THE JOBS ACT AT FOUR: EXAMINING ITS IMPACT AND PROPOSALS TO FURTHER ENHANCE CAPITAL FORMATION

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

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U.S. HOUSE OF REPRESENTATIVES

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CONTENTS

WITNESSES

Thursday, April 14, 2016

APPENDIX

Additional Material Submitted for the Record

THE JOBS ACT AT FOUR: EXAMINING ITS IMPACT AND PROPOSALS TO FURTHER ENHANCE CAPITAL FORMATION

Thursday, April 14, 2016

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS AND
GOVERNMENT SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:02 a.m., in room 2128, Rayburn House Office Building, Hon. Scott Garrett [chairman of the subcommittee] presiding.

Members present: Representatives Garrett, Hurt, Royce, Neugebauer, McHenry, Huizenga, Stivers, Hultgren, Ross, Wagner, Messer, Schweikert, Poliquin, Hill; Maloney, Sherman, Hinojosa, Lynch, Scott, Himes, Foster, Carney, and Murphy.

Also present: Representative Emmer.

Chairman GARRETT. Good morning. The Subcommittee on Capital Markets and Government Sponsored Enterprises will hereby come to order. Today's hearing is entitled, "The JOBS Act at Four: Examining Its Impact and Proposals to Further Enhance Capital Formation."

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Also, without objection, members of the full Financial Services Committee who are not members of the subcommittee may sit on the dais and participate in today's hearing.

I welcome all the members on the panel today.

And with that, I now recognize myself for 3 minutes for an opening statement.

It is not often that Congress can look back at a major piece of legislation and be able to measure the tangible positive impact of it that it is having on people's lives and our economy. Too often, we find ourselves, especially in this committee, counting up the costs of the many misguided Washington mandates and comparing them with the so-called phantom benefits promised by the bureaucratic class and the sponsors of those regulations.

Fortunately, that is not the case today. The Jumpstart Our Business Startups, or the JOBS Act, signed into law literally 4 years ago this month, has, by I think most measures, been a resounding success for our economy and for the future of innovation here in the United States.

The JOBS Act did this not by creating new Federal mandates or spending taxpayers' money on wasteful government programs, but instead by empowering entrepreneurs and innovators who were struggling under a regulatory regime that was better suited for 1934 than it was for 2016.

So, just consider some of these facts.

First, the JOBS Act has led to a resurgence in the initial public offering, the IPO market, with some 85 percent—yes, 85 percent—of IPOs since April 2012 coming from emerging growth companies.

Second, companies have raised some $50 billion under the new Reg D provisions that allow businesses to solicit an offering to the general public.

Third, while the newly modernized Reg A-plus is only a year old, businesses are already beginning to issue securities under that exemption.

And finally, recent reports indicates that the SEC has already received up to 30 applications for portals under the new crowdfunding rules, which are set to go into effect next month.

So while it is clear that many parts of the JOBS Act are working as intended, the point of the hearing that we are having today is not to say how great we are for doing that, and job well done. For starters, because the Senate tried its best, you would say, back in 2012 to neuter some of the provisions, especially in the crowdfunding title, and the SEC has also taken some liberties with other rulemakings, the JOBS Act obviously needs a little bit of fixing.

So I want to thank the gentleman from North Carolina, Mr. McHenry, for putting forward the Fix the Crowdfunding Act. What does it do? It makes some necessary changes to help ensure that Title III reaches its full potential.

And additionally, I have put forward a bill called the Private Placement Improvement Act, which will prohibit the SEC from implementing some burdensome new regulations on Reg D issuers that are uncalled for in the JOBS Act.

We will also consider two other bills today. Mr. Emmer, who is here today with us, has introduced an innovative bill that would create a safe harbor, if you will, for so-called micro-offerings. And Mr. McHenry, again, has another bill, which would raise the threshold for when venture capital funds would have to register with the SEC.

So finally, in addition to these targeted fixes, I am also interested in hearing from the witnesses about further areas that Congress should be addressing in order to maintain the competitiveness in our capital markets. For example, we should be exploring the cumulative burden that comes with being a public company, including, unfortunately, some of the ridiculous disclosure requirements of the Dodd-Frank Act, as well as the outside influence that proxy advisor firms have in the corporate government arena.

It is also time, finally, to think more about the lack of research and liquidity that exists for some public companies and whether the Equity Research Global Settlement of 2003 swung the pendulum just too far and has led to a dearth of research for small cap funds.

So these are all very important questions, and I look forward to hearing from each one of our witnesses today.

And with that, I now yield to the ranking member of the subcommittee, the gentlelady from New York, Mrs. Maloney, for 5 minutes.

Mrs. MALONEY. Thank you so much for calling this important hearing.

I thank all of our panelists for attending, particularly Mr. Beatty and Mr. Griggs, who is from NASDAQ, which is located in the district I am privileged to represent. I look forward to all of your testimony today.

This hearing will examine four legislative proposals that are intended to make it easier for companies to raise capital. While I am interested in hearing our witnesses' thoughts on these proposals, I do have some serious concerns with some of the bills as they are written.

H.R. 4850, the Micro Offering Safe Harbor Act, creates three entirely new exemptions from the requirement to register securities. First, the securities will be exempt from the registration requirement if the buyer has a "substantive preexisting relationship" with an officer of the company before he buys the securities.

Second, the securities will be exempt as long as the company "reasonably believes" that there are no more than 35 buyers who have relied on these new exemptions in the previous year.

And finally, the securities will be exempt if the company hasn't sold more than $500,000 of securities in the past year.

Based on the title of the bill, I believe that is intended to apply only to very small offerings of securities, or "micro offerings" as they are so called. However, the way I read the bill, it actually applies to all offerings, no matter how large, as long as the buyer has a substantive preexisting relationship with an officer of the company before he buys the security.

I am concerned that this would blow a hole in the securities law because a substantive preexisting relationship could even be developed during the company's sales pitch to the investor.

It is important to note that we are already seeing a trend toward the use of unregistered private securities rather than publicly registered securities. In fact, the private securities market is now larger than the public securities market in 2014. Companies raised $2.1 trillion through the private securities market, compared to only $1.3 trillion through the public securities market.

I believe we need to take a step back and think about whether this trend is a good thing. Clearly, this means that more securities are being sold with fewer investor protections.

Are investors in these securities being harmed or exposed to risks that they don't fully understand? Or are investors capable of bearing these risks, which they fully understood before they purchased the securities? These are important questions that I think we need to ask 4 years after the JOBS Act.

Finally, another bill we will consider today, H.R. 4854, would significantly expand the number of investors who can invest in venture capital funds that are exempt from SEC oversight. Under current law, a fund can be exempt from SEC oversight if it has less than 100 investors and its securities are not offered publicly.

A fund with fewer than 100 investors which is not marketed publicly poses fewer investor protection concerns than large funds that have lots of retail investors in them. This bill would raise that threshold from 100 investors to 500 investors, but only for venture capital funds.

I would like to hear from our witnesses as to why this change to such a longstanding rule is necessary, and what problem we are trying to solve.

So I would like to thank all of our witnesses for being here today, and I look forward to a robust discussion.

Thank you so much, and I yield back the balance of my time.

Chairman GARRETT. I thank the gentlelady, and for her questions that she raises there, as well.

I now recognize the vice chairman of the subcommittee, Mr. Hurt, for 2 minutes.

Mr. HURT. Thank you, Mr. Chairman. I thank you for holding today's hearing.

I am pleased that this subcommittee is continuing its efforts to enhance the strength and vitality of our domestic capital markets. Four years ago, this committee achieved bipartisan success with the JOBS Act, and I remain hopeful that we can continue to improve upon that work.

Capital formation for small companies is critical to the success of our economy. And as I travel across Virginia's 5th Congressional District, my district, I am regularly reminded of how our Nation's small businesses and startups are in dire need of capital, how they have trouble accessing capital, and how their potential success is often thwarted by outdated and unnecessary policies imposed here in Washington.

While small companies are at the forefront of innovation and job creation, these same companies often incur obstacles in obtaining funding in the capital markets. The JOBS Act sought to remove some of these burdens by recognizing that our securities regulations are often written for larger companies.

Today, we have four additional legislative proposals that all seek to expand and improve access to capital for our small businesses and startups. These proposals are aimed at amending the JOBS Act to enhance capital formation for small companies and their investors.

Small companies, as we all know, are the backbone of our economy and our Nation's most dynamic job creators. We must do everything possible to help them succeed. And if we can do so without compromising investor protection and transparency, then we must embrace these ideas.

The ideas we are discussing today are a step in the right direction, and I thank the sponsors for their work on this legislation.

I look forward to the testimony of our distinguished witnesses, and I thank you for your appearance before our subcommittee today.

Mr. Chairman, I thank you, and I yield back the balance of my time.

Chairman GARRETT. I thank the gentleman.

We now turn to our panel before us.

Some of you have been here before; some have not. You will each be recognized for 5 minutes, and without objection, your full written statements will be made a part of the record.

We will begin with Mr. Atkins.

Welcome to the panel once again. It is good to see you. And you are recognized for 5 minutes.

STATEMENT OF THE HONORABLE PAUL S. ATKINS, CHIEF EXECUTIVE OFFICER, PATOMAK GLOBAL PARTNERS, LLC

Mr. ATKINS. Good morning. Thank you very much, Chairman Garrett, Ranking Member Maloney, and members of the subcommittee, for inviting me to testify today.

My name is Paul Atkins. I am CEO of Patomak Global Partners here in Washington, D.C.; and for 6 years, ending in 2008, I served as SEC Commissioner.

Small businesses are vital to our Nation's economy. Startups and young companies are a primary driver of job creation.

If we are serious about spurring real economic growth, creating more jobs outside of Washington, D.C., and breaking down our two-tiered economy, we do not need higher taxes or more government spending. Instead, we need more entrepreneurs and small businesses and a sensible regulatory environment in which these individuals and firms can succeed.

The bipartisan JOBS Act proves that you do not need hundreds or thousands of pages of complex legislation to help Main Street businesses and protect consumers and investors. At only 22 pages, the JOBS Act has already achieved significant results for small businesses seeking access to much-needed capital while at the same time maintaining important investor protections and providing more opportunities for Americans to put their hard-earned dollars to work investing in America's future.

Thanks in large part to the IPO On-Ramp, 2014 was the best year for IPOs since 2004, with emerging growth companies taking advantage of the on-ramp's scale, disclosure, and reporting requirements, all of which make public offerings more attractive for smaller companies while preserving essential information for investors. More IPOs generally means more jobs.

Thanks to Titles II and IV, we are also seeing issuers and investors starting to take advantage of offerings using general solicitation and the amended Reg A-plus exemption. Just 4 years after its enactment, the JOBS Act has helped rationalize and modernize the current regulatory environment to better serve small companies and investors alike, but the job is not done.

The Obama Administration continues to bury small businesses under record amounts of red tape. I believe that a major cause of the uncertainty still handcuffing our economy is, in fact, government policy, particularly the sweeping Dodd-Frank Act.

The real tragedy behind Dodd-Frank and the hundreds of other major rules flowing from Washington every year is that consumers, investors, and small businesses are harmed the most. It is no surprise, then, that major small business surveys recently have highlighted government regulation and access to credit as being among the most significant growth concerns currently facing small companies.

The SEC, which has a statutory mandate to facilitate capital formation, has also neglected small business or, worse, firmly placed itself in the way of positive reform. The SEC could have implemented the provisions of the JOBS Act on its own, but instead the agency did neither, burying its head in the sand while Congress went to work. In fact, instead of fulfilling its core mission, the SEC has misprioritized its resources by focusing first on Dodd-Frank rules that do not address the real causes of the financial crisis and only add to the regulatory burden already weighing on our economy.

Finally, when faced with a clear JOBS Act mandate to simplify and lift the ban on general solicitation, the SEC chose on its own to slow the pace of reform by issuing an additional rule proposal to amend Reg D in ways that would fundamentally undermine the purpose of the JOBS Act.

The proposal would add unnecessary costs and burdens on small issuers and investors seeking to take advantage of general solicitation under Section 506(c)—for example, first, by making issuers submit two additional Form D filings; second, by imposing a draconian 1-year ban on using Rule 506 for failing to comply with the Form D filing requirements even for a foot fault; and third, by forcing issuers to file all general solicitation materials with the SEC.

Now, I have talked to lawyers, law professors, and venture capital investors in Silicon Valley and elsewhere, and they advise would-be issuers to shun—not use at all—506(c) offerings because of the uncertainty and the potential for "gotcha" enforcement actions by the SEC and, I think, by the States, as well. Indeed, because the nature of these nonpublic offerings means that it is hard to define a beginning and an end to the potential securities offering, the potential for "gotcha" enforcement actions with these offerings is real and a trap for the unwary.

Chairman Garrett's bill, the Private Placement Improvement Act, would go a long way towards allowing issuers to use 506(c) in the manner Congress intended.

Over the last 5½ years, this committee has been at the forefront of helping America's small businesses grow and create jobs. I thank you for all your efforts and for the opportunity to testify here today.

Thank you very much.

[The prepared statement of Mr. Atkins can be found on page 44 of the appendix.]

Chairman GARRETT. And I thank you.

Next, Mr. Beatty, welcome, and you are recognized for 5 minutes.

STATEMENT OF WILLIAM BEATTY, DIRECTOR, DIVISION OF SECURITIES, WASHINGTON STATE DEPARTMENT OF FINANCIAL INSTITUTIONS, ON BEHALF OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

Mr. BEATTY. Thank you.

Good morning, Chairman Garrett, Ranking Member Maloney, and members of the subcommittee. My name is Bill Beatty. For the past 30 years I have worked as an attorney in the securities division of the Washington State Department of Financial Institutions, and since 2010, I have served as the department's securities director.

I am also a member of the North American Securities Administrators Association (NASAA), having served as the Association's president from 2014 to 2015. Since October of 2015, I have served as Chair of NASAA's Committee on Small Business Capital Formation.

My many years in securities regulation have led me to the inescapable conclusion that successful capital formation must include robust investor protection. I am honored to testify before the subcommittee today on these four legislative proposals.

The first bill, the Private Placement Improvement Act, limits the SEC's authority to revise filing requirements for Regulation D. As we know, Title II repealed the longstanding prohibition on general solicitation and advertising under Rule 506. State securities regulators remain deeply concerned about the potential negative impact of these changes on investors.

When the SEC adopted these rules to implement Title II in 2013, it also voted on proposed rules that would mitigate the risk to ordinary investors in 506 offerings. These included requiring a prefiling of Form D when issuers intended to advertise and imposing penalties on issuers who failed to file Form D. Form D is crucial to State securities regulators like me because it is often the only information we can use to determine if an issuer is conducting an offering in compliance with a lawful exemption.

By prohibiting the SEC from adopting these commonsense investor reforms, the bill would tie the hands of the SEC to implement the few investor protections it has adopted or proposed in connection with Rule 506 and undercut the SEC's most promising efforts to gather data and additional information about the 506 marketplace. NASAA is strongly opposed to any action by Congress to diminish the ability of the SEC to address the risks to investors resulting from lifting the ban on general solicitation.

Finally, we take issue with the suggestions that filing of Form D is an onerous regulatory or compliance burden. Form D is a short form filed electronically. It captures 8 pages of information and is minimal, relative to the information in the issuer's offering documents.

Moving to the Micro Offering Safe Harbor Act, which would amend section four of the Securities Act and also preempt State securities offerings, we remain—we are deeply concerned about this bill as well. Notwithstanding the title, the new exemption would not be limited to micro offerings. In fact, it would permit the raising of unlimited amounts of money.

The bill would not prohibit general solicitation, disqualify bad actors, limit offering amounts, or even permit notice filings to State or Federal regulators. It would not impose a holding period or other restrictions on resale of securities purchased under these new exemptions, making these offerings highly susceptible to price manipulation and pump-and-dump schemes.

The bill would also make the task of policing the unregistered securities marketplace much more difficult for securities regulators. The new exemption established by the bill would likely supplant Rule 506, but without the basic information provided in Form D.

Beyond these overarching concerns, each of the new safe harbors is discussed in my written comments.

Moving finally to the Fix Crowdfunding Act—proposing revisions to Title III, State securities regulators understand the theoretical basis for several of the proposed amendments and we do not necessarily oppose them. We also appreciate Congress' frustration that Federal crowdfunding has yet to take effect. It has been 4 years since the passage of the JOBS Act, and during that time dozens of States have adopted and implemented intrastate crowdfunding exemptions.

However, the critical point for Congress today is that there is no answer to the question of how to fix Federal crowdfunding because we do not yet know what will work, what won't work, or what the new marketplace will look like. There is no data whatsoever about Federal crowdfunding, and only limited data about what is working at the State level.

By contrast, several years from now there will be a wealth of data both from State and Federal crowdfunding regimes.

State securities regulators urge Congress to refrain from amending Title III of the JOBS Act at this time. We believe that to enact legislation at this point would be counterproductive and premature.

Instead, we urge Congress to closely monitor the implementation of Regulation CF, State crowdfunding exemptions, to conduct oversight and gather information about the new marketplace. With the coming implementation of Federal crowdfunding rules and with intrastate crowdfunding already available in the majority of States, we shall very soon learn whether and how these new capital-raising tools will be used.

Thank you again, Chairman Garrett and Ranking Member Maloney, for the opportunity to testify before the subcommittee today.

[The prepared statement of Mr. Beatty can be found on page 55 of the appendix.]

Chairman GARRETT. I thank you, Mr. Beatty.

Next up, Mr. Griggs. Welcome, and you are recognized for 5 minutes.

STATEMENT OF NELSON GRIGGS, EXECUTIVE VICE PRESIDENT, NASDAQ

Mr. GRIGGS. Thank you, Chairman Garrett, Ranking Member Maloney, and members of the subcommittee, for the opportunity to testify on JOBS Act four. The work of this subcommittee to push forward the JOBS Act is a great achievement of Congress and a shining example of bipartisanship and statesmanship. However, there are issues that remain affecting private companies' view of the public markets today.

Capital formation and job creation are the NASDAQ's DNA. We brought the capital markets a trusted listing venue and the changed view that companies can go public earlier in their growth cycle, dispelling a common Wall Street perception about when companies should go public. NASDAQ recognized that while most companies wanted access to capital, investors also want access to companies at earlier stages of the growth cycle.

In the same vein, since the enactment of the JOBS Act, NASDAQ has created the NASDAQ Private Market (NPM). We established NPM to meet the unique needs and challenges of today's top growth companies.

Thus, NASDAQ, we feel, is uniquely qualified to speak about both public and private markets.

Four years have passed and the evidence is clear: The JOBS Act has successfully helped hundreds of companies to go public while generating new dynamics in the private space. In fact, 785 companies have gone public, leveraging the Emerging Growth Companies Act, and have raised over $103 billion to expand, hire, and compete on a global stage. And approximately 1,000 registration statements have been filed with the SEC confidentially.

From our vantage point, the JOBS Act has not resulted in diminished investor protection, an important outcome as you consider moving forward with reforms.

Without question, NASDAQ believes the most successful provision of the JOBS Act has been the ability for companies to file confidentially. This has been most evident in the increased number of IPOs in the biotech and life science sectors. Many quality companies have been able to work with the SEC to finalize their registration without public disclosure of their competitive proprietary information, and companies can better manage their decisions to go public as they evaluate market conditions.

Because confidential filing has improved the IPO process without decreasing investor protection, we believe Congress should go one step further and allow companies of all sizes to file on a confidential basis and also allow other types of registration statements to be filed confidentially.

So turning to some challenges that we see facing public companies today that I hear day in and day out from our listed companies, which create a negative light on entrepreneurship views of going public, for example, certain investors who accumulate long positions today are required to do public disclosures of their holdings, but there are no corresponding obligations for short-sellers to do so, even though the same policies of transparency, fairness, and efficiency apply.

We believe that some enhanced disclosure of short positions that matches disclosure for long requirements is warranted. From a company perspective, this lack of transparency has a real negative impact because it deprives a company of insights into trading activity and limits their ability to manage and engage with investors.

With respect to proxy advisory firms, we remain concerned that these firms do not always conduct their standard-setting in a fair and transparent manner. We are pleased that the SEC issued guidance regarding the use by investment advisories—advisors of proxy advisory firms, but it is apparent that much more work needs to be done here.

Last year, NASDAQ partnered with the U.S. Chamber on a survey of public companies' experience in the 2015 proxy season. Over 155 companies responded, and it is apparent that companies continue to have difficulty providing input to advisory firms or even having errors corrected.

Lastly, with respect to the PCAOB, public companies, especially smaller ones, face increasing auditing costs. While companies do not object to costs that provide equal investor benefit, the companies claim that some of these costs are the result of nonsensical, one-size-fits-all application of guidance and feel they are stuck because auditors claim that they must comply with the PCAOB. For these reasons, we believe the PCAOB should be required to establish an ombudsman's office as a resource for companies to bring up issues that they have.

So I want to commend the subcommittee for its continued work to help capital formation with the bipartisan passage of the last 15 capital formation bills, including the RAISE Act, authored by Representative Patrick McHenry and strongly supported by NASDAQ.

I also want to thank you, Mr. Chairman, for your leadership in offering an important bill, the Main Street Growth Act, to foster creation of venture exchanges. We certainly appreciate the discussion on this and we look forward to being a participant moving forward.

The subcommittee has asked NASDAQ to comment on the four proposals aimed at fostering capital formation, and I have done so in my written testimony. We are in favor of the efforts here and look forward to supporting them as they move forward.

Thanks very much for your time, and I appreciate the attention.

[The prepared statement of Mr. Griggs can be found on page 68 of the appendix.]

Chairman GARRETT. Thanks for your testimony.

Next up, Mr. Keating. Welcome, and you are recognized for 5 minutes.

STATEMENT OF RAYMOND J. KEATING, CHIEF ECONOMIST, SMALL BUSINESS & ENTREPRENEURSHIP COUNCIL

Mr. KEATING. Chairman Garrett, Ranking Member Maloney, and members of the subcommittee, thank you very much for hosting this important hearing today on the JOBS Act and the need to enhance capital formation. And I appreciate the invitation.

My name is Raymond Keating. I am chief economist with the Small Business and Entrepreneurship Council. We are a nonpartisan, nonprofit advocacy and research and training organization dedicated to protecting small business and promoting entrepreneurship.

Access to capital has been a key issue, a central issue for SBE Council since our very founding. Indeed, access to financial capital, whether via equity or debt, is vital for entrepreneurs seeking to start up, operate, or expand their businesses. But at the same time, gaining access to capital has remained an enduring challenge for many, if not most, small businesses.

