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[1] 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[2] 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

[1] Biographical information and the "Truth in Testimony" disclosure is set forth at the end of this written testimony.
[2] The Jumpstart Our Business Startups Act (JOBS Act), Public Law 112–106.

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."[3] 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

[3] 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.[4]

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

[4] 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.[5] 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.[6] 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.[7]

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.

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[5] 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.

[6] 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.

[7] March 15, 2012, Congressional Record — Senate, S1727.

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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.[8]

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.[9] 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.

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

[9] 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.[10]

[10] 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

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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.[11] This aspect of the Act has the potentially 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.[12] 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.

[11] 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 there 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.

[12] 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.[13] 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.

[13] 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.

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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.

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.[14] 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.[15] 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.

[14] Alternatively, of course, Congress could clarify the statute.
[15] Ibid.

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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.).[16]

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.[17] 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.

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[16] Ibid.

[17] 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.[18]

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).[19] 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."[20] 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.

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[18] See August 30, 2012, Comments to FINRA by David R. Burton, General Counsel, National Small Business Association for details.
[19] See, e.g., "Trends in Anti-Money Laundering 2011," July 2011, Celent.

[20] 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.[21] 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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[21] 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.

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