Written Testimony


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Before the

Subcommittee on Capital Markets

and Government Sponsored Enterprises

House Financial Services Committee

U.S. House of Representatives

Hearing On

The JOBS Act at Four: Examining Its Impact and Proposals to Further Enhance Capital Formation

April 14, 2016

Washington, DC

Thank you, Chairman Garrett, Ranking Member Maloney, and Members of the Subcommittee for the opportunity to discuss developments in the early stage fundraising environment.

I'm here as the Chief Operating Officer of AngelList, a web site and service that connects companies seeking funding with angel and professional investors.

Since the JOBS Act was passed in 2012 and the Securities and Exchange Commission (SEC) issued several clarifying no-action letters in 2013, AngelList launched what we call our "Syndicates" product. This product allows an experienced accredited investor, who is putting their own money into an early-stage startup, to make that investment available to other angels and professional investors online. Those investors who decide to participate are grouped into a venture fund that follows along with the lead investor and compensates them as VC funds do – with a percent of the profits if the investment is successful and nothing if it isn't.

We launched our first Syndicate in September 2013. Since then, we have helped over a quarter billion dollars in capital reach early stage startups through the AngelList platform. While that number seems small by Wall Street standards, keep in mind these are brand new companies that just need a little capital to get off the ground – in this case, that represents almost 1,000 companies that were launched in part using the online fundraising techniques the JOBS Act and subsequent clarifications allowed. And we are just one of many players. While we focus primarily on technology companies, others such as CircleUp focus on consumer products companies, and many more.

Of course, it was called the JOBS Act because it was intended to create jobs. The first priority for startups after raising money is using that money to hire. We launched AngelList Talent to help bring together the startups who recently raised money with the talent that can help them grow. At this point, we place over 600 people a month into startup jobs they found via AngelList.

So first, I want to thank Congress, in particular the leadership of this Committee, Cong. McHenry and the White House for the changes brought about by the JOBS Act and their attention to capital formation issues. The companies that raised money on AngelList range from those producing electric bicycles to Uber, from Spire Global that launches and rents imaging satellites by the hour to Cruise Automation which GM just paid over a billion dollars to acquire so that they can compete in self-driving automobiles. If capital formation does its job right, these startups are not only creating more jobs, but they are also producing innovations that affect our daily lives.

Second, I want to discuss a few of the bills under consideration that are aimed at improving some parts of the JOBS Act in ways that are aligned with the original intent.

Specifically, I will speak to HR 4854, known as the "Supporting America's Innovators Act of 2016", HR 4855, the "Fix Crowdfunding Act", and HR 4852, the "Private Placement Improvement Act".

The original JOBS Act raised the cap on investors in a privately-held company from 500 to 2,000 investors. This was a welcome change that helped companies go public only when ready. However, the limit on the number of investors acting as a coordinated group to invest in a company remained at 99, where it's been since 1940. With online fundraising and general solicitation becoming more common because of the JOBS Act, companies are bumping up against this limit more frequently. The limit of 99 investors now acts as a brake on the amount of sophisticated, accredited capital that is flowing into companies. On our platform alone, we have hit the total investor limit dozens of times and well before securing the total amount of money the company wanted to raise, leaving tens of millions of dollars on the table that did not go into startups. And we are not alone – as large as we are, we represent a small proportion of the capital invested in startups. The Angel Capital Association also has many member angel groups that have over 100 members – and thus need to exclude members and reduce the amount raised for the companies.

In line with raising the 500 cap to 2,000 for companies, we believe that raising the 99 investor cap to 500 for investment LLCs designated for would help with capital formation at that stage. HR4854 updates that law for today's technologies and investment opportunities.