Long after this last recession and the start of this recovery, the value of small business loans outstanding is still down notably from the recent high set in 2008. In fact, there has been really no growth over the last decade. When you look again at the small business share of business loans, the value has also declined markedly; also the number of small business loans.

On the equity side, angel investment is a critical source of funding for startups and early-stage businesses. But here, again, the story has been one of underperformance and sluggishness in recent years. For all of 2014, the most recent year that we have full data for, those numbers are still down from the recent high hit in 2007.

So based on these numbers, the struggle for entrepreneurs to gain access to the financial resources needed to start up, operate, or grow continues to be difficult. There are many reasons for this, including the state of the economy; certainly the policy environment, including regulations, and not just regulation directly imposed on small businesses but also on financial institutions. After all, they are the source of capital.

The bottom line is that small businesses need more avenues to expand access to financial capital. In the midst of these struggles, of course, the JOBS Act was passed by Congress' bipartisan effort and signed by the President 4 years ago. And the focus here was on helping to stimulate the U.S. economy by promoting capital formation.

There have been clear positives resulting from the JOBS Act. We have heard some of that already.

I looked at an interesting summary analysis done by Locavesting.com, and it is outlined in my testimony. One point I would like to highlight from that is under Title II of the JOBS Act, allowing accredited investor crowdfunding, in effect, by letting private companies conducting private placement under Reg D Rule 506 to publicly market the offering. Before that, of course, they couldn't do that.

And we saw the results. They note, Locavesting, that in the first 2 years there have been more than 6,000 offerings conducted under Title II.

Of course, Title II goes into effect on May 16th of this year, allowing for public, including non-accredited investors—crowd—investors—investment crowdfunding to take place on SEC-sanctioned funding portals. As I say, like Kickstarter for investing, crowdfunding promises to release an immense pool of capital that has been locked away from entrepreneurs—those entrepreneurs in search of start-up and growth capital.

Even given the significant and positive changes being brought about for entrepreneurs and investors with the JOBS Act, there are areas in need of improvement. A serious concern persists regarding extra government regulation or placing too many limitations on the ability of entrepreneurs to gain access to capital and/or on investors' abilities to make investments in entrepreneurial ventures.

In terms of making headway toward reducing the costs for entrepreneurs, SBE Council supports the four legislative initiatives that we are considering here today.

In terms of one of those, the Private Placement Improvement Act, that would amend Federal securities law to ensure that small businesses do not face complicated and unnecessary regulatory burdens when attempting to raise capital through private securities offerings under SEC Regulation D, we are certainly on board with that effort and the other pieces of legislation offered here today.

To sum up, the effort behind the JOBS Act was to expand entrepreneurial opportunities in the financial area and in the broader economy. Those four legislative measures would make further headway in a positive, pro-entrepreneur direction.

Thank you for your time and attention, and I look forward to answering any of your questions.

[The prepared statement of Mr. Keating can be found on page 74 of the appendix.]

Chairman GARRETT. Thank you.

Last but not least, Mr. Laws, you are welcome and recognized now for 5 minutes.

STATEMENT OF KEVIN LAWS, CHIEF OPERATING OFFICER AND CHIEF INVESTMENT OFFICER, ANGELLIST

Mr. LAWS. Thank you, Chairman Garrett, Ranking Member Maloney, and members of the subcommittee, for this opportunity. I am here as the chief operating officer of AngelList, an online service that connects companies seeking funding with both angel investors and professional investors.

Since the JOBS Act was passed 4 years ago, and the SEC issued several clarifying letters, AngelList launched what we call our syndicate service. A syndicate allows an experienced accredited investor who is putting his or her own money into an early-stage startup to make that investment available to other angels and professional investors online.

Online investors are grouped into a single fund that follows along with the lead investors. Companies like this option because it allows them to deal with just one investor and to raise capital more quickly; and investors like it because they get the protection of an experienced lead investor with skin in the game.

All of this was enabled by the JOBS Act and subsequent SEC rulings.

Since launching syndicates in 2013, we have helped over a quarter-billion dollars in capital reach early-stage startups. And I know that number seems small by Wall Street standards, but these are the newest companies that just need a little money to get off the ground. That quarter-billion dollars went into almost 1,000 companies.

And we are just one of many such platforms. For example, CircleUp focuses on helping consumer products companies the way we help technology companies, and there are many more.

So first, I want to thank Congress—in particular, the leadership of this committee, Congressman McHenry, and the White House—for the changes brought about by the JOBS Act. It helped many new companies, ranging from those producing electric bicycles to Uber; from Spire Global, that launches and rents imaging satellites by the hour, to Cruise Automation, which General Motors just paid over $1 billion to acquire so they can compete in self-driving cars.

All of these new companies raised early money on AngelList, all because of the JOBS Act. It not only helped these companies create jobs, but they are also producing innovations that help the American economy.

Second, I want to discuss a few of the bills under consideration by this committee. As online fundraising becomes more common because of the JOBS Act, companies are bumping up against the limit of 99 investors acting as a group that can invest in a company.

On our platform alone, we have hit that limit dozens of times, leaving tens of millions of dollars that didn't go into good startups. And we are not alone. We represent a small portion of the capital invested in startups.

The Angel Capital Association includes many angel groups with more than 99 members. They need to reduce the amount given to growing companies sometimes to comply with this law.

Raising the limit to 499 would help with capital formation at that early stage. H.R. 4854 updates the law for today's technologies but maintains reasonable limits that keep it focused only on investment in small venture opportunities so that there aren't unintended consequences. Anybody seeking to break this law can already do so by ignoring the 99-investor limit, so this law simply provides guidelines for legitimate players to help companies get capital that they need legally.

Next up, crowdfunding. While AngelList has worked only with accredited investors for the last few years, some of the opportunities on AngelList have been targeted to larger groups of online investors, the so-called accredited crowdfunding. As a result, we devised methods that protect investors' interests while still encouraging capital formation for good companies.

Unfortunately, many of those innovations would not be legal for unaccredited investors under the crowdfunding rules. AngelList filed comments with the SEC on the rules and I have attached that letter as part of my written testimony.

H.R. 4855 takes into account the experience AngelList and others have had in the real world with accredited investors over the last 3 years. The investor protections of a lead investor and syndicate, for example, would be made legal for crowdfunding, also.

Additional measures ensure that crowdfunding doesn't become so onerous that only companies accredited investors don't like would use it. I applaud the goal of preventing fraud, but we have to do it in ways that don't simply guarantee low returns for the crowd while giving wealthy investors first look at the good opportunities.

Finally, on H.R. 4852, the Private Placement Improvement Act, I have also included our letter to the SEC in my written testimony. We support the SEC's stated goals of information-gathering and transparency. Unfortunately, the draft regulations currently under consideration wouldn't just measure; they would adopt rules that startups would most certainly violate by accident.

For example, startups don't have the money to hire lawyers before they raise the money, but the proposed rules say they should already know they need to file 15 days before even mentioning their fundraising—something they would only learn from their lawyer. In our letter we proposed several ways the SEC could use technology to achieve the same transparency without impairing early-stage fundraising. These more modern methods would still be viable under H.R. 4852, which we support.

In closing, I would like to thank you for this opportunity to share our experience with the JOBS Act. The start-up community deeply appreciates your continued attention to the issues affecting capital formation for very young companies.

This is an unusual issue because most startups that will benefit from your work don't exist yet. With your continued support, we hope thousands more of them can make use of the JOBS Act to do what Congress intended: raise capital more easily so they can grow, create more jobs, and innovate.

Thank you.

[The prepared statement of Mr. Laws can be found on page 89 of the appendix.]

Chairman GARRETT. Thank you.

This is fascinating. I appreciate all the members on the panel. I will now recognize myself for 5 minutes for questions.

I will start with Mr. Atkins. You testified on this both in your testimony and just right now, as well, with regard to the proposed new restrictions of Reg D and including requirements as far as filing Form D, and before an offering is completed. You also just mentioned the fact as far as the 1-year ban on offerings.

So I am going to give you one, two, three quick questions to recapsulize that.

One, do these requirements that are out there do anything to enhance investor protection? Two, from your viewpoint, is the mere existence—and you sort of touched on this—of these proposals, even without the SEC implementing them, putting a lid on the 506(c) market? And three, is this doing—and I will go back if you want me to—anything that is burdensome now to your colleague next to you, as far as the State regulators doing their jobs, if we don't go in that direction?

So the first thing is, is this doing anything to advance investor protection, what the SEC is doing?

Mr. ATKINS. I think when you look at the SEC's own statements from its economists and whatnot, they show that there really is no fraud coming out of the JOBS Act, and especially 506. So I think that is attributable to it.

I don't think that these things are advancing investor protection at all. I think that what—if anything, it is dampening—

Chairman GARRETT. That is the second point. You said it is dampening, why? The attorneys are recommending to them—

Mr. ATKINS. Right. Basically they are saying that you should not use 506(c) because of the uncertainty behind it and there are other ways to do it. And so it is really putting a damper on the ability of people to make use of the JOBS Act provisions.

Chairman GARRETT. I will throw that same question over—Mr. Griggs, if you were listening, too, at the same time, in general, as we go down the three points as far—is there a dampening effect of the proposed rules? On the flipside, should we have it for investor protection?

Mr. BEATTY. I think that from my conversations with the lawyers in my community—I'm sorry.

Chairman GARRETT. I was going to Mr. Griggs actually on that one.

Mr. BEATTY. I'm sorry. I misheard.

Chairman GARRETT. That is okay.

Mr. Griggs?

Mr. GRIGGS. Yes. NASDAQ is not very involved in Reg D offering. We don't feel that investor protection, though, as we have seen it, has been harmed in any way, so we are supportive.

Chairman GARRETT. Okay.

And I want to jump down to Mr. Laws on where you were going. Well, one flippant sort of answer—response to the problem of—you raise a really crucial aspect is how do these people get into the marketplace and how do they know what the rules are without the lawyers there beforehand? How do they get the money to hire the lawyers?

Should we have a legal aid society for these—I am just being facetious on—

Mr. LAWS. There do exist such things that the startups, when they first do their fundraising, don't even know those exist. It is the first thing they think of when they start.

Chairman GARRETT. So, Mr. Keating, right now I—maybe right about now there are oral arguments in the challenge to the SEC's final Reg A-plus set to begin this morning in the D.C. Circuit Court. And as you know, as the JOBS Act was being developed, many reports, including one from the GAO, pointed out that the maze of State registration requirements was a direct cause for the lack of Reg A offerings over the years, and that is basically what we have been sort of hearing this morning.

In your testimony, you refer to Reg A-plus as the sleeper of the JOBS Act. Can you just delve in a little bit more as to what the effect on the Reg A market would be if the State challenges prevailed in the court arguments today?

Mr. KEATING. Sure. The bottom line is, why has Reg A-plus worked, providing various relief from the regulations you mentioned?

I am an economist. I like to look at the results. So when you see reports in terms of this being the sleeper and in terms of entrepreneurial ventures that have found funding where they wouldn't have found funding before, for example, this is exciting stuff.

This is exactly what we want to see done. Why would we want to backtrack on that for, from what I can see, no good reason from an investor protection standpoint or—you don't want to get caught in that regulatory turf game that we see so much in government, which may be the reason we got into some of this.

Chairman GARRETT. I will throw this out to a couple of you. Maybe I will start with you, Mr. Keating.

You say you like to hear the data and what have you. Mr. Beatty was raising the argument that so would he, that he would like to have the data before we move forward on a number of these—certain ones of these provisions on the State level and see how it plays out first.

So is that an argument? Maybe we should just be waiting on this and let the—just put a hold on it, let the SEC continue—

Mr. KEATING. What we have seen in our results, as I mentioned in my testimony, the results of the various titles—

Chairman GARRETT. So the results are in.

Mr. KEATING. —and what is going on—right. So we see results; we see positive benefits.

And not just here. There are examples internationally. I mentioned in my testimony the United Kingdom and what they have done there and the tremendous growth we have seen in crowdfunding, both debt and equity crowdfunding there, and they have done it very smart from a regulatory standpoint, relying very much on the crowd, if you will.

So there are plenty of examples for us to understand. I, as an economist, fall back to Economics 101 and understanding incentives and how the private market works and are there incentives to present a good, solid platform that provides great opportunities for investors.

Chairman GARRETT. So the two takeaways is, is this working, and Congress needs to go back to Economics 101 class.

Mr. KEATING. Yes.

Chairman GARRETT. Okay.

Mr. KEATING. Yes.

Chairman GARRETT. With that—also a flippant comment—I will now recognize the ranking member of the subcommittee, the gentlelady from New York, Mrs. Maloney, for 5 minutes.

Mrs. MALONEY. Thank you, Mr. Chairman. And I ask unanimous consent to place in the record testimony from the University of Denver.

Chairman GARRETT. Without objection, it is so ordered.

Mrs. MALONEY. Okay.

Mr. Beatty, I would like to ask you about the Micro Offering Safe Harbor Act. In your testimony you said that this bill would expose retail investors to "literally unlimited investment risks."

Can you talk about why you think this bill is so broad? Is it because companies could sell unlimited amounts of securities to buyers that they have a preexisting relationship with? Is that the main challenge that you see with this bill?

Mr. BEATTY. Yes, it is one—it is the main challenge I see.

Creating a substantial preexisting relationship is not a hard task. Certainly, we have seen it down through the years through SEC interpretations where an issuer can create a relationship to investors by dealing with a broker-dealer who has established a relationship.

More recently we have seen basically advice that seems to authorize the idea that a relationship could be established through an issuer questionnaire—

Mrs. MALONEY. If I could follow up on that—

Mr. BEATTY. Certainly.

Mrs. MALONEY. —would your view of the Micro Offering Safe Harbor bill change if a company had to comply with all three of the requirements in the bill in order to take advantage of the relief? In other words, what if the bill was limited to $500,000-worth of securities a year, to no more than 35 investors, and they all had to have a preexisting relationship with an officer of a company? Would that—

Mr. BEATTY. I think that makes it better. If the true purpose here is to create an offering for micro type of offerings, that already exists. Rule 504 has been around for decades, and allows offerings up to $1 million with a very simple filing.

I would also note that many States—almost all States that I am aware of—have specific small offering exemptions for these types of very small capital-raising, usually with a very minimal notice filing and very low fees.

Mrs. MALONEY. In your testimony you noted that you had serious concerns about the Private Placement Improvement Act because it would weaken the few existing investor protections in Rule 506. Can you elaborate on which investor protections this bill would weaken and which protections do you think are the most important? Do you think these investor protections are particularly onerous for companies?

In other words, are any of these protections really preventing any companies from raising capital?

Mr. BEATTY. I think one of the main features of the Improvement Act would be to allow—would require only one filing of the Form D. Right now there is a requirement to file amendments, and of course, the proposed rules posited the idea of perhaps a prefiling in the case of a general solicitation.

The only data we have available to us in the State on these types of offerings is the Form D. And unlike the SEC, we look at them. We run the officers through databases; we check on who might be selling them.

We are concerned about these offerings, and many times they are conducted lawfully, but once in a while we will find something. And perhaps more importantly, if an investor is solicited and they are unaware of—have questions, they pick up the phone and they call us. And if the only thing that we can say is, "Well, we don't have any information about this; you should be careful," that is really not providing a very good service to our constituents.

Mrs. MALONEY. Thank you.

Mr. Keating, the SEC just recently completed its crowdfunding rules, which are set up to take effect next month, and I was a Democratic sponsor of the original bill. Should we wait until we have some experiences from crowdfunding before we move forward with the other significant changes in crowdfunding exemptions?

And also, you mentioned you had studied what had happened in England. Has crowdfunding been used not only for the private sector but for public purposes, for good—not-for-profits? Have they used crowdfunding for public service endeavors also in England, or is it just limited to private sector investment opportunities?

Mr. KEATING. I can't speak to that. I know early on during this whole process, one of the examples that was mentioned for crowdfunding was the Statue of Liberty, the money being raised on that front.

Mrs. MALONEY. Yes.

Mr. KEATING. It was done in that manner.

Mrs. MALONEY. I think it could be public-funded, too.

Mr. KEATING. Right.

Mrs. MALONEY. Don't you think we should wait a little bit before we come forward with a little—all these changes that—

Mr. KEATING. No, because I don't—

Mrs. MALONEY. The rules haven't even gone into effect.

Mr. KEATING. No, I don't, and the reason is, like Mr. Laws mentioned, we are talking about the entrepreneurs here that drive our economy, that create jobs, things that we desperately need. We desperately need more growth and more jobs in this country, so why would we want to, for example, have any kind of—again, within the boundaries of what we laid out so far legally—but why not extend the opportunity to more people? Why would we want to leave money on the table, if you will, for those looking to raise funds to build businesses and create jobs?

So if there is an opportunity, for example, in crowdfunding in Title III to raise the limit, yes, I think that is a great idea. My job is to open more opportunity for small businesses by reducing their regulatory burdens, and I think that is a great idea.

Mrs. MALONEY. My time has expired. Thank you.

Chairman GARRETT. The gentlelady's time has expired. Thank you. Thank you for the questions.

We are joined now by the sponsor of the McHenry bill, Mr. McHenry.

Mr. MCHENRY. Thank you, Chairman Garrett, and thank you for having this hearing, Mr. Chairman.

And I thank you all for your testimony.

I will begin by asking Mr. Keating a question. You say that angel investment is a critical source for startup and early-stage business capital, but you also note that angel investment is still sluggish. What are the dynamics at play?

Mr. KEATING. Yes. It is sluggish. I have laid out some charts in my written testimony.

I think there are all sorts of dynamics at work here. I mentioned the state of the overall economy, but you have to look at issues on the public policy front, and I think you have to look at regulation and how much uncertainty is created. What are the costs?

From a small business perspective, you have to plug this whole debate into the overall regulatory picture, and that has been a very ugly picture from a small business perspective in recent years.

So where we have—we either have uncertainty in so many areas, or where we don't we have increased costs. The JOBS Act has been a wonderful exception to that, where it was a deregulatory effort, a reform effort that really expanded opportunity for small businesses to get access to capital.

So yes, I think part of the question on the angel investor front comes from the regulatory aspect, absolutely.

Mr. MCHENRY. So as an economist, you can perhaps state this more succinctly than I, but if you are capped at 99 investors you have to have 99 much larger investors than perhaps 150 smaller investors. And there is a cost associated with that, is there not?

Mr. KEATING. Absolutely. As I said, you want to—you don't want to—from a small business, pro-growth, pro-entrepreneurial perspective, you don't want to be leaving anything—anybody out of this equation that obviously is—that understands what they are getting into.

And it is important to mention—fraud is thrown around a lot, but fraud is not the same thing as risk in the marketplace; it is not the same thing as business failure; it is not the same thing as losses. Those things are all going to happen in the real world of business, so as long as people understand that—

Mr. MCHENRY. Mr. Laws, for that point, in your experience, this 99-investor cap, coordinating investment pools in conjunction with that—I had this example presented to me yesterday that one group decided they would only have 84 investors because the length of the hold they believed that there would be deaths and divorces, and as such, that number would rise and they didn't want to imperil the longer-term hold of it.

Are there examples like that, that you could mention to us today?

Mr. LAWS. Most certainly. I have mentioned that as a 99-investor limit we happen to, at the advice of our lawyers, use a 90-investor limit for that exact reason, because the courts will sometimes force you to add new investors when they split somebody's holding because of a death or a divorce and an inheritance situation. So it is actually, for practical purposes, a 90-investor limit or 84-investor limit in this case.

We are just hitting it more and more often—with sophisticated accredited investors, I should specify. This is still within the sophisticated accredited community.

Mr. MCHENRY. Shifting to the Fixing Crowdfunding Act, we have—there has been discussion about the problems with Title III as enacted and the problems with the over 500 pages of regs that the SEC has written. And so, Mr. Laws, in your opinion, if Congress doesn't amend Title III of the JOBS Act, will its intent actually be useful?

Mr. LAWS. I think it is actually a little dangerous as it exists now, primarily because of this risk that what we will create is a kind of guaranteed set of bad investments. They won't be fraud; they will just be bad investments because it will be used by companies that can't raise using the Title II of the JOBS Act.

And so I would want to make sure that the crowd gets an opportunity to get into the good investments, so it is something that the fixes will help balance the investor protections with making sure that the good investments will also use Title III.

Mr. MCHENRY. So at the current pace you see this as a potential marketplace for major problems.

Mr. LAWS. I think it is a danger. I think there are some good companies that will use it, primarily for publicity. But I don't see it yet as something that is a true alternative to Title II for those companies that have access to Title II.

Mr. MCHENRY. What is the most important thing or two that you would point out, in terms of our action here in Congress?

Mr. LAWS. I think the most important for that side of it are, first of all, being able to bring in some investor protections, frankly. There is one section in the Fix Crowdfunding Act that adds the ability to create these syndicates, the funds where a lead investor looks out for the interests of the crowd.

The other is this notion, the 12G problem, so called, where as soon as you cross $25 million in assets, if you have a large enough crowd then you have to start registering the same way a public company does—$25 million is the next financing round for a successful company. So if you are a high-growth company you would now avoid crowdfunding because of the danger of as soon as you raise your next round from a V.C., suddenly you are not private anymore.

So I think those are two of the primary ones.

Chairman GARRETT. The gentleman's time has expired. I thank the gentleman.

The gentleman from Massachusetts, Mr. Lynch, is recognized.

Mr. LYNCH. Thank you, Mr. Chairman.

And I want to thank the members of the panel.

I would like to talk about H.R. 4852, the Private Placement Improvement Act, so-called.

Mr. Beatty, the Form D—is that required right—is there a penalty for not filing a Form D?

Mr. BEATTY. There is currently no penalty for failure to file a Form D.

Mr. LYNCH. So any talk that we have heard on the panel today about the problem of filing this and the encumbrance on companies—they don't have to file this and there is no penalty if they don't file it, right?

Mr. BEATTY. No. I believe that the—I believe that there may have been one instance where the SEC might have taken action on the failure to file, but it is not—it is widely regarded as not an essential form to file, and I believe that in some places it is routinely not filed.

Mr. LYNCH. Right. However, I do know from talking to some of the State Secretaries of State and Attorneys General that this exemption under Rule 506 is the—and I will quote here—it is reported as the most frequently reported fraudulent product or scheme involved in enforcement actions by State securities regulators.

