET OFFICE ESTIMATES

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

U.S. CONGRESS,  
CONGRESSIONAL BUDGET OFFICE,  
*Washington, DC, April 15, 2016.*

Hon. JEB HENSARLING,  
*Chairman, Committee on Financial Services,  
House of Representatives, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 4498, the Helping Angels Lead Our Startups Act.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Stephen Rabent.

Sincerely,

KEITH HALL.

Enclosure.

*H.R. 4498—Helping Angels Lead Our Startups Act*

The Securities and Exchange Commission (SEC) exempts certain sellers of securities from registering their securities with the SEC and from related filing and disclosure requirements under Regula-

tion D. Private offerers of securities who are exempt under Regulation D are not allowed to engage in general solicitation or general advertising for their securities unless the purchasers of the securities meet specific requirements. H.R. 4498 would expand the manner in which securities issuers who qualify for exemptions under Regulation D can solicit and advertise their securities.

CBO estimates that implementing H.R. 4498 would cost less than \$1 million for personnel and administrative costs to revise SEC rules. However, the SEC is authorized to collect fees sufficient to offset its annual appropriation; therefore, CBO estimates that the net effect on discretionary spending would be negligible, assuming appropriations actions consistent with that authority.

Pay-as-you-go procedures do not apply because enacting H.R. 4498 would not affect direct spending or revenues. CBO estimates that enacting H.R. 4498 would not increase net direct spending or on-budget deficits in any of the four consecutive 10-year periods beginning in 2027.

H.R. 4498 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments.

If the SEC increases fees to offset the costs of implementing the bill, H.R. 4498 would increase the cost of an existing mandate on private entities required to pay those fees. Based on information from the SEC, CBO estimates that the aggregate cost of the mandate, if imposed, would be minimal and fall well below the annual threshold for private-sector mandates established in UMRA (\$154 million in 2016, adjusted annually for inflation).

The CBO staff contacts for this estimate are Stephen Rabent (for federal costs) and Logan Smith (for the private-sector mandate). The estimate was approved by H. Samuel Papenfuss, Deputy Assistant Director for Budget Analysis.

#### FEDERAL MANDATES STATEMENT

The Committee adopts as its own the estimate of Federal mandates prepared by the Director of the Congressional Budget Office pursuant to section 423 of the Unfunded Mandates Reform Act.

#### ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

#### APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of the section 102(b)(3) of the Congressional Accountability Act.

#### EARMARK IDENTIFICATION

H.R. 4498 does not contain any congressional earmarks, limited tax benefits, or limited tariff benefits as defined in clause 9 of rule XXI.

## DUPLICATION OF FEDERAL PROGRAMS

Pursuant to section 3(g) of H. Res. 5, 114th Cong. (2015), the Committee states that no provision of H.R. 4498 establishes or reauthorizes a program of the Federal Government known to be duplicative of another Federal program, a program that was included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111–139, or a program related to a program identified in the most recent Catalog of Federal Domestic Assistance.

## DISCLOSURE OF DIRECTED RULEMAKING

Pursuant to section 3(i) of H. Res. 5, 114th Cong. (2015), the Committee states that H.R. 4498 contains one directed rulemaking.

## SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

*Section 1: Short title*

This section cites H.R. 4498 as the “Helping Angels Lead Our Startups Act” or the “HALOS Act.”

*Section 2: Definition of angel investor group*

This section defines an “angel investor group” as any group that: is composed of accredited investors; holds regular meetings and has specific procedures for making investment decisions; and is not affiliated with brokers, dealers, or investment advisors.

*Section 3: Clarification of general solicitation*

This section requires the SEC to revise Rule 506 of Regulation D to clarify that general solicitation limitations do not apply to a presentation, communication, or event conducted on behalf of an issuer at an event (1) sponsored by certain organizations, (2) where any advertising for the event does not reference any specific offering of securities by the issuer, (3) and where no specific information regarding an offering of securities by the issuer is communicated or distributed by or on behalf of the issuer. This section also limits the SEC’s actions to amend the requirements of Regulation D with respect to presentations and communications, and not with respect to purchases or sales.

## CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

H.R. 4498 does not repeal or amend any section of a statute. Therefore, the Office of Legislative Counsel did not prepare the report contemplated by clause 3(e)(1)(B) of rule XIII of the House of Representatives.

## MINORITY VIEWS

The Jumpstart Our Business Startups Act (or the “JOBS Act,” P.L. 112–106) was signed into law in 2012 with the goal of expanding opportunities for small business capital formation. Democrats in Congress played a critical role in ensuring that the JOBS Act included modest investor protections, to balance out some of the capital markets deregulatory provisions in the Act. Indeed, Democrats believe that capital formation is only possible when investors have confidence that markets are transparent and fair.

H.R. 4498, or the Helping Angels Lead Our Startups Act (“HALOs Act”), runs contrary to Democrats’ goals under the JOBS Act, by undoing one investor protection put forward under Title II of the Act. This investor protection, included in the JOBS Act pursuant to a Democratic amendment, requires that companies, which sell securities in the private markets by advertising or soliciting buyers from the general public, to take “reasonable steps” to verify that the purchasers of their securities are, in fact, “accredited investors”—a special category of individuals deemed sophisticated enough under securities laws to need less protection in the marketplace.

The HALOs Act repeals that requirement when companies solicit their offerings at sales events (also called “demo days,” “venture fairs” or “pitch days”) that are sponsored by a governmental entity, a college or university, a nonprofit organization, an angel investor group, a trade association, or a venture forum or venture capital association.

This exemption raises investor protection concerns since these sales events constitute private securities offerings that are not subject to the heightened oversight by the Securities and Exchange Commission (“SEC”) and state securities regulators and have less legal recourse for purchasers. For example, under H.R. 4498 companies, including not only startups but established businesses and hedge funds, could pass out fliers on a college campus advertising their “hot new equity offering.” Individuals on the college campus could walk into the pitch, and purchase the offering on the spot with little to no understanding of the risks associated with the investment. Under the JOBS Act, this type of transaction would be permitted, but would require verification that the buyer has sufficient income or assets to meet the SEC’s standards to be considered an accredited investor. Under H.R. 4498, companies would not be required to take reasonable steps for verification of accredited investor status.

Finally, the SEC has already provided limited, administrated relief for sales events, recognizing that facilitating more tight-knit “pitch days” may, in some circumstances, be prudent. Under that relief, for example, companies, need only to have a pre-existing, substantive relationship with the potential buyers hearing their

pitch, or must have contacted the potential buyers through a personal network before the pitch, in order to avoid the verification requirement.

Had H.R. 4498 merely codified this existing SEC relief, the Minority would not have opposed the legislation. However, given the expanded exemptions provided in the bill, and the investor protection concerns they raised, the Minority opposed the passage of H.R. 4498.

MAXINE WATERS.