The next issue I wish to address is crowdfunding. While AngelList has been fortunate to thrive and succeed without unaccredited crowdfunding, we have been able to experiment with investments targeted to larger groups of investors. As a result, we have settled on techniques that protect investor's interests while still encouraging capital formation for good companies. Unfortunately, some of those techniques to protect investors would not be legal under the final crowdfunding rules. HR 2855, the "Fix Crowdfunding Act," would go a long way towards improving the underlying crowdfunding measure adopted four years ago. We filed comments with the SEC based on our experience suggesting ways to better align the statute with the realities of how companies raise money today. I have attached AngelList's letter to the SEC as an appendix and ask that it be a part of my testimony.

The first set of suggestions address an issue that complicates effective crowdfunding implementation: crowdfunding shouldn't be so onerous for companies that it becomes a "last resort" for those that can't raise money elsewhere. Making it perfectly safe but guaranteed to lose money in the aggregate would not be a good outcome for the companies nor do we think it would reflect the vision articulated by the Congress.

HR 4855 addresses the burden in several ways:

1. The original act required all companies to bear the legal and accounting costs of preparing for a crowdfunding campaign even if their campaign failed. On AngelList, less than 10% of companies trying to raise succeed, so it's important to put the costs only on the companies that already know they will raise. HR4855 contains a "test the waters" provision that allows companies to gather interest prior to going through the legal and accounting steps (but still requires them before company takes any money).

2. The SEC's final crowdfunding regulations contained a provision that required companies to register, similar to a pubic company, within 2 years of crossing $25 million in assets if they had 500 or more unaccredited investors (the so-called "12g problem"). That would dissuade later investors from investing in fast-growing companies if doing so would put the company in a 24-month path to meeting public company requirements; the very companies the need the most money to grow would be dissuaded from raising it because of the earlier registration requirement.

The second set of issues were suggestions to improve investor protections in the law by applying lessons we learned from allowing larger groups of accredited investors to invest.

1. Portals should have more leeway in who to include. This bill goes part way there by specifying that any evidence of fraud would be disqualifying.
2. As written, the current JOBS Act version of crowdfunding forbids the use of what I described earlier in my statement as "Syndicates", where a fund is formed to look out for the interests of the investors (and compensated transparently to do so). This bill allows single-security venture funds to be used as a vehicle for the investors. It simply brings the protections afforded to accredited investors to the unaccredited investors where they are likely to be even more necessary.

Finally, on HR 4852, the "Private Placement Improvement Act", we have also attached our letter to the SEC as an appendix to my testimony and ask that it be included in the written record. The changes to Reg D financing that the SEC was considering would be very impractical for startups – the very companies the JOBS Act was intended to help. Startups learn by copying one another. Seeing a successful company talk about their financing publicly would lead another to do so. Today, that would be called general solicitation and the company would have to verify the accredited status of their ultimate investors. If the proposed changes requiring Form D filing 15 days in advance of discussing a financing were adopted, however, that same company could be banned from using Reg D to finance their company at all. This seems against the spirit of the JOBS Act and we believe there are much better way to get at the stated goals of the proposed changes. HR 4852 would clarify for the SEC the methods that they can use to achieve those goals and would be a welcomed by the startup community.

Thank you very much for this opportunity to share AngelList's experience since the passage of the original JOBS Act and for your continued attention to the issues affecting capital formation for very young companies that don't usually have a voice. This is an unusual area in that the companies hurt the most by high friction in capital formation don't exist yet; with your continued support we hope thousands more of them can begin to make use of the JOBS Act to do what Congress originally intended: making it easier for good companies to raise capital and to create jobs.

<u>**Via electronic mail at rule-comments@ sec.gov**</u>

January 24, 2014

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

**Re: Crowdfunding**
**File No. S7-09-13**

Dear Ms. Murphy:

Thank you for the opportunity to provide comments to the Securities and Exchange Commission on its proposed rules for Crowdfunding.

AngelList is a web-based platform that helps connect startups in need of financing with accredited investors. While we operate only with accredited investors, we believe that our experiences operating a platform that is in some ways similar to what's envisioned under the Crowdfunding rules may help inform your deliberations as you work on the new Crowdfunding rules.

Over time, we have developed a set of mechanisms that work well for a large investor base to ensure that things flow smoothly and without fraud on both the investor and company side. While there are many alternative ways to accomplish the same thing, we do believe that allowing platforms like ours to extend a similar model to the crowd would be valuable.