Mr. BEATTY. Yes, that is correct. In our surveys, in terms of what types of action States are taking, and what they are—what is being reported to us in particular, 506 comes up, I believe, is the second-most popular thing that comes up. That is not surprising—

Mr. LYNCH. Popular meaning what? The most frequent—

Mr. BEATTY. More frequent, yes.

Mr. LYNCH. —fraudulent product.

Mr. BEATTY. Yes, right. And it is not—

Mr. LYNCH. Second-most. Okay.

Mr. BEATTY. Yes. It is not the most—it is not surprising, given that it is the vehicle of choice for raising capital in this country.

Mr. LYNCH. All right.

Form D is just four pages. It is not a whole lot of—

Mr. BEATTY. It is actually eight pages with three pages—

Mr. LYNCH. There are four pages of instructions.

Mr. BEATTY. Three pages of instructions, eight pages of questions and answers that need to be filled out.

Mr. LYNCH. Okay. Maybe I don't have it all then. Still, it's fairly brief and not very complicated, from what I can see.

As far as enforcement of Rule 506 and the exemptions, what is the wisdom of preempting States to protect small investors? I don't get that.

I do think that, as Mr. Keating says, he has a job to do, but I think that protecting investors from fraud is also part of the job, as well.

And, Mr. Laws, this is great, this new idea, crowdfunding. It is very exciting. But if we get into a situation where it is seen as an area that is rife with fraud and people are being taken, I think we might have a big disincentive of people getting involved, smaller investors especially, who are not sophisticated.

Mr. Beatty, what about taking the State regulator off the street here and preempting them from conducting enforcement actions?

Mr. BEATTY. I think that certainly enforcement is a big part of what States do, and anything that hinders our ability to bring enforcement actions in the appropriate cases is problematic. I think that in the Rule 506 area we have long been preempted, since 1996, from requiring any type of—doing anything except getting a notice filing. And we certainly have fraud authority.

But the question is—to us is, we appreciate the fraud authority but enforcement actions take place when people have already lost money, have already been harmed, their retirement savings have taken a hit, maybe they can no longer send their children to—

Mr. LYNCH. All right.

Mr. BEATTY. —to college.

Mr. LYNCH. I only have 38 seconds left, so the bill that is being offered today by Mr. McHenry would only require filing after. There would be no prefiling submission, so that investors wouldn't be able to look at this until after the offering was made. Is that right?

Mr. BEATTY. The current regime for 506 is a post-sale filing. If we are talking about the Micro Offering Act, that calls for no filings whatsoever with anybody.

Mr. LYNCH. Wow. Okay.

My time has expired. I yield back. Thank you.

Chairman GARRETT. The gentleman yields back.

The vice chairman of the subcommittee, Mr. Hurt, is recognized for 5 minutes.

Mr. HURT. Thank you, Mr. Chairman.

Mr. Griggs, I was interested in your testimony and your support for the JOBS Act generally, talking about the resounding success, embraced by investors and companies, and especially interested in your statement that the JOBS Act has not resulted in any trend that diminishes investor protection, which I think is critical.

Also, in your testimony you said that there are provisions, however, of the JOBS Act that are scarcely used because they run contrary to investor expectations. I was wondering if you could talk a little bit about that.

Mr. GRIGGS. Sure. There were a handful of things in the JOBS Act, most notably the ability for companies to reduce the years of audited filings from 3 to 2. And I think market dynamics have taken over there and really the investment community has an expectation for 3 years, so companies—the overwhelming companies that we work with or talk to and the advice of their different parties who are taking them public have not taken advantage of that.

Really, if I had to go back to repeat a point, it really is the confidential aspect of filings that has been overwhelmingly well received across the entire community. There were concerns about whether 21 days was enough for the investment community to really understand the investment, and I think from the perspective that we hear, clearly it is, so that has done no harm whatsoever.

Mr. HURT. And then the other thing I noted in your testimony was talking about the beginning of 2016 so far, that it looks like IPOs are not coming online as quickly as we would like to see. Can you talk a little bit about that, and what are things that we can consider to help increase those?

Mr. GRIGGS. Sure. That really started near the end of 2015, and I like to separate the market conditions versus companies' desire to go public.

As a statistic for you, in the first quarter of 2016 we received just as many applications for companies to go public as we did in 2015 first quarter. So there is still a very strong demand for companies to go public, but across all sectors right now, due to the overall public market volatility, I think it is very cyclical right now.

You have public companies. Their evaluations have come down. So we have seen across all sectors a general—again, I would call it more a cyclical freeze and companies going public. But by no means should this indicate there is not a desire to go public or a company that is still leveraging those key components of the JOBS Act.

So we do feel that there is going to be a bit of an opening here, hopefully in April, May, which will lead to a better second half of the year. But it is market conditions, not a regulatory issue.

Mr. HURT. Excellent.

And then I had a question for Mr. Atkins and Mr. Keating, sort of more of a general nature. But when you think back on the recession in 2008 and then you think about Washington's response to that in the form of Dodd-Frank, can you talk a little bit more generally about how important the JOBS Act and having us in—having policymakers take a close look on how you streamline regulations, reduce unnecessary burdens from a regulatory standpoint—how important that is in light of what Dodd-Frank has given us?

Because I represent a rural district, 23 counties and cities. We have a major university in Charlottesville that where we have small businesses that are eager and looking for capital, but because of Dodd-Frank have had tremendous difficulty in accessing capital.

And so the kind of things that we are working on today, it seems to me, in a way acknowledge, I think, some of the significant shortcomings of the overregulation that came out of Dodd-Frank and how—and speak to the necessity of making it easier to hook up investors with small ventures.

And I would love to hear from you, Mr. Atkins, and then Mr. Keating, from a economist standpoint.

Mr. ATKINS. Yes. With 45 seconds, we could talk about that for a long time. The Dodd-Frank Act, with 2,319 pages, itself was only part of it. Then, it had mandates of up to 500 rules and studies from the different agencies.

And a lot of that still has not been implemented yet at my old agency, the SEC. They still may be a little bit more than halfway finished.

So the huge amount of work that still has to be done, the uncertainty on the industry—just the other day I was approached by an investment bank with a new offering of a fund to invest in that will basically take away from small banks, community banks, loans that they can't carry on the books anymore because of the examiners from the Fed and elsewhere putting a lot of pressure on them not to make loans to small business anymore. Chair Yellen has basically said the same thing in testimony before Congress.

So it is the uncertainty and the costs that Dodd-Frank has imposed on the industry that has had ripple effects, which is why, really, we need to look at things like the JOBS Act, new ideas that will help spur capital to small businesses.

Mr. HURT. Mr. Keating, I apologize. My time has expired, so we will—

Mr. KEATING. I agree.

Mr. HURT. Thank you.

I yield back.

Chairman GARRETT. The gentleman yields back with a short answer.

The gentleman from Connecticut, Mr. Himes, is now recognized.

Mr. HIMES. Thank you, Mr. Chairman.

And let me thank all of you for being here to have this conversation. I want to just make a couple of observations and ask a few questions.

To be clear, I actually voted for the JOBS Act. I had some misgivings, but in the end I thought it was a good compromise.

I am always taken aback, though, when this topic is shoehorned into the debate that this institution has so often about where exactly the boundary line of government regulation, interference, presence should be. It doesn't really fit.

We can eliminate all regulation on the issuance of new securities. That will make it a much simpler process for businesses to do capital formation, unquestionably at the expense of the other half of our economy, which are the investors.

So it seems to me that this is a problem of really balancing the interests of two absolutely essential elements of our economy: the people who need the capital; and the people who are offering the capital.

I get so confused when the presentations are shoehorned into this world where, in this case, in this panel's case, if we just do everything for those people who need capital at the cost of those people who provide—well, everything will be fine.

We know that is not true. So I want to make that observation because it just drives me crazy when good work gets caught up in this deregulatory fervor.

The question I want to ask, just to bring this point home: It is well-known that most instruments that are available to retail investors—mutual funds, equity mutual funds—most managers, professionals of equity mutual funds, don't beat the market index.

So I guess my question is, in particular for those who are so enthusiastic about pushing the boundaries of the JOBS Act, can anybody here tell me that they are sure that retail investors—because that is who we are talking about here—that retail investors—setting aside the issues of fraud and 404(b) and what companies are actually more prone to poor compliance; that is a whole other story—but are retail investors going to make a lot of money in crowdsourcing—crowdfunding?

Can anybody here on the panel tell me that your average middle-class family out there with, let's just say, I don't know, $10,000, $20,000 to invest—would anybody here recommend that a middle-class retail unsophisticated investor ought to put $10,000, $20,000 into a private placement or a crowdfunding deal?

Mr. KEATING. If they do their homework, I see no reason why middle-income America cannot do their homework and make wise investment decisions.

Mr. HIMES. But do you think they would make money? Would you advise a—

Mr. KEATING. I think some of—

Mr. HIMES. Would you advise a retail investor to put money into an index fund or into some local crowdfunded—

Mr. KEATING. I'm not a financial advisor, but I would say that if you have extra money for investment purposes and you think you want to support entrepreneurial ventures, perhaps some in your State or your district, your neighborhood, and you have that opportunity and you choose to do that and you do your homework, that is great. Go for it, and I hope you make a lot.

Mr. HIMES. Okay. But that is not my question. My question is—and you have some economic background—is that individual likely to outperform an index with that as an investment strategy?

Mr. KEATING. I don't know if there is data available for me to answer that, but what I can say is on an individual basis, as an economist, that if you do your homework, you are going to—listen, investment—there is no guarantee here. I said very much at the outset that you have to recognize the risks. You have to—

Mr. HIMES. No, no. I understand. You are not actually answering my—I appreciate what you are doing, but you are not actually answering my—

Mr. KEATING. You asked me, would I advise somebody, and I said yes. Do your homework, be smart about it, and yes, go ahead and make the investment if you think that is wise.

Mr. HIMES. Right. Okay.

I have another important question here. But the fact is that the average professional mutual fund manager doesn't beat the index, so I am going to preserve some skepticism about whether a retail investor, homework or no homework, is going to do better.

I have one other question, though, which is—and I appreciate what the JOBS Act has done. We apparently are saving companies a lot of money. I did a lot of work on this and people assured me that full Sarbanes-Oxley disclosure was going to cost $1 million or $2 million absent the JOBS Act.

I want to ask a question, which is that the average IPO gross spread, which the average IPO, let's just say it is about $200 million—a little less than that, $200 million. Gross spread 7 percent, that is $14 million.

Ninety-five percent of all IPOs in the United States since 2008 have had a 7 percent gross spread, and $14 million has gone to the underwriters. Why is that?

Mr. ATKINS. Congressman, I think that is why crowdfunding and other things are really exciting. It is a disruptive new technological way of trying to raise money that will then disintermediate investment banks and other banks and maybe save companies that are raising money and their investors a lot of money over time, which is kind of an exciting thing and so why not try it. I think that is one thing that we are talking about here.

And I am as troubled as you by what you are citing.

Mr. HIMES. If the chairman will indulge me just for a few more seconds here—

Chairman GARRETT. We are just over time for everyone. We will circle back.

Mr. HIMES. All right. Thank you, Mr. Chairman. Thank you.

Chairman GARRETT. I recognize the gentleman from Texas, Mr. Neugebauer.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

I want to kind of pick up this line of reasoning because it is one of the things that I am very concerned about, and all across this government, is we have gotten into a mode now of the government telling people what is appropriate for them and what is not appropriate for them.

We have a Consumer Financial Protection Bureau (CFPB) that is out determining what kind of financial products that it—ordinary consumers should have, and so now we are trying to tell people whether they are smart enough or not to be able to make certain kinds of investments.

And one of the things that I think is very troubling to me is that the little guys have not had an opportunity in the past to get in on some of these wonderful companies that were started in a garage or in a dorm room or—and so I think one of the things that I wanted to mention, Mr. Laws, is in October the SEC finalized its rulemaking obligation under Title III of the JOBS Act but unfortunately imposed new restrictions on crowdfunding that Congress did not mandate, which could prevent Title III from reaching its full potential.

And the issue there is that the SEC placed arbitrary caps on the amount that individuals can invest in companies based upon the lesser of their annual income or their net worth. The new crowdfunding rules are set to go live in 2016.

As you know, Commissioner Piwowar dissented that decision and so I guess the question I have is, how do we determine what is appropriate for investors? Should the government just publish a list, "These are things that we think are appropriate for people to invest in and these are amounts," and just take that decision away from the individuals?

Mr. LAWS. I will honestly say I don't have an opinion on that. I do have an opinion mainly that because when accredited investors participate in a crowdfunding you can have some very wealthy investors who are also affected by the caps but would not be affected by the caps if they went directly.

I believe the changes in the Fix Crowdfunding Act are aimed at allowing accredited sophisticated investors to do larger amounts of money, not necessarily allowing individuals who don't have as much money to invest more. So I realize that doesn't quite answer your question, but I do believe that the changes are productive.

Mr. NEUGEBAUER. Mr. Keating, do you have an opinion on that?

Mr. KEATING. I think by definition, they are arbitrary. I think you are better off leaving it to individuals to make their own decisions, and it is also important to understand that with crowdfunding, investors are warned of the risks on the portals, so they have to go through a test. So they are going to be made even more aware of the potential risks involved.

But, yes, I default to the American people and the individuals over choices made by the government, yes.

Mr. NEUGEBAUER. The observation from my perspective is we make it difficult for the little guys to get started, and we also make it difficult for some of the little folks to get in on those kind of investments. And, quite honestly, mutual funds and exchange-traded funds and stuff, people lose money on that too, right?

Mr. KEATING. Absolutely. And your point about the little guy on both sides of the equation is what we are talking about here. We are talking about not just the small business being—getting access to capital, but the small investor having that opportunity where they didn't have it before, to be able to get in on the next great thing that is coming, as you said, out of somebody's garage.

Mr. NEUGEBAUER. Mr. Griggs, one of the things I was wondering, in looking at market activity right now, do—what—the private placement—do you still see a lot of companies, because of some of the barriers out there, still opting for trying to do private placement?

Mr. GRIGGS. Yes. Absolutely. Especially with the dearth of availability to go public right now, we do see many, many companies take advantage of private placements as—it is a very large market, so it is very active right now.

Mr. NEUGEBAUER. And so is there, do you think, and has anybody done an analysis, is there—does it raise the cost of that capital sometimes to be forced into a private placement as opposed to being able to look at a more market-based activity pricing based on the market being able to go public? Does that make sense to you?

Mr. GRIGGS. We don't have the specific data on that, but certainly any time you are going to raise money in a more liquid market the cost of capital is going to be lower, so private placements are not going to be as liquid, so that is the case.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. My time has expired.

Chairman GARRETT. The gentleman's time has expired.

Mr. Carney is now recognized.

Mr. CARNEY. Thank you, Mr. Chairman.

I thank the gentleman from California because I do have to go.

I am going to resist the urge to get pulled into this debate about what the government should or shouldn't tell small investors, but I would like to associate myself with the comments by my friend from Connecticut, Mr. Himes. I voted for the JOBS Act, as well, and I worked hard with Mr. Fincher, my friend from Tennessee, on the IPO On-Ramp part of it.

And there were a lot of folks in the industry and in my State who worked on it and expressed concern about it. Delaware, as you may know, is the place where most of these companies are incorporated. And my friends in the Division of Incorporation had alerted me to the—to what they were seeing a couple of years ago with the lack of companies going to an IPO, and we know that those public offerings have increased since the JOBS Act passed, and there was some testimony that each of you made with that respect.

I thought that the 404(b) audit question would be one of the things that the IPO On-Ramp provided a 5-year phase-in and that would be the biggest thing that some of these emerging growth companies would look to in choosing to go do an IPO with—as an emerging growth company. But actually, as was mentioned earlier, I think by Mr. Griggs, it is the confidential filing piece that we hear is the most important part of that IPO On-Ramp. Mr. Griggs said that we should allow all companies to file confidentially.

Mr. Beatty, do you have a view of that?

Mr. BEATTY. Certainly, that presents challenges, I think, from a regulatory aspect and a transparency access to allow all companies—

Mr. CARNEY. What would those be, at a real practical level? The attractiveness of it from the other side is a company can do that, "test the waters," is the terminology that is used, and not have to give up concerns about their I.P. or whatever it might be. So what would the concern on the other side of the scale be with respect to that idea?

Mr. BEATTY. Testing the waters, I think, is an idea that has been around for a long time and States have embraced it, many years ago in many respects. And if it is done properly, I don't think it imposes much by way of concern in terms of investor protection.

The things that we worry about in testing the waters is whether—is how open the communication will be in terms of will it be something that is, something that somebody says that is completely untrue? Is it not a good-faith effort to try and gauge interests but instead an effort to try and draw investors in a way that is inappropriate?

Protections that are put in place in terms of requiring a filing—some type of filing first, having some type of waiting time between the testing the waters communication and the actual offering—I think those are all good measures that help solve some of those problems.

Mr. CARNEY. Great.

One of the provision in the JOBS Act that did concern me was the crowdfunding aspect for concern about fraud and the vulnerability of unsophisticated investors. And I would just like to ask Mr. Laws and Mr. Keating, we really don't have, as Mr. Beatty said, any Federal experience here. Why should we change the rules now before doing that?

Mr. LAWS. I actually would disagree with the premise, because the so-called accredited crowdfunding has been legal since the JOBS Act passed and some of the SEC rulings. So since the JOBS Act passed we do have a good 3 years of experience of some of the techniques that seem to work well in accredited—

Mr. CARNEY. So do those apply to the investors that I am most concerned about, the unsophisticated investor who—

Mr. LAWS. I believe so. One of the more important aspects, for example, of the Fix Crowdfunding Act allows this structure of following after a sophisticated investor, putting a larger check in and having them look out for the interests of the other investors, which would not be legal under the current Act. So I think we could apply some of those learnings with this bill to improve the crowdfunding for the unaccredited investors.

Mr. CARNEY. Mr. Keating, I have 24 seconds.

Mr. KEATING. I think it goes back to the crowd aspect of crowdfunding, right? The wisdom of the crowd here is critical, and technology allows that where it didn't certainly in 1933 and 1934. So the fact that you have these communications and you have the crowd evaluating these investments is central to the whole effort.

Mr. CARNEY. Great. Thank you all for being here today.

Chairman GARRETT. Thanks. The gentleman yields back.

Mr. Hultgren is recognized for 5 minutes.

Mr. HULTGREN. Thank you, Mr. Chairman.

Thank you all so much for being here. I appreciate your time and expertise in this important discussion.

I want to address my first questions to Mr. Atkins, if I may.

Earlier this year you wrote an op-ed that ran in the Wall Street Journal that was titled, "Equity Policy Needs Surgery, Not Band-Aids." Volatility, flash-crash risks, and bigger dark pools are the legacy of the SEC's Regulation NMS.

This, of course, was with respect to IEX's application to be a registered national security exchange. I have commended IEX for putting forth ideas considered by some to be effective adjustments to our market, but I have also remained unsure about how the investor exchange would function in an already complicated market structure.

In your op-ed, you remarked about a broken process at the SEC, and I will quote your op-ed where you said, "Will the agency address equity market structure concerns comprehensively, as many Members of Congress and SEC Commissioners say is necessary, or will it make these far-reaching policy decisions in an opaque exchange application approval process?"

Over the last few months there have been some developments where your perspective would be valuable. One, the extended comment period for IEX's exchange application, to which they have made some modifications, ends today. Also, the comment period on the notice of interpretation for whether 1,000-microsecond delay should be de minimis for the purpose of Rule 611, the order protection rule, ends today.

So, Mr. Atkins, I have been frustrated with the Commission that it has been slow to act on changes to market structure, but do you think in general, changes to market rules through an exchange application process will result in good public policy?

Mr. ATKINS. Thanks for the question. I stand by what I wrote in the journal there.

I think what the SEC should do is take a total review of NMS. There were a lot of things that were put forth back there 10 years ago that did not make sense then and don't make sense now. And I can see the impetus behind trying to let a new entrant into the marketplace, but still it needs to be done in a transparent way.

Mr. HULTGREN. Following up on that, or continuing, the New York Stock Exchange recently filed with the SEC to use a replica of the Discretionary Pegged order that is included in IEX's application, which was made public through an exchange application process. Does this raise intellectual property concerns? It would seem the New York Stock Exchange could potentially make use of the D-Peg before IEX is granted exchange status, which would disadvantage IEX.

Mr. ATKINS. Yes. That is part of the whole issue here, where if you treat people disparately and in a manner that doesn't apply to everybody, you run into those issues.

Mr. HULTGREN. Isn't the use of the D-Peg and a notice of interpretation on the definition of "immediate evidence" that the exchange application process is being used to rush consideration and changes to market rules, and would notice and comment rule-making, not just an interpretation, be more appropriate?

Mr. ATKINS. Yes. I don't know that much about that particular issue, but I think in general, the Administrative Procedure Act really should apply in this area.

Mr. HULTGREN. As a free market conservative who wants to see competition and innovation rewarded by the markets, what advice would you give to IEX and its supporters?

Mr. ATKINS. I think they have created an innovative exchange where lots of investors and traders like to go, so hats off to them. What I really encourage the SEC to do is take a really robust view of NMS and the whole process and do it in an open manner and not just on a one-off exchange application basis.

Mr. HULTGREN. Good. Thank you.

Switching gears a little bit, I am going to address my next question to Mr. Keating.

I have some questions about implementation of the JOBS Act. What are the most burdensome provisions of Title III in the JOBS Act? And do these burdens make crowdfunding useless to small businesses seeking equity financing?

Mr. KEATING. I'm sorry?

Mr. HULTGREN. What are the most burdensome provisions of Title III in the JOBS Act, and do these burdens make crowdfunding useless to small businesses seeking equity financing?

Mr. KEATING. I don't know if it makes it useless. Hopefully not. But certainly I think the limitation, but also on the portal end of things, clarity on their liability and the liability issue I think is crucial and I—it is addressed in the one piece of legislation here, and I think that is certainly a big issue in terms of competition on that front and a flourishing number of portals.

And by the way, to really plug this very quickly, but Crowdfunding Demo Day on May 16th, SBE Council is part of a group that is going to be here in Washington giving demos on everything that we are dealing with today and I urge everyone to come. So there you go.

Mr. HULTGREN. Great.

My time has expired. I yield back. Thank you, Mr. Chairman.

Chairman GARRETT. The gentleman's time has expired.

I now recognize the gentleman from California, Mr. Sherman.

Mr. SHERMAN. Thank you, Mr. Chairman.

I am very old. I was around when Reg D was the new thing. And we were so impressed to think that, well, we are not the accredited investors' incomes of over $200,000. That was a tiny group of people who must be incredibly smart to be making that amount of money. Now it is an amount of money scarcely more than Congressmen and Federal Judges make.

Now we are here—you—for the most part, relaxing standards, letting—providing less protection to investors so that we can provide an easier path to providing capital for business.

If Reg D made sense back in, what was it, 1982, then it can't make sense now, and vice-versa, because if it made sense to put the limit at $200,000 then, then the income level should be $600,000 to $700,000 now.

I know that there has been discussion of indexing going further, but, Mr. Beatty, have we opened the door too much by deciding that $200,000 or $1 million in assets, excluding a home, is the definition of an accredited investor who can afford to lose a lot of money?

Mr. BEATTY. I think you have to start from the premise that the idea behind defining "accredited investor" and putting those limits in place was supposed to be a proxy for investor sophistication. Indeed, in many of the cases that we deal with nowadays, a fair percentage of the investors that we see who have been harmed are, indeed, accredited investors. So it is an imperfect proxy.

NASAA has long advocated for indexing—

Mr. SHERMAN. Mr. Beatty, was it more of a proxy for ability to absorb the loss without—

Mr. BEATTY. That has been posited, as well.

Mr. SHERMAN. —or a proxy for knowledge, or at least the ability to hire it?

Mr. BEATTY. Yes, it has also been put forth that that was meant to be an amount of money that—an amount of assets that—or net worth that they could absorb a loss.

Mr. SHERMAN. And does it make any sense—if it—if those were supposed to be the limits then, what should the limits be today?

Mr. BEATTY. I think you need—

Mr. SHERMAN. I realize that some people who make an awful lot more are unsophisticated, and some who make an awful lot less are very sophisticated. But we still have a rule based on income and assets. If we are going to have a rule that talks about accredited investor and looks at income and assets, where should we draw the line?

Mr. BEATTY. I think that certainly from my organization's standpoint, we have long advocated for indexing those amounts to inflation. If they had been indexed, I don't have the numbers right in front of me, but I believe that it would be roughly two to two-and-a-half times what they are now.

Mr. SHERMAN. Oh, more than that, but go ahead.

Mr. BEATTY. Okay. Other ideas that have been put forth questioning whether or not income or net worth is the appropriate standard also have been discussed, and I think there is some appeal to looking at things such as some type of liquidity factor that an investor might be held to, in terms of liquid assets, amounts in a portfolio, things like that.

Mr. SHERMAN. Mr. Atkins, do you have any comment? And is it enough for us to just index these numbers from 2016 forward, or do we need to index them from 1982 forward?

Mr. ATKINS. I wasn't actually around when Reg D was adopted, but I was just beginning to practice law, or just about to get out of law school. So, things have changed a lot since 1982. We have a lot more communication, a lot more sophistication where people can actually go and get information.

But if somebody can invest 100 percent of their net worth in Valeant and watch the stock crash overnight, in the single stock, that is one of the most risky things that one can do, versus some of the other alternatives. So one of the things that really impressed me back when I was a Commissioner when we were talking about raising this limit, was a comment letter where an investor said, "I can invest in a hedge fund today, but tomorrow if you raise the limit, I won't be able to."

Mr. SHERMAN. Let me just—

Chairman GARRETT. The gentleman's time has expired.

I recognize the other gentleman from California, Mr. Royce.

Mr. ROYCE. Thank you, Mr. Chairman.

In California, as you know, we have a world-class network of startups from Silicon Valley to Orange County, and the issue of access to capital for startup businesses—this is critical. This is critical to our State's economy, but also critical to ensuring that our country remains the best place for entrepreneurs—not only to get the entrepreneurs, but also to bring their products to market.

And so I was going to ask Mr. Keating, because you noted in your testimony that the Micro Offerings Safe Harbor Act, which I am an original cosponsor of, appropriately scale Federal rules and regulatory compliance for small businesses pursuing capital. Mr. Keating, how will this legislation help these startups that are looking for the investment to hire and to grow to enter the market?

Mr. KEATING. It all comes down to that cost, and that is why when we talk about scaling Federal rules, look at the data and there is data produced by the SBA and a whole host of other entities, if you will, that show that regulatory costs certainly fall much more heavily on small businesses. To take us the next step and consider the regulatory costs on startups and it becomes even more daunting.

So when I mentioned before the issue on angel investing, that is certainly in the equation here, in terms of both on the supply and the demand side of the equation. So any time you can open up avenues here through reduced costs for entrepreneurs to gain access to capital, it is a positive development.

And by the way, just understand that the SEC and certainly the State regulatory bodies have that ability to prosecute fraud no matter what.

Mr. ROYCE. Right.

Here is another question I am going to ask. I am an advocate for regulatory relief for our Nation's community financial institutions when it comes to their ability to lend. And legislation I have authored, H.R. 1188, the Credit Union Small Business Jobs Creation Act, would free up smaller lenders when it comes to working with business startups.

What role do community financial institutions play in capital formation for startups, and what are the problem areas since the financial crisis, and how could Congress help on that front?

I will go to Mr. Keating, and then to anyone else who wants to jump in.

Mr. KEATING. My immediate response is those small financial institutions are crucial for small businesses. That is the bottom line.

When you look at their share of loans to small businesses, they are it. They are critical.

So again, the regulatory cost—for example, Dodd-Frank and so on—for—fall more heavily on them, and small businesses get hurt as a result.

Mr. ROYCE. Others on the panel?

Mr. ATKINS. Yes, sir. Well, one thing that Chairman Hensarling likes to talk about is that every day a community bank goes out of business. And it is not because of bad business; it is because of the burdens, not just overt regulations, but then also the informal silent regulations of bank examiners who basically have a lot of ambits with which to squeeze them and to question the loans that are being made.

And as I referenced before, the private sector is trying to come into assistance here by taking off the books of some of the community banks some of the—through funds—some of the loans that they are making, but it is—

Mr. ROYCE. Even on performing loans. That is the great surprise. Performing assets, and suddenly comes the regulator—

Mr. ATKINS. Because the bank examiner will—

Mr. ROYCE. —that that just be imploded.

Mr. ATKINS. Right. It is a true crisis. I think we have to address it. And so I salute you for doing what you can.

Mr. ROYCE. Other members of the panel on this subject?

Mr. GRIGGS. I will comment that NASDAQ, for the publicly traded community banks, we list over 90 percent of them on our marketplace so we have regular dialogue, and I would echo the comments that they are in a very difficult situation right now when it comes to helping small businesses, particularly with all the regulations that are faced, and they do—that group in particular questions the reason why they would go public today, and we all know that when they do go public they do get more capital to support businesses. So I think it is a crisis situation.

Mr. ROYCE. The other two panel members on the subject?

Mr. LAWS. At my end of the market nobody has any assets against which to take out a loan, so it is all equity financing.

Mr. ROYCE. Yes, yes.

I yield back, Mr. Chairman.

Thank you very much, to the panel.

Chairman GARRETT. Thank you. The gentleman yields back.

Mr. ROYCE. Thank you again, Mr. Chairman.

Chairman GARRETT. Mr. Scott is recognized for 5 minutes.

Mr. SCOTT. Let me ask you about something I have not heard before and so I want a little bit of clarity of information referencing House Resolution 4855. Could you all explain to me what crowdfunding is? How would the average investor out there—what does that mean?

Mr. LAWS. Crowdfunding in general refers to something that is done online where there is broad participation by people in—I will use some examples like Kickstarter, or Indiegogo, or websites where people will fund a social cause or help a company get off the ground by buying their product ahead of time.

What we are talking about here for securities law is allowing individuals to, when they do that, not just buy a product or support a cause but take ownership in the company that they are funding. So it would allow a small company to sell part ownership in it to the crowd.

The regulation as it exists in law was set up to put a lot of protections in place to make sure it flows through certain websites and with certain regulations to make sure all the disclosures are happening and it is very transparent.

Mr. SCOTT. And so we are having all kinds of challenges with online lending, online investments, online payment transactions folks, online merchants. This machine that we have created, the Internet, the online services, sometimes appears to me to be like the machine that we created to serve us, but we are now having to become servants of that machine. And it puts us in Congress in a way of trying to navigate a situation that is constantly changing with our technology.

So the Securities and Exchange Commission has just recently, as I understand it, completed its crowdfunding rules. Is that correct?

Mr. LAWS. Yes, several months ago. They will come into effect in May.

Mr. SCOTT. In May, next month. Now to me, shouldn't we wait until we have some experience from crowdfunding before we make significant changes to the crowdfunding exemption?

Mr. LAWS. I would answer yes, with the proviso that the kind of so-called online fundraising for accredited investors, the accredited crowdfunding, has been legal since the JOBS Act passed in 2012.

There was, I believe, an earlier bill that had more extensive changes to crowdfunding. This bill, to my understanding, is narrowly taking some of the experiences that we have learned over the last 3 years and using that to improve the crowdfunding act, in some cases to include investor protections that were not available in the original one.

So I actually believe it is a wise thing to do to make sure that some of those make it in place—some of those learnings over the last 3 years make it in place into this crowdfunding version.

Mr. SCOTT. And now there is a grace period involved in this, right—a 5-year grace period?

Mr. LAWS. I am not sure.

Mr. SCOTT. From my understanding, there is a 5-year grace period during which the Securities and Exchange Commission would be prohibited from even enforcing the crowdfunding rules. Do you feel that is warranted?

Mr. LAWS. That is not my understanding of the law. I don't quite know how to answer that because I don't believe that is the way it is written.

I believe what is written into the law is there is a time period during which, when they find violations, they are supposed to give the portals a chance to address those rather than instantly shut it down, depending on the severity of the violation.

Mr. SCOTT. Let me ask you, is it not in the bill?

Mr. LAWS. I am not aware of that portion.

Mr. ATKINS. Congressman, I believe there is a provision in the bill for a grace period, but that is for good-faith efforts to comply. So, it is clearly open to interpretation. But anyway, but I think the intent is to try to encourage the SEC to guide rather than to come with a hammer.

Mr. SCOTT. It just seems to me that some problems—

Chairman GARRETT. The gentleman's time has expired on that one, and at the very end of the hearing, we always ask for members of the panel to answer any other additional questions, so at that time, if the gentleman would like to have additional input from the panel, he can certainly get more into the weeds on the answer on that one.

Mrs. Wagner is recognized for 5 minutes.

Mrs. WAGNER. Thank you, Mr. Chairman.

And thank you all for joining us today as we look at the JOBS Act 4 years later and examine the benefits it has brought to small companies and their ability to raise capital and grow their businesses.

As President Obama even said himself, this bill has been a game-changer for startups and for small businesses. We have seen this especially in my home district, where recent reports have said that St. Louis has the fastest-growing start-up scene in the country. This is exciting news. But as many of you have stated today, there is still more work that we can do to build on the success of the JOBS Act and in helping small businesses reach their full potential.

So in that vein, Mr. Griggs, you mentioned that—and it has been mentioned before—in the 4 years since the JOBS Act, there have been 865 IPOs with 86 percent being emerging growth companies. Can you talk a little bit, in some specifics here, about the most important steps that should be taken to build on the success?

Mr. GRIGGS. Sure. I think our viewpoint on the most important aspects would be to start considering what it means once you are public and focus on some aspects that we find continually come up with companies about what the challenges are once you do go public. Because there is certainly the brand of going public has, over the years, taken some hits based on what the "burdens" are to be a public company.

So I did highlight in my testimony, I think, what we feel would be the most important ones would be to provide much more transparency on the proxy firms and what they are requiring companies to do. Companies looking at—are continually frustrated by the PCAOB and how they make "recommendations" to audit firms they are not really sure how to interpret, and so we do feel that much more clarity needs to be done in that aspect.

And then you look at how a company helps—or goes understanding who their investors are. There are rules in place that are—the requirement is to report long positions but nothing on the short side. And that has become much more prevalent in terms of how investors use shorts. Companies continually ask us to advocate for that.

So those three aspects, to us, would do a lot to help instill more confidence in the public market and going public.

Mrs. WAGNER. Thank you very much. And my colleague, Mr. Hurt, kind of touched on things we were all looking at at the slowdown at the end of 2015, beginning of 2016, in the IPO period.

Now, you talked about market conditions being really the driving force there, but there was still demand. And you have touched on it a little bit, but can you talk about some of the regulatory impediments that are perhaps chilling the IPO market?

Mr. GRIGGS. Yes. I really would go back to we see a very—have a very robust pipeline of companies that would like to go. And typically sometimes you can point to various sectors that have certain regulatory challenges. That is not the case today, so our view of it is much more a market condition than a regulatory condition because it is across all sectors right now where there just have not been IPOs.

But we have seen this in the past and we do feel very strongly that the second half of 2016 is going to be strong.

Mrs. WAGNER. Good. Let's hope so.

I would like now to turn to the market for private financing for those companies that haven't gone public yet, which is a very important source of funding for startups and early-stage businesses.

In following up, again, my colleague, Mr. McHenry, Mr. Keating, you stated that angel investors—investment is sluggish. And you pointed to regulation and the over-regulatory burden.

Can you expand on some of the specifics of that? You mentioned it in a broad, overreaching sense, but what are those impediments, those regulatory impediments that exist regarding this kind of investment?

Mr. KEATING. Actually, the best way to answer that, it is a broad, overarching issue. I think it is a broad overarching issue for the entire economy.

When Mr. Griggs talks about the IPO market, when we are talking about angel investment, when we are talking about the decline in business loans to small businesses, that is all—there are a whole host of issues in there, but overarching is the state of this economy, a recovery that is growing at 2.1 percent when we should be growing, if you base it on history, at almost 4.5 percent.

So it all goes—but then the question becomes, why is that? And I will go back to, it is pointing policy in the wrong direction in every possible area you can think of in the last several years, especially on regulation. We have been in a hyper-regulatory market on a whole host of fronts. But taxes, as well. No leadership on trade.

I will even pick on the Federal Reserve while I am here, in the sense that they have been saying that they are saving the economy, but in terms of the monetary policy that has been run, it is without precedent and I have never heard so many small business owners say, "What is going to happen with what the Fed has been doing?" And they have never talked to me about the Fed every before because it is uncertainty now. Nobody knows how this is all going to come out.

So I would say it is an overarching environment, and then you can go down and drill down into all sorts of individual regulations and taxes.

Mrs. WAGNER. Thank you, Mr. Keating. I have run out of time here, and I would say that fourth branch of government, that over-regulatory nature that we have that has been created here, which are the regulators, the agencies, the departments, is not just here in financial services; it is overarching in many different areas across our jurisdiction. So I thank you very much.

I yield back.

Chairman GARRETT. The gentlelady yields back.

Mr. Hill is recognized for 5 minutes.

Mr. HILL. Thanks, Mr. Chairman. Thank you for hosting this panel. It is useful, and it is also great to be talking about kind of a positive topic for the economy because clearly, over the past 4 years, this was a bright spot in the Obama Administration and congressional collaboration on the economy, so it is nice to be talking about ways to enhance something that is generally working well.

Before I ask questions, I will make a note that I recently introduced a bill that is related to this topic that will head over to the Ways and Means Committee, H.R. 4831, which will allow people who are using crowdfunding and a Subchapter S company to not have that crowdfunding count as one of the 100 shareholder limitations.

Since pass-through ownership has gotten so popular, I am not sure S Corps are as popular as they once were because of State LLC encouragements. We all recognize that. But in the small community bank arena, and in some niches in the economy, Subchapter S is still popular, and so this is a way, I think, to combine the benefits of the JOBS Act with that Subchapter S form of incorporation.

Mr. Keating, I want to start with you, and you raised a question that we talk a lot about in here, and that is the AML, the money-laundering laws. And you made a reference in your testimony about portals and how they might be treated under AML. Could you elaborate just for a second on that?

Mr. KEATING. Sure. We are concerned with applying those to portals. It doesn't make any sense when you think about what the anti-money-laundering laws—

Mr. HILL. They are being applied. It is currently applied to portals—

Mr. KEATING. Yes. My understanding is that it is under consideration, that it has been kicked around, if you will. And I believe FINRA said no, but now, from what I understand, Treasury is—it is at least being kicked around there and we are concerned about that because it is tremendous regulatory costs. There are examples of foreign banks not wanting to deal with American depositors, and so on and so on, because of the tremendous regulatory costs.

So if you apply that to portals, that would be catastrophic, I think, in many ways.

Mr. HILL. Thank you.

Mr. Beatty, a question for you from a State perspective: Since we have had this experience on general solicitation for a private placement, has it generally been successful that there haven't been noted through the State securities Commissioners anything kind of catastrophic happen by having this general solicitation of certain private placements covered by the act? Has it gone pretty well, in other words?

Mr. BEATTY. I think that a relatively small percentage of the Reg D filings that we see are utilizing general solicitation, and in the early history, no, there have not been much by way of reported complaints with regard to them.

Mr. HILL. Yes.

And, Mr. Griggs, you talked in your—you had two interesting comments in your testimony. One was on the short positions disclosure. Would you elaborate on that for a moment?

Mr. GRIGGS. Sure. If you look at a—

Mr. HILL. Explain to the committee why that is important. What is going on out there in the capital markets of people shorting stocks that is concerning right now?

Mr. GRIGGS. Yes. So a very large part of being a public company is how you are going to communicate with your investors, and senior management dedicates quite a bit of time to doing that because it does help represent in the capital markets those who are either currently stock to raise, but also they want to raise more capital.

So today investors are required at certain levels to report that they are a long holder in the stock, and that dates back to the 1970s. If you look at a short position, companies by no means are saying that shorts are not valuable. They do provide liquidity to the marketplace and they are an important part of the investment community strategies, but there is no insight to a company about who those investors are that are short in the stock the same way there are for long positions.

So in the interest of transparency, companies feel to really communicate effectively to their shareholders, knowing who those investors are at certain levels the same way they know longs would be very valuable.

Mr. HILL. Have you seen anything recently in the market that concerns you more particularly, like this IVR patent troll issue and short positions? Are you familiar with that? That seems to strike at the heart of emerging companies.

Mr. GRIGGS. I can't speak to that, but this is not a new issue with short—not knowing who your short positions are. This has been ongoing for quite some time.

But I think as you look at the rise of activist investors it has really come to fruition in the last several years. It has become much more common conversations we have with our companies.

Mr. HILL. Thank you.

And thanks, Mr. Chairman. My time has expired.

Chairman GARRETT. Mr. Emmer is now recognized for 5 minutes.

Mr. EMMER. Thank you, Mr. Chairman.

And thanks to the panelists for being here today.

As we all know, small businesses are vital to our economy. If you define a small business as a firm with fewer than 500 employees, like the Small Business Administration does, then there are more than 28 million small businesses in the United States, and over half of the 120 million American workforce is employed by one of them. Small businesses have also created more than 64 percent of the net new jobs over the past 15 years, and today that number is north of 70 percent.

Despite the overwhelmingly positive impact small business has on our economy, traditional bank lending to small business is still at pre-recession lows. Furthermore, if a firm would like to sell stock to raise money, often it must register with the Securities and Exchange Commission. According to the SEC, registration costs $2.5 million on average, which many small businesses simply can't afford.

Fortunately, certain security offerings are exempt from SEC registration, including a private offering exemption under Section 482 of the Securities Act of 1933.

There is a problem, however. The problem is the ability of small businesses to effectively use this exemption is—the term “private offering” is not defined in law. Not only does this prevent small business from using the exemption, it leaves businesses who try to use the exemption and can’t afford a team of expensive lawyers—which, again, most small businesses cannot—exposed to potential lawsuits and future liability.

That is why I introduced the Micro Lending Safe Harbor Act with seven of my colleagues. This legislation will create a bright line safe harbor for small private offerings. It will help entrepreneurs open new businesses and expand existing ones.

It does this by clarifying the safe harbor exemption—not by creating something new, but by clarifying something that exists for any offering that meets one or more of the following criteria: one, each purchaser has a substantive preexisting relationship with an owner; two, there are no more than 35 purchasers of securities from the issuer that are sold in reliance on the exemption during the 12-month period; or three, and this may be the most important, the aggregate amount of all securities sold by the issuers does not exceed $500,000 during the 12-month period preceding.

The bill also exempts any of the aforementioned security offerings from blue sky laws while maintaining anti-fraud provisions at the Federal and State level. Again, I want to make it clear, all Federal and State anti-fraud laws will remain fully applicable to these offerings.

On March 27, 2015, former SEC Commissioner Daniel Gallagher gave a speech at the Vanderbilt Law School where he noted: “Given the substantial changes in technology and the markets since this law was enacted, it may be time to see if there are other ways to balance access to capital and investor protection, giving the issuers other choices when raising capital.”

He went on to say, “Advancing a micro offering safe harbor, which would deem certain extremely small or limited offerings is not involving a public offering under Section 4(a)(2) of the Securities Act, worth exploring.”

As our economy continues to evolve, it is imperative that our laws and regulations also evolve to keep up with new business opportunities and demands. The Micro Offering Safe Harbor Act, which is endorsed by the National Small Business Association and the Small Business and Entrepreneurship Council, is a next-generation vehicle for capital formation.

The time has come for Congress to come together and help small business help themselves by making this important update and improvement to the Securities Act of 1933.

And in the short time I have left, I wanted to start with Mr. Atkins. It is interesting because I heard testimony earlier that I believe it is Section 504 of Regulation D already exists, so this would solve this problem. But that would require you to sell up to $1 million in securities in, I think, any 12-month period preceding.

How would that impact the discussion that we had earlier about the small businesses? I had one in Minnesota: Medtronic. We have several of them. The Disney Corporation, just name them, Amazon. If you wanted to buy—or borrow $30,000 from a family member, for instance, how would this impact that?

Mr. ATKINS. Yes, well, I think your bill really helps to clarify what already exists under 506 and I think gives a good amount of certainty. For that, I think it is a very good effort.

I don't really see huge companies making use of anything like that. It doesn't make sense in the grand scheme of things.

Mr. EMMER. Thank you.

I see my time has expired.

Chairman GARRETT. Mr. Messer is now recognized.

Mr. MESSER. Thank you, Mr. Chairman.

And I thank the panel today for being here for this important topic.

I want to direct my question to Mr. Atkins to start. You note in your testimony that there is more work to be done with respect to modernizing the Federal regulatory environment, and you also importantly note that Federal agencies have issued a record 392 major rules with economic impact of over $100 million annually on the economy. And many of us are supporters of the REINS Act, which would have Congress approve any regulation that had that kind of impact on the broader economy.

Could you just talk a little bit about how the regulatory burden impacts small businesses in America in search of capital?