We were very pleased to see that the Crowdfunding regulations do allow a simultaneous Reg D offering; this will allow the crowd to get the benefit of a sophisticated investor group vetting the company and terms.

We believe there are several improvements that could further improve the likelihood of a functioning Crowdfunding marketplace within the scope of the JOBS Act:

1. **Allow issuers to "test the waters".** The proposed regulations don't allow companies to "test the waters" by seeing what investor interest would be before bearing the regulatory expense. We believe the same investor protection goals could be met by requiring the disclosures, bad actors checks, etc., 15 days before *accepting cash* rather than before just soliciting interest. Using the SEC's own regulatory burden estimates, the current regulations would imply $350,000 of expenses for every successful raise if Crowdfunding issuers see the same success rate as open non-equity crowdfunding portals or foreign equity crowdfunding portals (1 success for every 10 tries, but with all 10 companies bearing the costs of trying).

2. **Allow Funding Portals to curate opportunities.** While we are mindful that the law bans "investment advice or recommendations" from Funding Portals, we are looking to the Commission to clarify the line between curation and recommendation. We believe the proposed regulations go too far by banning any form of judgment, including which issuers to allow on the Funding Portal.

   AngelList would not function if we could not provide that service for accredited investors. We do not make recommendations to our investors (they would ignore them if we did). However, investors value that we rank order investments by likelihood of interest to them and only feature or notify them of those most likely to be worth reviewing. With near 100,000 companies, the site would fail if we did not, as investors would find themselves seeing poor quality businesses next to great startups. The net effect would be the same as your email provider or ISP not being allowed to provide the service of filtering out spam. Your ISP is not "recommending" the emails that pass the filter, but if they didn't provide that service, you would be awash in junk.

   Our ability to use our judgment to sort, filter, and feature (while not crossing over into telling investors what they should and shouldn't invest in) is critical to the fact that over 1,300 companies have found investors on AngelList and we have 0 reported instances of fraud. I would be very concerned about removing that important protection from the market, which the current proposal appears to do.

   Likewise, I'm uncertain what protection is added by banning the intermediary from that critical function. There is a very important distinction between screening & sorting (which is done absent any judgment to customize to specific users or to identify specific portfolios to invest in) as separate from recommendations or investment advice (whereby we would select specific companies for investors and recommend they buy into them).

3. **There should be no "issuer liability" for the intermediary.** The JOBS Act is quite specific about liability. For example, it extends the definition of issuer to include individuals associated with the company. However, it does not place additional liability on the intermediary. We were surprised to see an opinion in the regulations that the intermediary bears liability as an issuer. When combined with the ban on Funding Portals choosing who can be an issuer on the platform, this appears to make Funding Portals untenable.

4. **Encourage intermediaries to take equity for services.** The current proposal bans the intermediaries from taking equity in the underlying company in return for services. So long as the program was consistently applied without judgment by the intermediary, the net effect would purely be to align the interests of the intermediary with the investor. In a market characterized by such extreme information asymmetries, this is an important investor protection. The proposals

appear to go to the other extreme and ban this important investor protection in a way that doesn't appear to be based on the requirements of the law.

We would be happy to make ourselves available to discuss our views on this at more detail at your convenience if you would like to know more about how AngelList handles the investor protection issues that arise in a marketplace similar to this one.

Sincerely,

Naval Ravikant
CEO, AngelList

**Via electronic mail at rule-comments@ sec.gov**

August 12, 2013

Ms. Elizabeth M. Murphy
Secretary, Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

**Re: Amendments to Regulation D, Form D and Rule 156 under the Securities Act File No. S7-06-13**

Dear Ms. Murphy:

Thank you for the opportunity to provide comments to the Securities and Exchange Commission on its proposed amendments to Regulation D under the Securities Act of 1933, and Form D.[1]

AngelList is a web-based platform that, among other things, helps accredited investors connect with startups in need of financing. Congress sought to encourage platforms precisely like AngelList by passing Section 201(c) of the Jumpstart Our Business Startups Act (the "**JOBS Act**"). With over 100,000 startups on AngelList and almost 20,000 accredited investors, we have a view into how most modern technology startups finance the early stages of their growth.