Mr. ATKINS. Yes. We talked a little bit before about how community banks are being squeezed not just by the market in general, but also by formal and informal regulations. So by information regulations, I mean the great latitude that bank examiners have.

Going all the way back to when I was working for Chairman Breeden at the SEC back in the early 1990s in the wake of the S&L crisis, you could see how the effect of the bank examiners, what they had on the decrease of commercial investor loans and the increase of what banks are holding in treasury securities. You are seeing a similar thing right now, but even worse, we are seeing community banks going out of business. And so there is a real, palpable effect.

Mr. MESSER. And you mentioned community banks, but I would ask you a question: Who do you believe receives the most harm or bears the greatest compliance cost of today's current regulatory regime?

Mr. ATKINS. It comes down to investors and to Main Street businesses, frankly, ultimately. They bear the burden just like on any sort of imposition on the economy.

Mr. MESSER. Yes, the back-end consumer.

I want to turn now a little bit to the JOBS Act, which increased the cumulative Reg A offerings by an issuer from $5 million to $50 million—again, something this panel would understand well. Despite the significant delays in finalizing the rule, has the new threshold been enough to entice companies to use Reg A offerings?

Mr. Keating or Mr. Atkins, if you could—

Mr. KEATING. My quick response is that we have seen positive results with Reg-plus. I noted those in my testimony. But certainly, again, limiting—I think that limitation, if you will, leaves money on the table, and why would we want to do that, as I said earlier.

Mr. MESSER. Yes. What does increasing access to Reg A offerings mean for U.S. businesses looking to raise capital and grow?

Mr. KEATING. Again? I'm sorry—

Mr. MESSER. What does increasing access to those offerings mean for U.S. business?

Mr. KEATING. Oh, this, again, goes back to the engine of the economy. When we are talking about—we have heard wonderful things today about small businesses and how vital they are. Well, they have to get capital to make it all happen, whether it is through debt or equity.

So when you are looking at these regulations, they very much have a direct impact on small business and therefore the economy, without a doubt.

Mr. ATKINS. And one thing, just to add to—

Mr. MESSER. Yes.

Mr. ATKINS. —my former answer to your question. The main effect of all these regulations and the cost is ultimately on the consumers and the employees of the United States. And in this economy, where we have—to call it a tepid economy or recovery is—from 2008 and 2009—I think is a real misnomer; it is kind of a false recovery.

And so in order to try to get people back to work and have consumers enjoy a better lifestyle, I think we have to make it possible for small businesses, which are the engine of the economy, to get back to work.

Mr. MESSER. Yes. Most new jobs in any recovery come from small business, and so if small businesses can't operation and function in our economy it is very difficult to create jobs. Folks want jobs. We need to have healthy small businesses, and that requires access to capital, really.

One last point, maybe Mr. Atkins or Mr. Keating, in the limited time we have, I understand that the SEC is statutorily required to review the Reg A-plus threshold every 2 years, meaning that such a review is due this month. What do you think is the most appropriate threshold and how would increasing it to that amount further aid small business?

Mr. ATKINS. It would be interesting to see what the report looks like, but Chair White talked about Reg A-plus a little bit at the end of last year, I believe, and talking about how there have been a lot of—it has an increasing number of registrations under it. But it seemed to me that there is a long way to go, and reading between the lines, I think even the people at the SEC recognize that.

Mr. MESSER. Okay. Thank you very much.

I yield back to the Chair.

Chairman GARRETT. The gentleman yields back.

And seeing no other Members with questions, I will end where I began, by saying thank you to the entire panel for being here, for I think a fairly good discussion on where we are looking to go in this area: not a position of no regulation, but basically a position of the appropriate level of regulation; not a repeal of everything, but actually just making sure that we have the right level of regulation to ensure investor confidence on the one hand, and at the same time, capital formation on the other hand.

I thank all the members of the panel for all their views here today.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing.

Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

Without objection, this hearing is adjourned. And again, thank you.

[Whereupon, at 12:08 p.m., the hearing was adjourned.]

A P P E N D I X

April 14, 2016

Testimony of

Paul S. Atkins
Chief Executive Officer
Patomak Global Partners, LLC

Before the

United States House of Representatives
Committee on Financial Services

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

Good morning. Thank you Chairman Garrett, Ranking Member Maloney, and Members of the Committee for inviting me to testify today.

I am Paul Atkins, CEO of Patomak Global Partners. For six years ending in 2008, I served as a commissioner on the U.S. Securities and Exchange Commission (SEC), and from 2009 to 2010, I was a member of the Congressional Oversight Panel for TARP, where I had the pleasure of serving with Chairman Hensarling. I am testifying this morning on my own behalf.

* * *

Mr. Chairman, as you know, small businesses are vital to our nation's economy. Since 2002, small businesses generally have been responsible for almost 50 percent of U.S. private, non-farm GDP.[1] In 2012, small businesses with fewer than 20 employees made up almost 90 percent of the 5.73 million employer firms in the U.S.[2] Indeed, start-ups and young companies are a primary driver of job creation in the U.S.[3] For example, between 1993 and the middle of 2013, small businesses accounted for 63 percent of the net new jobs created in the U.S.[4] More recently, a year-end 2015 report from the National Small Business Association shows that 23 percent of small businesses hired more employees last year, 57 percent reported increasing employee compensation, and 35 percent plan to hire new workers.[5] From February to March of this year alone, private sector small business employment increased by 86,000 jobs.[6]

What do these numbers really mean? Put simply, if we are serious about spurring strong and lasting economic growth, creating more jobs outside of Washington, D.C., and breaking down our two-tiered economy, we do not need higher taxes or more government spending – instead, the data suggest that we need more entrepreneurs and more small businesses, and we need to continue to create a sensible regulatory environment in which these firms and individuals can succeed. With that background in mind, I appreciate the opportunity to testify here today on the early achievements of the JOBS Act, as well as additional measures to promote small business capital formation.

I. The JOBS Act at Four

The bipartisan JOBS Act proves that you do not need hundreds or thousands of pages of complex legislation to help Main Street businesses and protect consumers and investors. Weighing in at a lean seven titles spanning only 22 pages, the JOBS Act has already achieved significant results for small businesses seeking access to much-needed growth capital, while at

1 *See* Small Business & Entrepreneurship Council, Small Business Facts & Data (citing SBA Office of Advocacy) ("SBEC Facts & Data"), http://sbecouncil.org/about-us/facts-and-data/.

2 *See id.* (citing U.S. Census Bureau).

3 *See, e.g.*, Haltiwanger, Jarmin & Miranda, Who Creates Jobs? Small vs. Large vs. Young, NBER Working Paper 16300, at 2 (Aug. 2010), http://www.nber.org/papers/w16300.pdf.

4 *See* SBEC Facts & Data.

5 *See* National Small Business Association, 2015 Year-End Economic Report, at 8, http://www.nsba.biz/wp-content/uploads/2016/02/Year-End-Economic-Report-2015.pdf.

6 *See* ADP Press Release, ADP Small Business Report: Small Business Employment Increased by 86,000 Jobs in March (Mar. 30, 2016), http://investors.adp.com/releasedetail.cfm?releaseid=962715.

the same time maintaining important investor protections and providing more opportunities for Americans to put their hard-earned dollars to work investing in America's future.

A. Title I – The IPO On-Ramp

Thanks in large part to the self-effective provisions of Title I of the JOBS Act, also known as the "IPO On-Ramp", IPO activity accelerated from the second quarter of 2013 through year-end 2014.[7] In fact, 2014 was one of the strongest years for the IPO market since 2004.[8] According to one study, "the JOBS Act has led to 21 additional IPOs annually, a 25% increase over pre-JOBS [Act] levels."[9] Since the JOBS Act was enacted in 2012, Emerging Growth Companies (EGCs) – a new class of issuer created by Title I of the JOBS Act – have dominated the IPO market, representing 85% of IPOs that have gone effective.[10] Many EGCs have taken advantage of Title I's scaled regulatory requirements, including the confidential review accommodation, simplified executive compensation disclosure, and streamlined financial information disclosure (for example, two years of audited financial statements in an EGC IPO registration statement, versus three years for a registration statement on Form S-1), all of which make public offerings more attractive for smaller companies, while preserving essential information for investors.[11] Ultimately, more IPOs mean more jobs,[12] something that the U.S. could really use after nearly seven years of what Chairman Hensarling has referred to as the current "non-recovery recovery."

B. Title II – Lifting the Ban on General Solicitation

Title II of the JOBS Act required the SEC to lift the ban on general solicitation and advertising in connection with private securities offerings to accredited investors under Rule 506 of Regulation D. The SEC completed its rules to implement Title II in July 2013, about a year after the deadline set forth in the statute.

According to the SEC, from September 23, 2013 through December 31, 2015, issuers raised over $50 billion under Rule 506(c) offerings.[13] While this was a promising start – and

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7 *See* Ernst & Young, The JOBS Act: 2015 mid-year update, at 3 (Sept. 2015) ("E&Y 2015 Mid-Year Report"), http://www.ey.com/Publication/vwLUAssets/JOBSAct_2015MidYear_CC0419_16September2015/$FILE/JOBSAct_2015MidYear_CC0419_16September2015.pdf.

8 *See id.* Although IPO activity slowed during the first half of 2015, according to E&Y's 2015 mid-year report, this period still exceeded the average number of IPOs for the half-year periods during the past five years, which averaged around 94 IPOs.

9 Michael Dambra, Laura Casares Field & Matthew T. Gustafson, The JOBS Act and IPO Volume: Evidence that disclosure costs affect the IPO decision, 116 J. of Fin. Econ. 121, 121 (2015), *available at* http://leeds-faculty.colorado.edu/bhagat/JOBSAct-IPO-Volume.pdf.

10 *See* E&Y Mid-Year 2015 Report, at 1.

11 *See id.* The on-ramp has been used by companies across the country in various industries including automotive, biotechnology, and consumer products and services. *See, e.g.*, Edward Teach, On the IPO On-Ramp, How the JOBS Act helped five CFOs take their companies public, CFO Magazine (Sept. 15, 2014), http://ww2.cfo.com/capital-markets/2014/09/ipo-ramp/.

12 *See, e.g.*, Martin Kenney, Donald Patton & Jay R. Ritter, *Post-IPO Employment and Revenue Growth for U.S. IPOs, June 1996-2010*, at 1 (May 2012) (finding that EGCs' post-IPO employment increased 156%).

13 *See* Scott W. Bauguess, SEC Division of Economic and Risk Analysis, Private Securities Offerings post-JOBS Act (Feb. 2016) ("DERA JOBS Act Report"), https://www.sec.gov/info/smallbus/acsec/private-

certainly there likely have been more 506(c) offerings since the end of 2015 – it represents about 3 percent of the total capital raised under Rule 506 since 506(c) became effective.[14] There likely are a variety of reasons why Rule 506(c) has not caught on as fast as supporters of the rule change may have hoped. For example, critics have pointed to the Rule's overly-burdensome accredited investor verification requirements.[15] Another major impediment is the uncertainty surrounding the SEC's additional rule proposal in July 2013 to further amend Reg. D in ways that would make – and apparently already have made – Rule 506(c) offerings less attractive to potential issuers.[16] As discussed in more detail below, passing H.R. 4852, The Private Placement Improvement Act, would be a great start toward allowing Rule 506(c) offerings to flourish in the manner originally intended by the JOBS Act.

C. *Title III – Crowdfunding*

Title III of the JOBS Act required the SEC to draft rules allowing companies to seek up to $1 million through equity crowdfunding from all types of investors, including unaccredited investors. The SEC finalized its rules to implement Title III in October 2015, more than two and a half years after the statutory deadline. While the forms enabling funding portals to register with the SEC have been effective since January 29, 2016, the crowdfunding rules do not go into effect until mid-May of this year. While I expect crowdfunding to develop over time into a valuable source of equity capital for America's small businesses, critics have already pointed to a number of flaws in the SEC's rules that initially will likely make crowdfunding a less attractive option than Congress intended.[17] By passing H.R. 4855, The Fix Crowdfunding Act, Congress

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securities-offerings-post-jobs-act-bauguess-022516.pdf (does not include amendments to offerings or Rule 506(c) offerings initiated by issuers that had a prior Regulation D offering during 2009-2013). *See also* Scott Bauguess, Rachita Gullapalli & Vladimir Ivanov, SEC Division of Economic and Risk Analysis Research Report, Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2014, at 2 (Oct. 2015) ("DERA Capital Raising Report"), https://www.sec.gov/dera/staff-papers/white-papers/unregistered-offering10-2015.pdf.

14 *See* DERA JOBS Act Report (does not include amendments to offerings or Rule 506(c) offerings initiated by issuers that had a prior Regulation D offering during 2009-2013).

15 *See, e.g.*, Karlee Weinmann, 5 Reasons Funds Won't Touch JOBS Act Marketing Rules, Law360 (Apr. 10, 2014), http://www.law360.com/articles/526895/5-reasons-funds-won-t-touch-jobs-act-marketing-rules; William Carleton, The Trojan Horse of Accredited-Investor Verification, Wall St. J. (Sept. 27, 2013), http://blogs.wsj.com/accelerators/2013/09/27/weekend-read-the-trojan-horse-of-accredited-investor-verification/; David Verrill, SEC Rules Will Clip the Wings of Angel Investors, Wall St. J. (July 24, 2013), http://www.wsj.com/articles/SB10001424127887323309404578611543232094874.

16 *See, e.g.*, DERA Capital Raising Report, at 13 ("[T]he Commission's proposed amendments to Regulation D and Form D at the time Rule 506(c) was adopted have elicited widely divergent views from commenters and remain outstanding."); Laura Kolodny, Startups Advertising to Raise Funding More Than VC Firms Are, Study Says, Wall St. J. (Oct. 2, 2014), http://blogs.wsj.com/venturecapital/2014/10/02/startups-advertising-to-raise-funding-more-than-vc-firms-are-study-says/; Weinmann, 5 Reasons Funds Won't Touch JOBS Act Marketing Rules; Emily Chasan, New Private Fundraising Rules Attract Meager Interest, Wall St. J. (Mar. 24, 2014), http://blogs.wsj.com/cfo/2014/03/24/new-private-fundraising-rules-attract-meager-interest/.

17 *See, e.g.*, JD Alois, Title III Crowdfunding Fix: House Financial Services Committee Schedules Hearing to Build on JOBS Act Success, Crowdfund Insider (Apr. 8, 2016), http://www.crowdfundinsider.com/2016/04/84007-title-iii-crowdfunding-fix-house-financial-services-committee-schedules-hearing-to-build-on-jobs-act-success/; Christopher Mims, Tech Startup Crowdfunding Isn't All It's Cracked Up to Be, Wall St. J. (Dec. 7, 2015), http://www.wsj.com/articles/tech-startup-crowdfunding-isnt-all-its-cracked-up-to-be-1449464460.

can prevent some of these problems before they negatively impact crowdfunding issuers, crowdfunding platforms, and the ordinary investors seeking to deploy capital to small businesses.

D. Title IV – Regulation A+

Title IV of the JOBS Act directed the SEC to amend the Regulation A offering exemption to allow issuers to, among other things, raise up to $50 million in a 12-month period subject to certain basic disclosure requirements and exempt from the requirements of state blue sky laws (so long as the securities are sold to qualified purchasers). The SEC issued its final rules, now commonly known as Regulation A+, in March 2015. While Reg. A+ is only about a year old, the exemption has already been used by a number of small businesses to raise much-needed growth capital.[18] As SEC Chair Mary Jo White recently remarked:

> As for Regulation A+, which just became effective in June, it is obviously too early to draw conclusions. Companies are beginning to take advantage of the new rules in greater numbers than was the case under the prior version of the exemption, with approximately 34 companies publicly filing offering statements and 16 companies filing non-public draft offering statements. The staff has qualified three offerings so far, and it remains to be seen how investors will react to such offerings.[19]

II. The Continuing Regulatory Burden on Small Businesses and the Economy

As described above, just four years after its enactment, the JOBS Act has been a major step toward rationalizing and modernizing the current regulatory environment to better serve small businesses and investors alike. But there is more work to be done. Today, our startups and small businesses continue to be buried under an ever-increasing mountain of red tape that inhibits the ability of these firms to innovate, grow, create jobs, and spur economic growth.

The Obama Administration has been perhaps the most prolific regulatory force in U.S. history. To date, federal agencies have issued a record 392 major rules with economic impacts greater than $100 million annually.[20] At least another forty-seven major rules are expected in the coming months.[21] Six of the seven highest Federal Register annual page counts now belong to President Obama.[22] And these rules do not only affect big corporations. In fact, the number of

18 *See* Robin Sosnow, Reg A+: A Successful First Year Despite Regulatory Ambiguities, Crowdfund Insider (Mar. 31, 2016), http://www.crowdfundinsider.com/2016/03/83688-reg-a-a-successful-first-year-despite-regulatory-ambiguities/.

19 SEC Chair Mary Jo White, Keynote Address at the 47th Annual Securities Regulation Institute: "Building a Dynamic Framework for Offering Reform" (Oct. 28, 2015), https://www.sec.gov/news/speech/building-dynamic-framework-for-offering-reform.html.

20 *See* Nick Timiraos, Obama Readies Flurry of Regulations, Wall St. J. (Apr. 7, 2016), http://www.wsj.com/articles/obama-readies-flurry-of-regulations-1460077858.

21 *See id.*

22 *See* Clyde Wayne Crews, Bureaucracy Unbound: 2015 is Another Record Year for the Federal Register, Competitive Enterprise Institute (Dec. 30, 2015), https://cei.org/blog/bureaucracy-unbound-2015-another-record-year-federal-register.

federal regulations affecting small businesses at the end of 2012 was 13 percent higher than in 2008.[23]

As I have said in the past, I believe that a major cause of the uncertainty handcuffing our economy today is in fact government policy, particularly the sweeping Dodd-Frank Wall Street Reform and Consumer Protection Act, enacted in 2010 ostensibly for the sake of market stability and investor confidence. This 2,319-page behemoth, requiring between 243 and 533 new rules, depending on how you count them, continues to spawn uncertainty and undermine the climate necessary for economic growth.[24]

Indeed, the real tragedy – or inconvenient truth – behind Dodd-Frank and the hundreds of other rules flowing from Washington every year is that consumers, investors, and small business are harmed the most.[25] For consumers and investors, increasing amounts of regulation means higher prices, diminished returns, or restricted choices. Small businesses, which have fewer monetary and human resources available to handle red tape compared to their larger peers, also are disproportionately impacted by government regulation. In 2015, for example, the National Federation of Independent Business (NFIB) estimated that the "runaway train" of government regulation now costs small businesses almost $12,000 per employee every year, 30% more than the regulatory costs to larger companies.[26] And, major small business surveys recently have highlighted access to credit as being one of the most significant growth concerns currently facing small companies.[27] A 2014 Harvard Business School report found, for example, continued "weakness in small business credit markets, which disproportionately impacts Main Street businesses."[28] Similarly, even though small businesses were the victims – not the cause – of the financial crisis, a report from the American Enterprise Institute finds that "it is the start-up

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[23] *See* Scott Shane, To Help Small Business, Cut Regulation, Entrepreneur Magazine (Jan. 10, 2014), https://www.entrepreneur.com/article/230727.

[24] While some may argue that Dodd-Frank was necessary to address the financial crisis and prevent future crises, it was failed federal housing policy, not a lack of regulation, that was the primary cause of the crisis. *See generally* Peter Wallison, Hidden in Plain Sight: What Really Caused the World's Worst Financial Crisis and Why It Could Happen Again (2015). Dodd-Frank did not address this primary cause at all.

[25] *See, e.g.*, Ben Gitis & Sam Batkins, Regulatory Impact On Small Business Establishments, American Action Forum Research Report (Apr. 24, 2015), http://www.americanactionforum.org/research/regulatory-impact-on-small-business-establishments/; Clyde Wayne Crews Jr., Competitive Enterprise Institute, Ten Thousand Commandments: An Annual Snapshot of the Federal Regulatory State, at 1-2 (2014 ed.), http://cei.org/sites/default/files/Wayne%20Crews%20-%20Ten%20Thousand%20Commandments%202014.pdf.

[26] *See* Andrew Wimer, NFIB Legal Counsel to Congress: "Who is minding the regulatory store?" (July 15, 2015), http://www.nfib.com/article/nfib-legal-counsel-to-congress-who-is-minding-the-regulatory-store-70163/.

[27] *See* Karen Gordon Mills & Brayden McCarthy, The State of Small Business Lending: Credit Access During the Recovery and How Technology May Change the Game, Harvard Business School Working Paper 15-004 (July 22, 2014) ("Harvard Credit Markets Study"), http://www.hbs.edu/faculty/Publication%20Files/15-004_09b1bf8b-eb2a-4e63-9c4e-0374f770856f.pdf. *See also* William C. Dunkelberg, National Federation of Independent Business Small Business Economic Trends, at 3, 18 (Feb. 2016), http://www.nfib.com/assets/SBET-February-2016.pdf (ranking "government regulation and red tape" as the second most important problem facing small business owners behind taxes, and noting that small business owners reported being "very pessimistic about business conditions in the coming months and spending and hiring plans have softened").

[28] Harvard Credit Markets Study at 26.

category that would be having the most difficulty getting bank credit as a result of the tightening lending standards and greater small bank regulatory costs induced by Dodd-Frank."[29]

III. Next Steps to Promote Small Business Capital Formation

A. H.R. 4852, The Private Placement Improvement Act of 2016

The U.S. market for private securities offerings under Reg. D is the largest, most vibrant private securities market in the world. From September 23, 2013 through December 31, 2015, over 48,000 offerings under Rule 506 raised well over a trillion dollars in capital.[30] Many small businesses depend on Rule 506 of Reg. D to raise capital to maintain and grow their operations – for example, the mean and median offering sizes of Reg. D offerings of non-financial companies in 2014 were $10 million and $1 million, respectively.[31] In Title II of the JOBS Act, Congress sought to further enhance this market by lifting the ban on general solicitation in connection with private securities offerings under Rule 506.