We are concerned that the newly proposed Form D filing rules could create disastrous unintended consequences for the startup community. We will explain how the proposed rules are a poor mix with modern startup financing and suggest some alternatives that better support the stated goal of monitoring general solicitation financing activity.

AngelList would be happy to discuss any of our concerns or recommendations further as you develop your proposed regulations on this matter.

## Overview of Modern Startup Financing

The proposed rules appear to be tailored to how Wall Street raises funds, not the startup community. If the issuer generates a detailed Private Placement Memorandum (PPM) and circulates it to a variety of investors, then most of the steps detailed in the proposal may not be difficult: just file a Form D 15 days before you circulate the PPM, file the PPM with the SEC, and amend the Form D when the financing is complete. The fact that non-compliance is severely punished is not a concern in this scenario, because the issuers, investment banks, and law firms know and implement the rules carefully.

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[1] *See* Amendments to Regulation D, Form D and Rule 156 under the Securities Act, 78 Fed. Reg. 44806 (July 24, 2013) (the "**Release**").

However, the same rules applied to early stage startups will prevent them from forming. Since young companies are responsible for most of the job growth in the US, we believe this is against the spirit of the JOBS Act. Modern entrepreneurs usually are not well-financed business people; they are engineers and designers who realize their idea is growing fast enough that they need capital to feed it. They often need small amounts of capital (less than $1 million) and can't afford the lawyers, investment bankers and broker dealers the proposed rules imply must be available to them. The proposed requirements involve many technical legal determinations, which most startups will not be able to afford at that stage. Because the rules are written with well-financed and well-lawyered issuers in mind, the result will be inadvertent non-compliance by otherwise well-meaning startups. Combined with the stiff penalties, this can prevent the early stage startups from fundraising entirely We believe the requirements should take into account the more limited resources of the startup community.

Unlike the Wall Street fundraising envisioned by the proposed rules, entrepreneurs are open to fundraising throughout their growth. In most cases, that's before they even have a lawyer (and they rarely, if ever, use bankers for this stage). The materials are usually pictures of the product in action, a constantly-updated profile on a site like AngelList, and links to bios of founders and others associated with the company. Investor questions and concerns are addressed transparently and instantly by modifications to the materials, emails, or postings on private forums. If investors keep asking about potential market size, for example, the startup will add a few sentences to their overview, or a slide to a presentation available online.

In that environment, rules that may be easy for Wall Street are a death sentence for startups. They are easy to break accidentally and the penalty for noncompliance is severe. There isn't a "start" to a formal financing round that a startup controls. They are constantly testing the waters to see whether their venture is far enough along that it can attract investor interest at a high enough valuation. Over time, startups "soft circle" investors and know they have enough interest to close a financing. The lead investor or startup proposes terms then a close happens very quickly. Chance meetings or opportunities to promote your startup rarely come with a 15-day advance notice built in. More importantly, many entrepreneurs will see others publicly discussing fundraising and will do the same – without filing papers first, since they didn't know it was required. Fundraising startups aren't profitable yet, so the penalty for non-compliance - a one-year financing ban – often means death for the startup.

There isn't a PPM. Materials entrepreneurs share with investors change daily – transparently, since investors are often following the startups on AngelList and are notified of the changes. This transparency supports good investment decisions. At AngelList, we've facilitated introductions that have resulted in over 2,000 financings with zero reported cases of fraud. That transparency disappears if entrepreneurs are told that every change the public can see requires a new SEC filing (the rule "510T"). Ironically, this will have the impact of moving information flow to conversations only, where it can't be monitored – the exact opposite of transparency.

There is an irony in these proposals. The stated reason for them is to track general solicitation financing activity – the very activity that is now entirely out in the open and trackable on sites like AngelList without needing additional regulation. The net effect of these proposals will be reduce transparency and real-time communication rather than merely measuring it as it happens.

**Alternative Solutions**

To summarize the problems that the proposed regulations will impose on the startup community:

1. The requirement to file a Form D 15 days prior to the financing, or at the close of financing even if a financing doesn't close, is meaningless in our world. Startups are always financing.
2. The requirement to formally file all written materials provided to investors with the SEC is not feasible in a world where the materials are updated continuously.
3. The requirement to include disclosures every time you mention a financing doesn't work for most places those appear (try tweeting boilerplate legal text in 140 characters, or requiring reporters to include it in stories).
4. These technical legal requirements place burdens on startups at a stage before they may have legal advice, and the very severe penalty for non-compliance (not fundraising for a year) is a death penalty for a not-yet-profitable business.
5. Specifically relevant to AngelList, "affiliates" or "promoters" of startups that violate these rules are also subject to penalty. Given our neutral role, we are concerned that a broad interpretation there could lead us to accidentally be swept up in this. With over 100,000 companies I'm quite certain at least one will accidentally miss something and not cure with the SEC, potentially barring offerings by AngelList and all other companies listed on AngelList for one year.

We believe the SEC can monitor financing activity even better without putting the startup ecosystem at risk. Here are some suggestions that overcome the specific problems outlined above:

1. ***Allow third parties to do the filing on issuer's behalf via API[2].*** Sites like AngelList can automatically register, via API, some very simple data with the SEC: Company, founder, contact information, date when they turned on financing, optional URL to view financing materials. We can help both communicate the new regulations and facilitate compliance with them. This

[2] An API (application programmer interface) allows a program to automatically communicate with another program. In this case, AngelList's site could automatically file the correct information with the SEC in the normal course of an entrepreneur kicking off fundraising. To really encourage compliance, filing requirements should be limited to information already collected while setting up a profile.

only works if we don't have to collect heavyweight information envisioned in a Form D – just a lightweight "we're raising" sent at any time up to close.

2. ***Allow the company (or a third party like AngelList) to hold the financing materials so the SEC can access them.*** Companies should just need to give the SEC a simple URL where most of the financing activity happens, as opposed to making a formal filing with the SEC every time an update is made. AngelList or other sites can keep change logs so the SEC can see what the materials looked like at a point in time.

3. ***Only require legends and disclosures when terms are communicated.*** Acknowledging the existence of the financing somewhere publicly (media, Twitter, conferences, etc.) shouldn't require legends and disclosures.

4. ***Drop the 15-day-in-advance before financing rule entirely.*** This creates a minefield for startups without actually helping anybody – even the SEC states that they won't review the materials at that time. Make the Form D filing "after the fact" as it is today.

5. ***Don't impose death penalties for noncompliance. Instead, reduce the costs of compliance.*** The reason for the high non-compliance rates in the venture and startup community is that the information made public by the Form D is usually highly confidential. Startups often want to control the timing of their financing announcement and prefer not to reveal amounts raised for competitive reasons. If more of the Form D information was confidential rather than public, compliance rates would jump dramatically.

6. ***Don't be overly broad in the penalty application.*** There are many businesses like AngelList, incubators, and VCs that surround startups. These businesses are built to avoid getting in the way of a startup's autonomy – they should not be penalized for activities that a startup undertakes on their own that the business can't control. The current penalties seem to apply broadly; any penalties should be applied only to the entity that doesn't comply, not to all of the supporting businesses surrounding it.

Thank you for your attention to these matters. We remain excited by the opportunities new startup companies will have to reach capital and grow more quickly. We just want to make sure the SEC can meet the public needs without accidentally harming the startup community we believe the JOBS Act was intended to foster.

We would be happy to make ourselves available to discuss our views on this at more detail at your convenience. We believe that implemented correctly, the JOBS Act will be a boon to the startup community, and are willing to help in any way we can.

Sincerely,

Naval Ravikant
CEO, AngelList