Title II mandates that within 90 days of enactment of the JOBS Act, the SEC revise its rules to lift the ban on general solicitation in connection with private securities offerings under Rule 506 of Reg. D, provided that the purchasers of the securities are accredited investors and the issuer take reasonable steps to verify that such purchasers are accredited investors using methods determined by the SEC. Despite this clear language, in connection with issuing final rules in 2013 to lift the ban on general solicitation, the SEC simultaneously issued a separate rule proposal to further amend Reg. D and Form D in order "to assess developments in the private placement market now that the rule to lift the ban on general solicitation has been adopted."[32]

Notwithstanding its rather innocuous justification, the SEC's rule proposal – which was not called for under the JOBS Act – would impose a number of burdensome and unnecessary obligations on issuers seeking to raise capital using general solicitation under Rule 506(c). For example, while the current rule requires issuers to file a single Form D within 15 days of the first sale of securities, the proposed rules would require that issuers file two additional Forms D, one 15 days before the offering and another within 30 days of completion of the offering. The proposed rules would also take the drastic step of imposing a one-year ban on offering securities under Rule 506 for any issuer that fails to comply with the Form D filing requirements.

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29 Peter J. Wallison, Is the Dodd-Frank Act Responsible for the Economy's Slow Recovery from the Financial Crisis and the Ensuing Recession? American Enterprise Institute Paper for the Ninth Hillsdale College Free Market Forum, at 9 (Oct. 16, 2015), http://www.aei.org/publication/is-the-dodd-frank-act-responsible-for-the-economys-slow-recovery-from-the-financial-crisis-and-the-ensuing-recession/. *See also* Gitis & Batkins, Regulatory Impact On Small Business Establishments (finding that regulations cumulatively reduce the number of small and medium-size businesses, while being associated with an increase in the number of large businesses).

30 *See* DERA JOBS Act Report.

31 *See id.* at 9. *See also* David R. Burton (The Heritage Foundation), Comment Letter to SEC on Amendments to Regulation D, Form D and Rule 156 (Nov. 4, 2014), https://www.sec.gov/comments/s7-06-13/s70613-462.pdf.

32 SEC Fact Sheet, Proposing Amendments to Private Offering Rules (July 10, 2013), https://www.sec.gov/news/press/2013/2013-124-item3.htm.

In addition, the SEC's proposed rules would require that issuers include certain legends and cautionary statements in written general solicitation materials, as well as temporarily to file such materials with the SEC. Finally, the rule proposal would extend SEC guidance in Rule 156 on potentially misleading statements in the sales literature of investment companies to the sales literature of private funds, whether or not such funds are involved in general solicitation.

The SEC's rule proposal, which is still pending, has been widely criticized as adding to the already large administrative costs and burdens on small issuers seeking to raise capital through private securities offerings.[33] Many of these critics have pointed to the uncertainty of the proposed rules as a wet blanket deterring many small businesses from raising capital using general solicitation under Rule 506(c), contrary to the very spirit and intent of Title II of the JOBS Act. As noted above, private securities offerings using general solicitation have so far accounted for only about three percent of the total capital raised under Rule 506 from September 2013 through December 2015.

The SEC fundamentally departed from its more normal practice of adopting a rule change, conducting after an appropriate implementation period a study of how the rule works in the marketplace, and then (if needed based on the study) considering proposals to amend the rule, including an analysis of the costs and benefits thereof. Basically, regarding 506(c), a majority of the Commission put the cart before the horse, proposing further amendments even before the ink was dry on the rule as adopted.

I believe that H.R. 4852, introduced by Chairman Garrett, is critically important to remove the regulatory uncertainty currently holding many issuers back from utilizing general solicitation under Rule 506(c) as Congress originally intended. H.R. 4852 would prevent the SEC from implementing the most burdensome provisions of its Reg. D rule proposal, including the requirement to file multiple Forms D; the one-year statutory ban for failing to file Form D; the requirement to file general solicitation materials with the SEC; and the extension of the requirements contained in Rule 156 to private funds.

In addition, H.R. 4852 contains two additional reforms to enhance private securities offerings under Rule 506(c). Current rules require that an issuer using Rule 506(c) file its Form D in every state where securities have been sold. In an electronic age, this burden is quite a throwback to an earlier era, particularly given that Forms D are filed electronically with the SEC. H.R. 4852 would relieve this burden on issuers by requiring the SEC to distribute Form D filings to each state securities commission. In addition, H.R. 4852 would address some of the concerns of those who find the accredited investor verification requirements to be unreasonable by classifying "knowledgeable employees" of private funds as accredited investors for purposes of Rule 506 offerings.[34]

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[33] *See generally*, *e.g.*, Burton, Comment Letter to SEC on Amendments to Regulation D; Annemarie Tierney (SecondMarket Holdings, Inc.), Comment Letter to the SEC on Amendments to Regulation D, Form D and Rule 165 (Sept. 18, 2013), https://www.sec.gov/comments/s7-06-13/s70613-359.pdf. *See also supra* notes 15-16.

[34] The SEC also should consider other ways to make it easier to verify that purchasers are accredited investors for purposes of Rule 506(c).

It bears mentioning that, as the SEC acknowledged this year, there has been "[n]o measured increase in the incidence of fraud in [the] new Rule 506(c) market," and nothing in H.R. 4852 changes or diminishes the SEC's existing enforcement authorities.[35] I urge the Committee to pass H.R. 4852 so that we can more fully realize the intended impact of the JOBS Act on the private securities markets.

B. Additional Legislation to Improve Small Business Capital Formation

I also support H.R. 4855, the Fix Crowdfunding Act, to improve the regulations governing equity crowdfunding under Title III of the JOBS Act;[36] H.R. 4854, the Supporting America's Innovators Act, to increase funding for start-ups by qualified venture capital funds; and H.R. 4850, the Micro Offering Safe Harbor Act, to exempt certain micro-offerings from the registration requirements of the Securities Act of 1933. These bills contain important reforms needed to further enhance the ability of startups and other small businesses to access the capital markets, create jobs, and promote a healthy economy fueled from the ground up.

C. A More Active Role for the SEC

Although the SEC's statutory mission is to promote fair, orderly, and efficient markets, to protect investors, *and* to facilitate capital formation, it often has neglected its duty to help small businesses obtain much-needed growth capital. For example, while the SEC had the authority to effect most, if not all, of the changes called for in the JOBS Act on its own, these reforms emanated from the halls of Congress rather than the SEC's headquarters just a few blocks away. In addition, as noted above, when the SEC was faced with a clear Congressional mandate under the JOBS Act to lift the ban on general solicitation, the SEC chose unnecessarily to insert itself in the way of reform by proposing, on its own accord, additional amendments that would undermine the fundamental purpose of the JOBS Act.

In the wake of the financial crisis, it was incumbent on the SEC to take steps to address issues within its statutory remit that helped to cause the financial crisis and to act to foster a robust recovery. Unfortunately for the American people, the SEC failed property to prioritize its activities. While the SEC delayed finalizing growth-encouraging rules under the JOBS Act well beyond their statutory deadlines, the SEC implemented rules under the Dodd-Frank Act that have nothing to do with fixing the actual causes of the financial crisis and only add to the regulatory burdens facing U.S. companies, both large and small, including, among others, the conflict minerals, resource extraction, and CEO pay ratio disclosure rules. In fact, former SEC Chair Mary L. Schapiro unmistakably responded to political pressure from special interest groups favored by the Administration to give precedence to rules supported by those groups. The SEC should have exercised its discretion to prioritize its limited resources first and foremost on rules that fulfill its core mission. If start-ups and young companies are to continue to serve as the primary drivers of job creation and economic growth in this country, the SEC must devote more consistent attention and resources to promoting small business capital formation.

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35 *See* DERA JOBS Act Report.

36 *See, e.g.*, Senator Michael F. Bennet, Letter to Hon. Mary Jo White (Feb. 16, 2016), *available at* https://wefunder.com/post/59-senator-bennet-s-letter-to-the-sec.

One area I am particularly concerned about is the potential for reflexive over-regulation of the evolving "fintech" industry. This past February, Mark Carney, governor of the Bank of England and head of the Financial Stability Board (FSB), told the G-20 finance ministers that the FSB will evaluate "the potential financial stability implications of emerging financial technology innovation for the financial system as a whole, working with standard setters that are monitoring developments in their respective sectors."[37] Shortly thereafter, Chair White followed suit, announcing in March that the SEC also is considering how best to regulate financial technology, including blockchain, robo-advisers, and online marketplace lending platforms.[38]

Innovative and dynamic new technologies in the securities, banking, lending, and other financial services industries have the potential to greatly reduce transaction costs and administrative burdens, enhance market efficiency, create new sources of capital for small businesses, and enhance investment options for investors. While I applaud Chair White's recognition of the challenges posed by fintech and her commitment to investor protection, I would urge the SEC not to rush to regulate in this area until it has a more complete understanding of the products and services these emerging companies provide, their businesses models, and the marketplaces in which they operate. Disruptive technology and business models can be a huge boon for industries, increasing competition, breaking down barriers to entry, and benefiting consumers, investors, employees, and taxpayers. Nor should the SEC necessarily attempt to jam fintech into its existing, one-size-fits-all regulations. But that does not mean simply kicking the proverbial can down the road as the agency seems to have done in other areas, such as addressing market structure regulation; instead, the SEC needs to be proactive and thoughtful at the same time, responsibly embracing evolving trends that will shape the future of our capital markets.

As the SEC considers whether and how to regulate fintech, it also should – as my colleague, former SEC Commissioner Dan Gallagher has noted – take a step back and assess the rules governing small business capital formation "on a big picture level."[39] This effort should include, among other things, a retrospective review of SEC rules to ensure that small companies operate under a regulatory regime that is understandable (without the help of expensive lawyers), up-to-date, and right-sized; improvements to the market structure for publicly-traded small and

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37 *See* Caroline Binham, Financial Stability Board adds fintech to list of worries, Financial Times (Feb. 27, 2016), http://www.ft.com/intl/cms/s/0/d6813cba-dd55-11e5-b072-006d8d362ba3.html#axzz45TzEMDO1.

38 *See* SEC Chair Mary Jo White, Keynote Address at the SEC-Rock Center on Corporate Governance Silicon Valley Initiative (Mar. 31, 2016), https://www.sec.gov/news/speech/chair-white-silicon-valley-initiative-3-31-16.html. In addition, the Office of the Comptroller of the Currency recently issued a white paper on fintech, and the Consumer Financial Protection Bureau issued a bulletin and set up an online complaint portal on marketplace lending. *See* Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective, OCC White Paper (Mar. 2016), http://www.occ.gov/publications/publications-by-type/other-publications-reports/pub-responsible-innovation-banking-system-occ-perspective.pdf; CFPB Press Release, CFPB Now Accepting Complaints on Consumer Loans from Online Marketplace Lender (Mar. 7, 2016), http://www.consumerfinance.gov/newsroom/cfpb-now-accepting-complaints-on-consumer-loans-from-online-marketplace-lender/.

39 Remarks by SEC Commissioner Daniel M. Gallagher, Whatever Happened to Promoting Small Business Capital Formation? (Sept. 17, 2014), https://www.sec.gov/News/Speech/Detail/Speech/1370542976550#_edn22.

mid-cap stocks, including measures to enhance market liquidity[40] (for example, through the formation of venture exchanges) and eliminate one-size-fits-all disclosure rules and other regulatory requirements that disincentivize companies from going public; and additional enhancements to the private securities markets, including possible broader blue sky exemptions for Reg. D offerings. Not only will such measures improve small business capital formation, they will benefit investors by providing more investment options and the potential for higher investment returns.

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Over the last five-and-a-half years, this Committee has been at the forefront of helping America's small businesses grow and create jobs. I thank you for all of your efforts and for the opportunity to testify here today.

40 *See, e.g.*, Charles Collver, SEC Division of Trading & Markets, A characterization of market quality for small capitalization US equities, (Sept. 2014) https://www.sec.gov/marketstructure/research/small_cap_liquidity.pdf ("The smallest stocks with market capitalization less than $100 Million are exceptionally illiquid relative to larger stocks with capitalizations between $1 Billion and $5 Billion. They have wider quoted and effective spreads and trade lower dollar volumes.").

Written Testimony of William Beatty

Washington Securities Division Director and

Past-President of the North American Securities Administrators Association, Inc.

House Committee on Financial Services,

Subcommittee on Capital Markets and Government Sponsored Enterprises

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

April 14, 2016

Washington, D.C.

Introduction

Good Morning Chairman Garrett, Ranking Member Maloney, and members of the Subcommittee. My name is Bill Beatty. For the past 30 years, I have worked as an attorney in the Securities Division of the Washington State Department of Financial Institutions, and since 2010 I have served as the Department's Securities Director. I am also a member of the North American Securities Administrators Association, Inc. ("NASAA"),[1] having served as the association's President from 2014 to 2015, and before that, as Chair of its Corporation Finance Section Committee. Since October of 2015, I have served as the Chair of NASAA's Committee on Small Business Capital Formation.

I am honored to testify before the Subcommittee today about legislative proposals to enhance capital formation for small and emerging growth companies.

State securities regulators have protected Main Street investors longer than any other securities regulator. Ten of my colleagues are appointed by Secretaries of State, and five are under the jurisdiction of state Attorneys General. Some, like me, are appointed by their Governors and Cabinet officials, and some of my colleagues work for independent commissions or boards. My colleagues and I are responsible for enforcing state securities laws including investigating complaints, examining broker-dealers and investment advisers, registering certain securities offerings, and providing investor education programs to many of your constituents.

States also are the undisputed leaders in criminal prosecutions of securities violators. In 2014 alone, state securities regulators conducted nearly 5,000 investigations, leading to more than 2,000 enforcement actions, including 271 criminal actions. Moreover, in 2014, among licensed financial professionals, NASAA members reported 230 enforcement actions involving broker-dealer agents, 190 actions involving investment adviser representatives, 156 involving broker-dealer firms, and 146 involving investment adviser firms.

States also continue to serve a vital gatekeeper function by screening bad actors before they have a chance to conduct business with unsuspecting investors. A total of 2,857 securities licenses were withdrawn in 2014 as a result of state action and an additional 728 licenses were either denied, revoked, suspended or conditioned. State securities regulators continue to focus on protecting retail investors, especially those who lack the expertise, experience, and resources to protect their own interests.

In addition to serving as "cops on the beat," state securities regulators serve as the primary regulators of many small and local securities offerings. As such, state securities regulators regularly work with and assist local businesses seeking investment capital. Moreover, state securities regulators, acting within NASAA, have a long history of working closely with the U.S.

[1] The oldest international organization devoted to investor protection, the North American Securities Administrators Association, Inc. (NASAA) was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

Securities and Exchange Commission ("SEC" or "Commission") to effect greater uniformity in federal-state securities matters.

NASAA also plays an important role in coordinating state efforts to promote capital formation. In my capacity as Chair of the NASAA Committee on Capital Formation, one of my tasks this year will be to preside over NASAA's Capital Formation Roundtable – an annual meeting sponsored by NASAA sponsors and attended by dozens of innovators and corporation finance practitioners. The Roundtable provides attendees with the opportunity to speak directly with NASAA leaders about current state and provincial regulations, policies and actions that affect the ability of small businesses to raise capital.

Views on the Legislative Proposals Before the Subcommittee

The Subcommittee has requested that NASAA comment on four legislative proposals. H.R. 4852, the Private Placement Improvement Act, would alter the filing requirements under Regulation D and would foreclose certain actions that the SEC proposed in a 2013 release. H.R. 4850, the Micro Offering Safe Harbor Act, proposes three new exemptions from state and federal securities registration. A third proposal, H.R. 4854, the Supporting Americas Innovators Act, would amend the Investment Company Act to expand relief from investment company registration for venture capital or angel investment syndicates. Finally, a fourth bill, H.R. 4855, the Fix Crowdfunding Act, would amend Title III of the JOBS Act, which is the basis for the federal crowdfunding regime that will come into being when the SEC's Regulation CF takes effect in May, 2016.

I will address these proposals in the order listed above.

1. The Private Placement Improvement Act (H.R. 4852)

The Private Placement Improvement Act, H.R. 4852, directs the SEC to revise the filing requirements of Regulation D. The legislation would require an issuer that sells securities in reliance on Rule 506 to file with the SEC, no earlier than the date of first sale of such securities, a single notice of sales containing the information required by Form D for each new offering of securities. The bill prohibits the SEC from requiring the issuer to file any notice of sales containing the information required by Form D except for this single notice; from conditioning the availability of the Rule 506 exemption upon the filing of a Form D or similar report; and from requiring issuers to submit written general solicitation materials in connection with an offering subject to Rule 506, except when it requests such materials pursuant to specified authority. The bill further prohibits the SEC from extending restrictions on to private funds.

NASAA has serious concerns with H.R. 4852. We oppose any action by Congress to diminish the ability of the SEC to undertake prudent steps to limit the risks to investors resulting from the lifting of the ban on general solicitation. Further, it would be a mistake for Congress to weaken the few existing investor protections in Rule 506, as this bill would in important ways.[2]

[2] For example, H.R. 4852 would repeal the SEC's present authority to require the filing of amendments to Form D where there have been certain changes in the offering.

Title II of the JOBS Act repealed a long-standing prohibition on general solicitation and advertising of securities under Rule 506. State securities regulators remain deeply concerned about the negative impact these changes will have on investors in our states. In 2014, the most recent year for which data is available, Regulation D Rule 506 offerings were the second most frequently reported fraudulent product or scheme involved in enforcement actions by state securities regulators.[3]

As the SEC recently noted, the exemptions in Regulation D are the most widely used transactional exemptions for securities offerings by issuers. Issuers using these exemptions raised over $1.3 trillion in 2014 alone, an amount comparable to that raised in registered offerings.[4]

Under Section 18 of the Securities Act of 1933, states are preempted from requiring registration of securities that are sold in compliance with Rule 506 of Regulation D. However, states are not prohibited from investigating and bringing enforcement actions related to fraud and deceit. In reality, states have proven to be the primary regulators of offerings conducted under Rule 506 because we have demonstrated a willingness to exercise this antifraud authority, and to expend resources monitoring this market by reviewing Form D notice filings to detect fraud.

When the SEC adopted rules to implement Title II on July 10, 2013, it also voted to propose rules that could mitigate the risk to ordinary investors from 506 offerings, including by requiring a pre-filing of Form D when issuers intend to advertise Rule 506 securities to the general public, and by imposing meaningful penalties on issuers who fail to file a Form D. NASAA strongly supports these proposed rules. We called upon the SEC to propose them, and we believe that if adopted, they stand to confer substantial benefits to investors at minimal costs to issuers. By prohibiting the SEC from adopting these common-sense investor reforms, H.R. 4852 threatens to eliminate the few investor protection components the SEC has either adopted or proposed adopting in connection with Rule 506. It also threatens to undercut the SEC's most promising effort to gather additional, essential information about the Rule 506 marketplace.[5]

The importance of requiring the filing of Form D prior to sales or general solicitation:

NASAA has consistently advocated that the SEC require the filing of Form D prior to the sale of securities in reliance on Rule 506 – especially prior to the use of any type of general solicitation. The information contained in a Form D is crucial to state securities regulators who

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[3] NASAA Enforcement Section. (2015, September). *NASAA Enforcement Report* (p.7). Retrieved from nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2011/08/2015-Enforcement-Report-on-2014-Data_FINAL.pdf

[4] Bauguess, S., Gullapalli, R., & Ivanov, V. (2015, October). *Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2014.* Retrieved from sec.gov/dera/staff-papers/white-papers/unregistered-offering10-2015.pdf. Underlying data in the Unregistered Offerings White Paper obtained from Form D filings. While Rule 503 of Regulation D (17 CFR 230.503) requires the filing of a notice on Form D no later than 15 days after the first sale of securities, the filing of a Form D is not a condition to a Regulation D safe harbor or exemption. Consequently, it is possible that some issuers do not make Form D filings for offerings relying on Regulation D and the available data on Regulation D offerings could underestimate the actual amount of capital raised through those offerings.

[5] The SEC's Proposing Release notes that the prefiling requirement is intended, in part, to enhance the SEC's understanding of the Rule 506 market by improving compliance with Form D filing requirements. *Amendments to Regulation D, Form D and Rule 156, SEC Release Nos. 33-9416, 34-69960, IC-30595. 78 Fed. Reg. 44806.* (2013, July 24). Retrieved from gpo.gov/fdsys/pkg/FR-2013-07-24/html/2013-16884.htm

regularly encourage investors to "investigate before you invest." When investors contact their state regulators with questions about an offering they may have learned about through an advertisement or solicitation, a Form D filing is often the only information the state can use to determine if an issuer is conducting the offering in compliance with a lawful exemption. Without the information contained in a Form D, state securities regulators are blind to these offerings. This is why we welcomed the SEC's proposal to institute such a pre-filing requirement.

Opponents of pre-filing requirements have expressed opposition to the SEC's proposal to require the filing of Form D prior to conducting a Rule 506 offering, and again upon the completion of the offering, on the grounds that "multiple" filings impose an onerous compliance burden. The facts simply do not support such claims. Form D is a short, 11-page form that contains instructions and captures only eight pages of information, including basic information about the issuer (e.g., business address, officers, directors, business type, etc.). The amount of information required on this form relative to the information contained in an issuer's private placement memorandum or offering document is minimal. These additional modest filing requirements designed to provide limited but important information to regulators are particularly important in light of the fact that more than $1 trillion in unregistered Regulation D, Rule 506 securities are sold to the investing public.[6]

The importance of providing penalties for issuers who fail to file Form D:

The Private Placement Improvement Act also would prohibit the SEC from adopting proposed rules intended to establish consequences for issuers who fail to file a Form D when conducting a Regulation D, Rule 506 offering. Much like the pre-filing requirement, the imposition of a penalty for failure to file is a common-sense remedy that is long overdue. Absent such a penalty, there is no sufficient incentive for issuers to file Form D. NASAA is not alone in this view. The SEC's Inspector General, in 2009, noted, "There are simply no tangible consequences when a company fails to file a Form D." This current, "voluntary" nature of Form D has significant negative repercussions for state regulators.[7] In addition, the data gathered by the Form D provides essential insight into the opaque Rule 506 market, which rivals the public market in size, and about which very little is known.[8]

Comments on other elements of H.R. 4852:

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[6] Securities & Exchange Commission. (2015, December 15). *Report on the Review of the Definition of "Accredited Investor" (p.1). Retrieved from* sec.gov/corpfin/reportspubs/special-studies/review-definition-of-accredited-investor-12-18-2015.pdf

[7] As the SEC's Investor Advisory Committee noted in a 2013 report, "One reason for the dearth of information is that the Commission relies on Form D filings for data, and an unknown but apparently significant percentage of issuers do not file Form D." Securities and Exchange Commission. *Recommendation of the Investor as Purchaser Subcommittee and the Investor Education Subcommittee: Accredited Investor Definition.* (p.5). Retrieved from sec.gov/spotlight/investor-advisory-committee-2012/accredited-investor-definition-recommendation.pdf

[8] As the Commission noted in the release for the final rule lifting the ban on general solicitation in Rule 506 offerings, it has "relatively little information on the types and number of investors in Rule 506 offerings." *Amendments to Regulation D, Form D and Rule 156, SEC Release Nos. 33-9416, 34-69960, IC-30595. 78 Fed. Reg. 44806.* (2013, July 24). Retrieved from gpo.gov/fdsys/pkg/FR-2013-07-24/html/2013-16884.htm

Finally, NASAA questions the basis for Section 5 of H.R. 4852, which would also block the SEC's effort to extend the antifraud guidelines of Rule 156 to sales literature of private funds, whether or not used in a Rule 506(c) general solicitation.[9] It is important to note that Rule 156 merely provides guidance on when sales literature may be materially misleading. As noted in the rule "whether or not a particular description, representation, illustration, or other statement involving a material fact is or might be misleading depends on evaluation of the context in which it is made." The rule goes on to state that all pertinent factors should be considered and provides examples of situations that may be pertinent. NASAA believes that this information could be useful to private fund issuers.

H.R. 4852 further prohibits the Commission from requiring "an issuer to file any notice of sales containing the information required by Form D except for the single notice [to be filed no earlier than the date of first sale of securities in the offering]." The apparent intent of this language is to eliminate any further filing requirements under Regulation D. This ostensibly would prohibit the Commission from requiring termination filings as proposed in 2013, as well as eliminate existing amendment filing requirements that have been in place since at least 2007. Amendment filings are currently required, for example, where an issuer appoints additional officers and directors. Regulatory notice is appropriate in such an event to ensure bad actors are not participating in offerings that do not benefit from the disinfecting effect of registration. Amendment filings also are required when the issuer has raised the offering amount or the amount of sales commissions by more than ten percent. This information aids regulatory oversight and helps to detect fraud. While the SEC mandates this information, it is used by state regulators to detect fraud in their own jurisdictions. The mere fact that amendments are required serves a prophylactic effect that protects investors.

2. The Micro-Offering Safe Harbor Act (H.R. 4850)

The Micro-Offering Safe Harbor Act would amend Section 4 of the Securities Act to create three new exemptions from registration. Contrary to the bill's title, these exemptions are not limited to "micro offerings." The bill would exempt offerings that meet any of the following three criteria: (1) each purchaser has a substantive pre-existing relationship with either an officer or director of the issuer, or with a shareholder holding 10 percent or more of the issuer's shares; (2) there were no more than, or the issuer "reasonably believes" that there were no more than, 35 purchasers of securities from the issuer during the preceding 12 months; or (3) the aggregate amount of all securities sold by the issuer during the 12-month period preceding the transaction does not exceed $500,000. The bill also preempts state regulation of these securities offerings. The bill would not prohibit general solicitation, disqualify "bad-actors," limit offering amounts, or even permit notice filings to state and federal regulators.

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[9] Rule 156 is an elaboration on the general antifraud rules under the Securities Act and Exchange Act, including Rule 10b-5, that applies to sales literature of investment companies and contains various examples of statements and representations in such sales literature that could be deemed misleading, such as unqualified representations regarding past or future performance, as well as portrayals of past results that may expressly or impliedly convey misleading inferences about past or future results.

The legislation stands to expose investors, including retail investors, to literally unlimited investment risk.[10] We have learned that efforts to spur successful capital formation must reflect a balanced regulatory approach that minimizes unnecessary costs and burdens on small businesses while protecting investors from fraud and abuse.[11] Without adequate investor protections to safeguard the integrity of the private placement marketplace, investors should and will flee from the market, leaving small businesses without an important source of capital.

The legislation also would undoubtedly serve to make the task of policing the Rule 506 marketplace much more difficult for state securities regulators. In fact, the bill likely would supplant Rule 506 given the similarities in the types of offerings but without the basic information provided in Form D. Given the lack of regulatory oversight, it is not hard to imagine that fraudsters would use these provisions to raise money from unsuspecting investors, ultimately eroding investor confidence and harming legitimate small businesses. Further, because the bill would not impose a holding-period or other restriction on the resale of securities purchased under the new exemptions, these offerings could be highly susceptible to price manipulations and "pump-and-dump" schemes.

Beyond the specific shortcomings of the safe-harbors established by H.R. 4850, which I will briefly discuss below, the goals of the legislation are unclear. The bill's title suggests its goal is to facilitate small-sized or "micro" offerings, but the bill would in fact permit the raising of unlimited amounts of money. Each of the new "safe harbors" that would be established by H.R. 4850 presents its own challenges for Congress.

Safe-harbor contingent upon substantive preexisting relationship:

Section 2(e)(1) of the bill would create a safe-harbor for transactions where "each purchaser has a substantive, preexisting relationship with an officer of the issuer, a director of the issuer, or a shareholder holding 10 percent or more of the shares of the issuer." It should also be noted that H.R. 4850 would impose a requirement of a substantive pre-existing relationship prior to the *sale* of securities, as opposed to prior to the *offering* of securities.

The availability of this type of exemption would very likely all but eliminate the need for Rule 506 of Regulation D. According to the SEC, a vast majority of Regulation D offerings are made to investors that have preexisting relationships with the issuer or its management.[12] Establishing a substantive preexisting relationship is not overly onerous. In SEC no-action letters

[10] In contrast to other exemptions focused on small-sized offerings, such as Title III (crowdfunding) and Title IV (Regulation A+) of the JOBS Act, the exemptions established by H.R. 4850 would not impose any limitation on investor losses. Further, in contrast to the exemption under Rule 506, while H.R. 4850 would allow unrestricted general solicitation, it would not require issuers to even take "reasonable steps" to verify the accredited status of prospective purchasers.

[11] In 1992, the SEC amended Rule 504 to allow general solicitation, but reversed course when investors were inundated with fraudulent offerings. Securities & Exchange Commission. *SEC Release No. 33-7644.* Retrieved from sec.gov/rules/final/33-7644.txt

[12] *Securities Act Release No. 9416* (2013, July 10). ("The vast majority of Regulation D offerings are conducted without the use of an intermediary, suggesting that many of the investors in Regulation D offerings likely have a pre-existing relationship with the issuer or its management because these offerings would not have been conducted using general solicitation.").

dating back to the 1980s, the staff of the SEC have provided relief to issuers wishing to offer and sell securities in so-called private offerings. The SEC staff first dealt with issues involving intermediaries, allowing issuers to take advantage of non-public offering exemptions in selling to investors with which they have no connection if an intermediary had a relationship with the investors.[13] Most recently, the SEC staff have issued guidance that has been interpreted as permitting issuers themselves to establish pre-existing, substantive relationships with investors through the internet.[14] Given the relative ease with which broker-dealers and even issuers may establish "substantive pre-existing relationships" with prospective investors, the proposed exemption in Section 2(e)(1) of the bill would allow far more than "micro offerings."

Safe-harbor contingent upon 35 or fewer purchasers:

Section 2(e)(2) of the bill would create a safe-harbor for offerings when an issuer reasonably believes there are no more than 35 purchasers of the securities during the 12-month period preceding the sale. The significance of limiting the offering to 35 purchasers is of dubious significance. A recent SEC Staff Study noted that the average number of purchasers in Rule 506(c) offerings from September 2013-December 2014 was 10, and average of 14 purchasers in Rule 506(b) offerings during the same period.[15] The exemption undoubtedly would be attractive to bad actors, however, who would not be disqualified from relying on the exemption. Indeed, under the bill, fraudsters would be free to raise an unlimited amount of money from up to 35 investors every 12-month period. Federal and state regulators would have no ability to respond to inquiries from potential investors concerning the legitimacy of the offering in the absence of any regulatory notices or oversight.

Safe-harbor for offerings of below $500,000 in a 12-month period:

Section 2(e)(3) of the bill would create a safe-harbor for offerings where the aggregate amount of securities sold by the issuer in the 12-month period preceding the sale does not exceed $500,000.[16] Most state securities acts have small offering exemptions designed specifically for these kinds of small, local offerings. Again, this is an opportunity for fraudsters to sell to investors without any regulatory oversight, as this provision would not appear to permit any federal or state notice filings. Further, this provision is unnecessary in light of the federal crowdfunding rules and state intrastate offering exemptions that are already implemented to facilitate micro-offerings in a way that is consistent with investor protection. Rather than trying to create an unprecedented and dangerous new exemption, we urge Congress to allow the SEC to focus on implementing the proposed changes to the intrastate offering exemption under Rule 147 and the small offering

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[13] For example, the Staff have indicated that a company can sell securities to investors through a broker-dealer that has formed a relationship with the investors through the use of a questionnaire. E.F. Hutton & Co. *SEC No-Action Letter, 1985 WL 55680*. (1985, November 3).

[14] Citizen VC, Inc. (2015, August 3).

[15] Bauguess, S., Gullapalli, R., & Ivanov, V. (2015, October). *Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2014* (p.36). Retrieved from sec.gov/dera/staff-papers/white-papers/unregistered-offering10-2015.pdf

[16] Further, this provision contains no integration clause. Effectively, the $500,000 cap is illusory with no integration clause.

exemption under Rule 504 that would provide relief to issuers that want to pursue offerings under state law.

In summary, the policies embodied in H.R. 4850 are unnecessary, confusing, contradictory and dangerous. NASAA strongly urges Congress to reject this deeply flawed and incoherent piece of legislation.

3. The Supporting America's Innovators Act (H.R. 4854)

Section 3(a)(1) of the Investment Company Act defines an "investment company" as an issuer which is "engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting or trading in 'securities," or "proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities, and owns or proposes to acquire 'investment securities' having a value exceeding 40 percent of the value of its total assets."[17] If an investment company is organized or otherwise created under the laws of the United States or of a state, meets the definition of an investment company, and cannot rely on an exception or an exemption from registration, generally it must register with the Commission and must register its public offerings under the Securities Act.

The Investment Company Act also specifically excludes certain investment pools from the definition of "investment company," and exempts from regulation a number of investment pools and entities. If an issuer falls within one of these exclusions or exemptions, it may not register as an investment company with the Commission. Many companies rely on one of the exceptions from the definition of investment company set forth in Section 3(c)(1) and Section 3(c)(7) of the Investment Company Act - hedge funds and private equity funds, for example.[18]

Section 3(c)(1) excepts from the definition of investment company any issuer whose outstanding securities are beneficially owned by not more than one hundred persons, and that is not making and does not at that time propose to make a public offering of such securities. H.R. 4854 proposes to expand the limitation on beneficial owners established in Section 3(c)(1) from 100 to 500 investors for any "qualifying venture capital fund," which the bill defines pursuant to SEC Rule 203(l)-1.[19]

Expanding 3(c)(1) in the manner proposed by H.R. 4854 would expand not only the current exemption allowing yet another investment vehicle to operate without regulatory oversight, but also allow an investment adviser that is not licensed or examined to manage funds raised from a pool of investors that would be five times the size of that currently permitted (100 to 500). The Dodd-Frank Act took steps to bring more regulatory oversight of these important market

[17] (1940). *Investment Company Act of 1940* (Section 3(a)(1)).
[18] These companies are commonly known as "private investment companies."
[19] Rule 203(l) defines a venture capital fund as a private fund that: (i) holds no more than 20 percent of the fund's capital commitments in non-qualifying investments (other than short-term holdings); (ii) does not borrow or otherwise incur leverage, other than limited short-term borrowing, excluding certain guarantees of qualifying portfolio company obligations by the fund); (iii) does not offer its investors redemption or other similar liquidity rights except in extraordinary circumstances; (iv) represents itself as pursuing a venture capital strategy to its investors and prospective investors; and (v) is not registered under the Investment Company Act of 1940, as amended (the "Investment Company Act") and has not elected to be treated as a business development company ("BDC").

participants. Expanding the exemptions as contemplated by this bill would undermine important investor protections by allowing more firms to avoid regulatory scrutiny.

4. The Fix Crowdfunding Act (H.R. 4855)

State securities regulators appreciate Congress's continued interest in federal crowdfunding and frustration that federal crowdfunding has yet to take effect. Implementing Title III of the JOBS Act undoubtedly required the SEC to weigh novel questions and complex issues. However, it has been more than four years since the passage of the JOBS Act. During that time, dozens of states have adopted and implemented intrastate crowdfunding exemptions.[20] The United States is on the verge of entering a new era in crowdfunding with the SEC's Regulation CF due to take effect on May 16, 2016. In light of the soon to be effective federal rules, the developing nature of state laws, and the recent proposal of the SEC to revise Rules 147 and 504, Congress would be prudent to wait until the regimes have matured and there is a sufficient regulatory record in place before making changes to the crowdfunding laws.

The Fix Crowdfunding Act proposes a variety of revisions to Title III of the JOBS Act. It would amend Title III of the JOBS Act to increase the offering cap from its current $1 million to $5 million. The bill provides a grace period of 5 years to comply with the requirements of notice and confirmations, registration, written policies, and record keeping. The bill requires a "good faith" standard for those five years. The bill would also re-define "reasonability" for purposes of background checks and risk for fraud, and allow testing the waters. H.R. 4885 also provides relief from liability for funding portals, which would not be considered issuers under section 4A(c) of the Securities Act unless they knowingly make untrue statements or omissions, and grants a wholesale exemption from Section 12(g) of the Exchange Act. H.R. 4885 further provides that special purpose vehicles ("SPVs")[21] may invest in these offerings, and would allow public reporting companies and investment companies to conduct crowdfunding campaigns.

State securities regulators understand the theoretical basis for several of the proposed adjustments embodied in H.R. 4855, and do not necessarily oppose them. However, the critical point for Congress is that there is not now any way to provide a thoughtful answer to the question of what steps will or will not improve or "fix" federal crowdfunding, because we do not yet know what will work, what will not, or even what the new marketplace will look like, under existing law. There is no data whatsoever about what is or is not working with regard to federal crowdfunding, and only limited data about what is working at the state level. By contrast, several years from now, there will be a wealth of data, both from the state and federal crowdfunding regimes.

[20] Thirty states and the District of Columbia now have provisions on their books aimed at facilitating capital formation through crowdfunding. With the exception of the states of Maine and Mississippi, state crowdfunding provisions are premised upon the offering being conducted in compliance with the exemption from registration under Section 3(a)(11) of the Securities Act of 1933 and Rule 147 adopted thereunder.

[21] An SPV is a legal entity created to serve one function, such as facilitating a financial arrangement or creating a financial instrument. An SPV allows the ownership of a single asset, often by multiple parties, and allows for ease of transfer between parties.

Nevertheless, I am pleased to offer some observations on H.R. 4855, based on both my own analysis of the bill and the state experience with intrastate crowdfunding to date.

Pooled investments and equity crowdfunding:

One of the more interesting features of H.R. 4855 is Section 3(b) of the bill, which seeks to encourage investors to purchase crowdfunded securities through special purpose vehicles or "SPVs." Section 3(b) seeks to remedy a legitimate challenge for issuers that rely on crowdfunding. One of the defining features of equity crowdfunding is that it enables businesses to access equity capital from many investors at the earliest stages of their business growth cycle, sometimes known at the "seed stage." However, the flip-side to this feature is that businesses that choose to avail themselves of crowdfunding during the "seed stage" may complicate their ability to raise additional investment capital at a later date from other types of investors, such as from venture and private equity. This is because having numerous small-dollar shareholders may prevent the company from presenting a clean "capitalization table" to such prospective later-stage investors.

The basic concepts embodied in Section 3(b) – the pooling of many individual investments into a single entity, with one point of contact, the SPV organizer, who represents all of the SPV's investors – are familiar ones. SPVs have been used for many years in private equity to purchase equity in private and fast-growing companies. The utilization of SPVs in this context has the potential to offer benefits to both investors and issuers, but is not without significant concern. In case of investors, SPVs serve as a way for high net-worth individuals, families or other investors without specialized knowledge of or access to fast-growing companies to make investments alongside professional investors, who presumably possess detailed knowledge regarding such investments. The question for Congress is whether or not the pooled-investor structure makes sense in the context of small-dollar equity crowdfunding, as provided for under Title III of the JOBS Act.

At the most basic level, shifting the center of gravity away from individual investors, and toward SPVs managed by a single organizer, seems to invert the basic premise underlying crowdfunding: the wisdom of the crowd. Should Congress determine to introduce SPVs to crowdfunding, there are additional questions Congress should consider, including what fees could be associated with SPVs that invest in crowdfunding, and whether such fees have the potential to misalign the incentives for SPV organizers from those of investors.[22] Congress should also carefully consider what rights shareholders will be ceding by investing in crowdfunded offerings through an SPV, as opposed to purchasing shares directly.

Increasing the Offering Cap from $1 million to $5 million:

As already noted, NASAA strongly believes that the best way to evaluate the impact of many, if not all, of these changes to is monitor the actual experience of the crowdfunding marketplace once Regulation CF goes into effect next month. This is particularly true concerning the appropriate offering cap. At the present, we see little, if any, evidence to suggest that

[22] Depending on how the vehicle is structured, investments in crowdfunded offerings placed through SPVs could be subject both to management fee and carried interest fees, on a per SPV basis, making crowdsourced investments through an SPV rather than directly could be a more costly proposition for investors.

crowdfunding as envisioned by the JOBS Act would be more successful with an offering cap of $5 million. The limited information that is available from state crowdfunding experience suggests it likely would not. On the other hand, we cannot rule out the possibility that increasing the investment cap could be beneficial under some circumstances. We also note that the SEC has proposed amendments to Rule 504 that would increase the offering cap to $5 million for the expressed purpose of encouraging intrastate crowdfunding.[23]

Immunity for funding portals:

Section 3(e) provides that "no enforcement action" may be brought against a funding portal before May 16, 2021. The bill does require funding portals to make a good faith effort to comply with applicable rules. However, the requirement appears to be independent of the prohibition on SEC enforcement action. In other words, the legislation does not appear to require a demonstration of a good faith effort to comply in order to prevent a potential enforcement action. If that is the intent of the legislation then funding portals would be free to disregard all such rules. Further, there is no need for an exception for a "good faith effort" in the first place as the SEC has enforcement discretion and its limited resources necessarily cause regulatory reaction to violations to be appropriately scaled. This provision would frustrate the ability of the SEC to bring enforcement action where it deems such action is appropriate and in the public interest. We can see no legitimate basis for such a provision.

Testing the waters:

Section 3(d) of bill provides that testing the waters in Title III offerings would "not be considered an offer or sale of securities under this Act or the Securities Exchange Act of 1934." These provisions would effectively allow fraudulent offers in testing the waters campaigns without liability. The anti-fraud protections under the Securities Act (Sec. 12) are triggered by offers and sales of securities. Where there is no "offer" or "sale," there can be no violation.

Recommendations for Congress:

With the finalization of federal crowdfunding rules and intrastate crowdfunding available in more than half of the states, we shall now find out whether these new capital-raising tools will be frequently used, and whether state or federal rules prove more useful. As we learn what works and what does not from the viewpoint of entrepreneurs and small business owners, states and the SEC may make further adjustments to their crowdfunding rules. Any further adjustments should give due consideration, however, to investor protection.

State securities regulators urge Congress to refrain from amending Title III of the JOBS Act at this time. To enact legislation at this point would be counterproductive and premature. Until Congress has a body of data that can yield answers to questions about the efficacy of Title

[23] State crowdfunding provisions generally limit the offering amount that may be raised in a crowdfunding offering to $1 million in a twelve-month period with the opportunity to raise up to $2 million if audited financial statements are provided to prospective investors and filed with the state. Some states allow even greater amounts, with Illinois coming out on top with a maximum offering amount of $4 million in a twelve-month period. Other states specify lower amounts. Oregon, for example, limits the offering amount to $250,000, while Maryland has the lowest offering amount cap at $100,000.

III, it has little basis upon which to legislate coherently save for informed speculation, and the value of such speculative analysis cannot begin to compare to the value of real information that Congress will have at its disposal soon. Instead, Congress would be well served to closely monitor the implementation of Regulation CF, to conduct oversight, and to gather information about this new marketplace. Once real information begins to emerge about federal crowdfunding, Congress can seriously begin to explore how it can be improved.

Conclusion

Thank you again, Chairman Garrett, and Ranking Member Maloney, for the opportunity to testify before the Subcommittee today. I would be pleased to answer any questions you may have.

Nasdaq

Testimony of Nelson Griggs
Executive Vice President, Nasdaq
Before the House Financial Services Committee
Subcommittee on Capital Markets and GSEs

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

April 14, 2016

Chairman Garrett and Ranking Member Maloney,

Thank you for the opportunity to testify on "The JOBS Act at Four: Examining Its Impact and Proposals to Further Enhance Capital Formation." The work of this subcommittee to push forward that legislation is still a great achievement of the 112th session of Congress and a shining example of bipartisanship and statesmanship. Even with the JOBS Act in place, there are issues that remain, and there are dark clouds still affecting the private company view of the public markets.

Capital formation and job creation are in Nasdaq's DNA. Forty-five years ago, Nasdaq introduced the world to the electronic market, which is now the standard for markets worldwide. The creation of Nasdaq introduced sound regulation to over-the-counter trading. Around Nasdaq grew an ecosystem of analysts, brokers, investors and entrepreneurs allowing growth companies to raise capital that was not previously available to them and investors, in turn, to profit from these companies' innovation. Companies like Apple, Microsoft, Gilead, Google, and Intel, all of which are listed on Nasdaq, use the capital they raised to make the cutting edge products that are now integral to our daily lives. As these companies grew, millions of jobs were created along the way.

Nasdaq brought to the capital markets a *trusted* listings venue and the changed view that companies can go public earlier in their growth cycle, dispelling the common Wall Street perception that companies had to be profitable for three or more years before considering going public. Nasdaq recognized that while most companies wanted access to capital, investors also wanted access to these companies at their earlier stages of growth. Today, with 24 markets, three clearing houses, and five central securities depositories, spanning six continents, Nasdaq owns and operates the global infrastructure of our public markets.

In the same vein, since the passage of the JOBS Act in 2012, Nasdaq also added an important offering with the creation of The NASDAQ Private Market, focusing on private companies. Launched in 2014, NASDAQ Private Market was established to meet the unique needs and challenges of today's private companies. In October of last year, NASDAQ Private Market also acquired SecondMarket, a recognized innovator in facilitating liquidity for private company securities. The combination of the services and industry expertise of SecondMarket with the NASDAQ Private Market team has established NASDAQ Private Market as a leading provider for innovative and efficient solutions to deliver secondary liquidity and equity management services for private companies.

As companies remain private longer, and sometimes permanently, they are using NASDAQ Private Market's services to facilitate shareholder liquidity and manage their equity in a controlled manner and on their terms. In particular, as companies extend their pre-IPO lives, they face increasing pressure to provide liquidity to employees and early investors. NASDAQ Private Market helps companies attract, retain, and reward employees by enabling them to conduct company-controlled, periodic liquidity programs and thus compete more effectively for employee talent with their public peers and competitors. Thus, Nasdaq is uniquely qualified to speak about both the public and the private markets.

The JOBS ACT IS A SUCCESS STORY FOR PUBLIC POLICY

Four years have now passed and the evidence is clear that the JOBS Act has successfully helped hundreds of companies access capital and go public while also generating new dynamism in the private company sector. Our records indicate that 785 companies have gone public as Emerging Growth Companies (EGCs) under the JOBS Act raising over $103 billion in capital to expand, hire employees and compete on the global stage. In the four years prior to the JOBS Act (2008 – March 2012) there were just 500 IPOs in the U.S. In the four years since the JOBS Act (April 2012 – 2016 YTD) there have been 865 IPOs with 86% being EGCs. Approximately 1,000 registration statements have been filed with the SEC confidentially and to our knowledge every EGC that has gone public since the designation was created by the JOBS Act has used this ability. In April of 2015, the Wall Street Journal reported at the three year mark that they estimated the JOBS Act had added about 82,000 jobs.[1] The JOBS Act also proves that the marketplace works. There are provisions of the JOBS Act that are scarcely used because they run contrary to investor expectations. Other provisions are a resounding success, embraced by investors and companies. From our vantage point, the JOBS Act has not resulted in any trend that diminished investor protection, which has been and will continue to be a focus for us as we operate our Exchange. As SEC Chair Mary Jo White said recently in a speech at Stanford:

> "For the new and evolving markets to be successful, all investors need confidence that they are being treated fairly and that the full range of risks are transparently disclosed. We must work together to ensure that this confidence is well-placed, so that investors feel comfortable providing the capital essential for business development and growth. Only then can we

[1] The Wall Street Journal, http://www.wsj.com/articles/pinning-new-jobs-to-2012-ipo-legislation-proves-a-challenge-1428011862.

> reap the full rewards of the creativity, genius, and innovation for which this Valley is famous."[2]

We couldn't agree more. That is why we originally supported the JOBS Act when it was making its way through Congress and testified in favor of its main provisions both in this Subcommittee and in the U.S. Senate. We joined with a broad coalition that was led by the National Venture Capital Association, Biotechnology Industry Organization (BIO), TechNet, the Chamber of Commerce and so many others.

We also think there are other incremental steps that the Subcommittee should consider that would build on the success of the JOBS Act and remove disincentives for companies considering going public. NASDAQ Private Market recently surveyed 126 representatives of private companies attending the South by Southwest Interactive Festival in Austin, Texas, an incubator of cutting-edge technologies and digital creativity that brings together job creators and innovators from around the country. Of this group, 32 percent were founders or chief executives. We asked them about their outlook on a number of issues affecting entrepreneurs and almost half said they do not intend to go public. As we have seen, 2016 is starting as one of the slowest initial public offering (IPO) years since 2008. So it is timely that we are here today to focus on how public policy can further enhance the ability of entrepreneurs to raise capital and go public. Going public is still our focus and the best public policy outcome in our opinion. As indicated in the IPO Task Force's Report, which was a valuable resource for the development of the JOBS Act, the post- IPO job growth for a company is an amazing 92%.[3]

Without question, we at Nasdaq believe the most successful provision of the JOBS Act has been the ability of companies to file their registration statements on a confidential basis with the SEC. This has been most evident in the IPOs that have increased markedly from the biotech and life sciences sectors over the past four years since the JOBS Act was enacted. Many quality companies have been able to work with the SEC to finalize their registration without disclosure of their competitive, proprietary information and companies can better manage their decision to go public as they evaluate market conditions. And, while the JOBS Act mandated that companies wait at least 21 days after they publicly disclose their registration statements before they can begin their outreach to investors (and that period has been shortened to 15 days by Rep. Fincher's recent legislation), a Latham and Watkins study in 2013 suggested companies were actually waiting about 49 days before they began their road shows.[4]

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[2] SEC Chairman Mary Jo White, March 31, 2016, Keynote Address at the Rock Center for Corporate Governance, "Protecting Investors in an Innovative Financial Marketplace," available at: https://www.sec.gov/news/speech/chair-white-silicon-valley-initiative-3-31-16.html.

[3] "Rebuilding the IPO On-Ramp," available at: https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf.

[4] Latham and Watkins, The Jobs Act After One Year, available at: www.lw.com/thoughtLeadership/jobs-act-after-one-year-review-of-new-ipo-playbook.

Nasdaq

Keeping with the view that confidential filing has improved the IPO process without decreasing investor protection, *we believe Congress should go one step further and allow companies of all sizes to file on a confidential basis and should allow other types of registration statements, besides IPOs, to be initially submitted on a confidential basis.*

We also believe that some enhanced disclosure of short positions that matches the disclosure requirements for long positions is warranted. Currently, certain investors who accumulate long positions are required to publicly disclose their holdings. But there are no corresponding obligations for short sellers to do so. This is so even though the policies that underlie the disclosure requirements applicable to long investors – transparency, fairness and efficiency – apply in equal measure to investors with short positions. From a company perspective, this lack of transparency has a real impact because it deprives the company of insights into trading activity and limits the company's ability to engage with investors and understand their motivation. And we hear some companies complain that this information asymmetry may give rise to possibly abusive trading behavior that could make long term investors wary about providing the capital necessary to fund research and development.

The lack of transparency has other negative consequences too. It limits investors' ability to make informed investment decisions and prevents the market from operating in a fully efficient and fair manner.

To be sure, we are not suggesting limitations or restrictions on short sale activities. There is ample evidence that legitimate short selling enhances liquidity, contributes to efficient price formation and facilitates risk management. But there are no policy or practical reasons to maintain the current disparity in disclosure of long and short positions. Congress recognized this in 2010, in the Dodd-Frank Act, and late last year we petitioned the SEC to act on this.

We also remain concerned that proxy advisory firms do not always balance their standard-setting in a fair and transparent manner. It was in this spirit that we petitioned the SEC to improve these firms' disclosure of how they make recommendations and any relationships they have that may give rise to conflicts of interest.[5] We were pleased that the SEC issued guidance regarding the use by investment advisers of proxy advisory firms but it is apparent that more work needs to be done. Last year Nasdaq partnered with the U.S. Chamber of Commerce Center for Capital Markets Competitiveness on a survey regarding the public company experience in the 2015 proxy season. Over 155 companies responded, and based on those responses it is apparent that companies continue to have difficulty providing input to the advisory firms or even having errors corrected. And almost half of the companies that took steps to verify the nature of proxy advisory firm conflicts of interest reported finding significant conflicts.

[5] Request for Rulemaking to Revise the Commission's Guidance to Proxy Advisory Firms, available at: http://www.sec.gov/rules/petitions/2013/petn4-666.pdf.

Similarly, public companies, especially smaller ones, face increasing auditing costs. While companies do not object to costs that provide a concomitant investor benefit, the companies claim that some of the costs are the result of nonsensical, one-size-fits all application of guidance given in different situations. These companies feel stuck because the auditors claim these additional costs are due to requirements imposed on the auditor by the PCAOB, but the companies have no avenue to discuss the requirements with the PCAOB. For these reasons, we think the PCAOB should be required to establish an "ombudsman" office to consider these complaints and address them, as appropriate, with the auditors and PCAOB staff, serving as a resource for companies who feel their internal controls are being over-audited.

THIS SUBCOMMITTEE'S CURRENT AGENDA

I want to commend this Subcommittee for its continued work to help capital formation with the passage late last year of 15 surgically precise bills aimed at further refining regulations to help companies access capital more efficiently. As you know, Nasdaq was an enthusiastic supporter of the RAISE act, authored by Rep. Patrick McHenry, which received bipartisan support from this Committee and was included in the package that became law in late 2015 through its rather unique addition to the Highway bill. Thank you for your continued effective actions in this area.

I also want to thank you Chairman Garrett for your leadership and willingness to offer an important bill, H.R. 4638, the Main Street Growth Act, to foster the creation of Venture Exchanges. We appreciate your efforts to move the discussion forward on how to best design the rules of the road for venture exchanges and the companies they would serve. We believe that a regime that balances the need to have special, lighter-touch standards for smaller companies, and also partners with regulators and exchange surveillance professionals to ensure appropriate investor protections, can one day be a valuable resource in the U.S. capital formation arsenal. We are committed to working with you, your staff and other stakeholders to find that balance.

The Subcommittee has asked that Nasdaq comment on several new legislative proposals also aimed at fostering capital formation.

With respect to the Chairman's bill, H.R. 4852, the Private Placement Improvement Act, the JOBS Act directed the SEC to complete a rulemaking that would lift the ban on issuers being allowed to solicit private offerings of stock under Rule 506 of Regulation D. Prior to the JOBS Act, companies were not allowed to advertise their shares to the general public, and therefore relied on brokers or existing relationships in order to complete an offering. The SEC completed its Title II mandated rulemaking in July 2013, providing private companies with the ability to advertise their shares so long as the ultimate purchasers were "accredited investors". However, the SEC proposed two new regulations that could hamper Reg. D issuers and the ultimate success of the JOBS Act improvements – Reg D issuers would be required to file their Form D 15 days prior to completing an offering (as opposed to the current requirement of within 15 days

Nasdaq

after an offering) and companies using general solicitation would have to submit their advertising materials to the SEC prior to their offering. H.R. 4852 states that the SEC may not require issuers to file a Form D prior to each new offering of securities, and issuers shall not be required to submit their advertising materials to the SEC prior to completing an offering.

Your proposed legislation would not remove the SEC's existing requirement that issuers take reasonable steps to verify that investors in Rule 506 offerings are accredited, would not reduce the SEC's existing rules requiring disclosures to investors, and would not limit the SEC's powerful existing authority to prevent and punish fraud and other misconduct under the Federal securities laws. Accordingly, Nasdaq supports this effort to help private companies raise money within an already functioning regulatory framework that protects investors.

We also congratulate the Subcommittee for its creative thinking about other ways to allow entrepreneurs and their companies to raise needed capital, while maintaining appropriate investor protections. We look forward to working with you on these initiatives, including:

- Rep. Tom Emmer's H.R. 4850, the Micro Offering Safe Harbor Act which would create a safe harbor for small securities offerings where there is substantive pre-existing relationship between the investor and issuer, where the issuer has less than 35 purchasers utilizing the exemption or where the total amount raised is less than $500,000;
- Rep. McHenry's H.R. 4854, the Supporting American Innovators Act, aimed at helping venture capital funds by moving the current cap of 100 investors up to 500 investors, and
- Rep. McHenry's H.R. 4855, Fix Crowd Funding Act, which seeks to improve the ecosystem for crowd funding to develop into a workable solution for early startups seeking capital and investor protections that will be so critical in this area of investing.

Thank you again for your invitation to testify on the critical contributions to capital formation that resulted from the JOBS Act and its passage into law four years ago. Nasdaq was a proud supporter of the JOBS Act and believes that its success is evident in the results. We appreciate this Committee's continuing commitment to the start-up agenda. I am happy to answer your questions.

SBE COUNCIL
Small Business & Entrepreneurship Council

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

Testimony by
Raymond J. Keating
Chief Economist
Small Business & Entrepreneurship Council

Before the
Subcommittee on Capital markets and Government Sponsored Enterprises
Committee on Financial Services
U.S. House of Representatives

The Honorable Scott Garrett, Chairman
The Honorable Carolyn Maloney, Ranking Member

April 14, 2016

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Protecting Small Business, Promoting Entrepreneurship

Chairman Garrett, thank you for hosting this important hearing today on the JOBS Act and the need to enhance capital formation. The Small Business & Entrepreneurship Council (SBE Council) is pleased to submit this testimony. Thank you for your invitation.

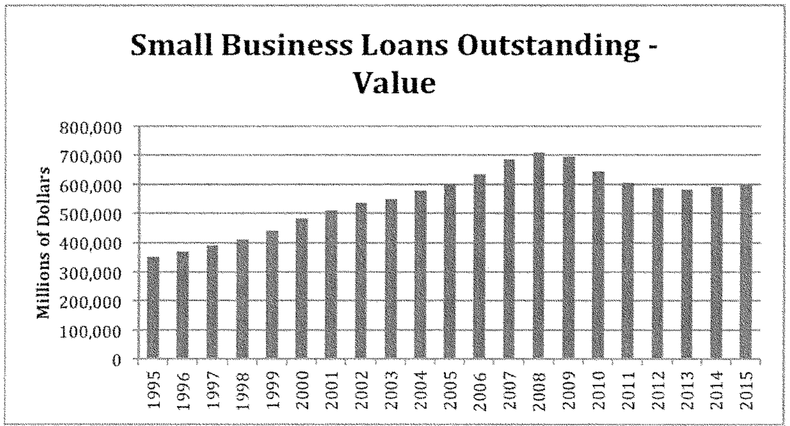
My name is Raymond Keating, and I am the chief economist for SBE Council, as well as serving as an adjunct professor in the Townsend Business School at Dowling College where I teach a variety of courses in the MBA program; and being the author of several books, including the latest nonfiction book being *Unleashing Small Business Through IP: Protecting Intellectual Property, Driving Entrepreneurship*.

SBE Council is a nonpartisan, nonprofit advocacy, research and training organization dedicated to protecting small business and promoting entrepreneurship. With more than 100,000 members and our network of business groups nationwide, SBE Council is engaged at the local, state, federal and international levels where we collaborate with elected officials, policy experts and business leaders on initiatives and policies that enhance competitiveness and improve the environment for business start-up and growth. Since our founding in 1994, SBE Council has helped to strengthen the ecosystem for small business and entrepreneurial success in the U.S. and across the world. Access to capital has remained one of SBE Council's core issues since our founding.

Small Business Challenged on Raising Financial Capital

Access to financial capital – whether via equity or debt – is vital for entrepreneurs seeking to start up, operate or expand businesses, and at the same time, gaining access to capital has remained an enduring challenge for many small businesses. The financial crisis and Great Recession made the situation worse as capital became increasingly hard to access from institutional banks and various capital market players. And while there have been improvements due to the economic recovery and healing in the capital markets, many entrepreneurs continue to struggle with accessing the capital they need to compete and grow.

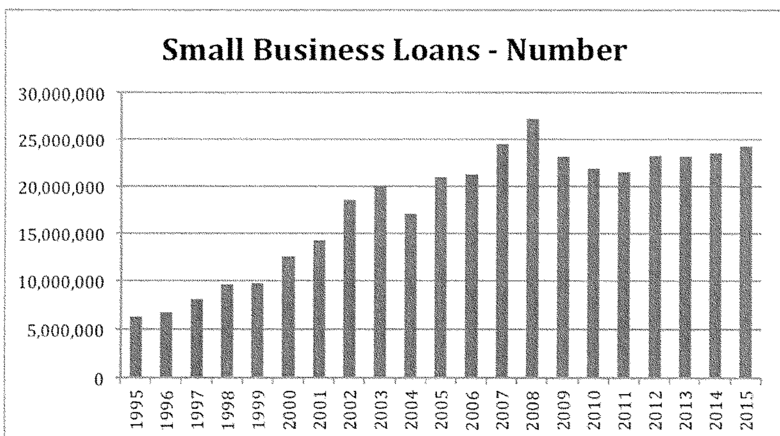
Consider the decline in bank small business loans (less than $1 million) over the past several years. The value of small business loans outstanding hit a high of $711.5 billion in 2008, and subsequently fell for five straight years, with some growth resuming in 2014 and 2015. The 2015 level came in at $599.3 billion, which is roughly where the small business loan level was in 2005. That's a decade of no growth.



Data Source: Federal Deposit Insurance Corporation, Quarterly Banking Profile

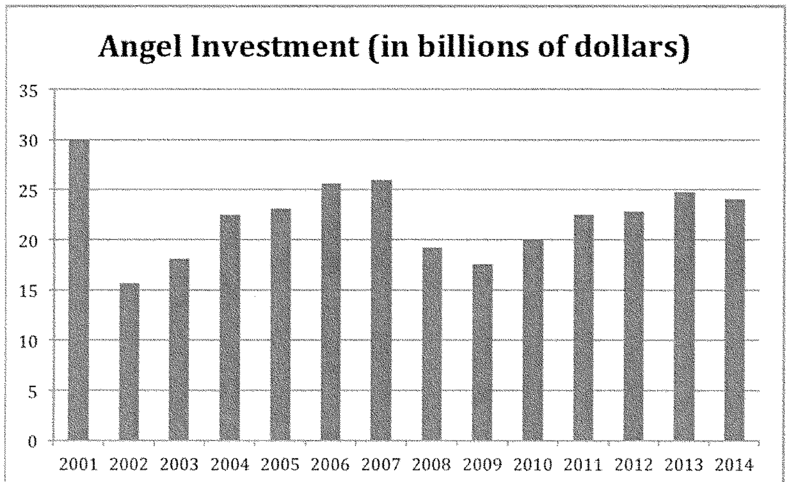
The small business share of commercial and industrial loan value outstanding registered, for example, 33 percent in 1995, 35 percent in 2004, and 30 percent in 2007. As of the fourth quarter of 2015, however, it had fallen to only 20 percent. Looking at nonfarm nonresidential loans, the small business share came in at 52 percent in 1995, and had declined to 39 percent in 2007. At the end of 2015, the small business share further declined to 23 percent.

As for the number of small business loans, these rose steadily up to 2008 (hitting 27.1 million in 2008 compared to 6.3 million in 1995), and subsequently declined and struggled to recover, climbing back to 24.3 million in 2015.



Data Source: Federal Deposit Insurance Corporation, Quarterly Banking Profile

On the equity side, angel investment is a critical source of funding for start-ups and early-stage businesses. But here, again, the story has been one of under-performance or sluggishness in recent years. According to the Center for Venture Research at the University of New Hampshire, after a big drop in 2002, coinciding with the aftermath of the 2001 recession (as well as the post "tech bubble"), growth resumed from 2003 through 2007, with angel investments increasing from $15.7 billion in 2002 to $26 billion in 2007. However, subsequently, there was a big drop-off in 2008 and 2009, and the subsequent growth has been underwhelming. For all of 2014, angel investment came in at $24.1 billion, down from $24.8 billion in 2013, and still not back to the $26 billion level in 2007. In fact, the 2014 level came in just ahead the 2005 level – again, nearly a decade of no growth. For the first half of 2015 compared to the same period in 2014, angel investment was up by 4.1 percent.



Source: Center for Venture Research at the University of New Hampshire

To sum up, long after the financial crisis hit in late 2008 and the Great Recession came to an official end in mid-2009, the value and number of traditional small business loans are still down markedly, and angel investment is still down compared to 2008. Based on these numbers, the struggle for entrepreneurs to gain access to the financial resources needed to start up, thrive or just survive continues to be difficult.

The bottom line is that small businesses need more options or avenues to expand access to financial capital. The securities market would seem to be an option, but the regulatory and legal costs long had been prohibitive.

The JOBS Act

In the midst of these struggles, SBE Council staff and members were instrumental in advancing the JOBS Act into law. SBE Council President Karen Kerrigan and key SBE Council members joined President Obama at the White House for the JOBS Act signing ceremony in April 2012. The overwhelmingly bipartisan bill focused on helping to stimulate the U.S. economy by promoting capital formation.

At the time the legislation was signed, Kerrigan observed: "Passage of the JOBS Act is proof that elected officials and leaders can put political differences aside for the good of the country and the economy. President Obama's steadfast leadership and support of the JOBS Act was central to this important victory for small businesses. The unwavering support of House and Senate Republican leaders, as well as the collaborative work that many Democrat and GOP members of Congress put into this important package was critical to a successful legislative effort. These leaders on both sides of the political aisle were driven by one goal – to find solutions that would free up capital for America's job creators… The lack of access to capital is holding budding entrepreneurs and promising firms back, and without money or credit these businesses cannot grow, innovate or create jobs. The JOBS Act is a potent mix of regulatory reforms and relief that will free up precious capital for growth, and create new models and platforms for businesses to raise funds."

On April 5, 2016, Locavesting.com offered an excellent status report on the JOBS Act as it turned four years old, summing up key sections and the impact in the marketplace. A few points from the report warrant noting here:

> • Title I ("Reopening American Capital Markets to Emerging Growth Companies") "created a new category of issuers called 'emerging growth companies,' defined as an issuer with total annual gross revenues of less than $1 billion during its most recently completed fiscal year. To encourage these growth companies to go public and address an alarming drop-off in IPOs, Congress created an IPO 'on-ramp' … by relaxing regulatory requirements for going public, including requirements for financial disclosure and reporting. ECGs may also submit draft registrations for confidential, non-public review by the SEC… The provision was further modified by the FAST Act, signed into law in December, 2015," which "simplified disclosure requirements for smaller issuers and clarified rules for secondary selling of these privately issued securities."
>
> ***The impact? "Emerging Growth Companies have accounted for the lion's share of recent IPOs—86% of IPOs in 2015, according to Citi, and two-thirds of IPOs in 2014, according to another study." (Emphasis added.)***
>
> • Title II ("Access to Capital for Job Creators") allows for "accredited investor" crowdfunding by letting "private companies conducting a private placement under Regulation D Rule 506 to publicly market the offering. Before that such marketing was banned. The securities can only be sold to accredited (wealthy)

investors. Specifically, the JOBS Act amended Reg D Rule 506—a widely used securities exemption for private companies raising money from accredited investors—to include a new sub-rule, Reg D 506(c) that eliminates the ban on general solicitation and advertising. Companies issuing securities under the new 506(c) exemption can now openly talk about and advertise the fact they are raising money… In practical terms, Title II improves the existing private placement process, allowing companies to reach out to more accredited investors, but it does not represent a major new funding avenue." The rules went into effect on September 23, 2013.

The impact? "In its first two years, there have been more than 6,000 offerings conducted under Title II, according to Crowdnetic, with recorded capital commitments of $870 million (there is no way of tracking how much of that capital was successfully raised). That's still a small portion of Regulation D private offerings, but growing fast." (Emphasis added.)

• Title III (The Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act or CROWDFUND Act), which goes into effect on May 16, 2016, "allows any American, regardless of wealth, to easily invest in private companies for the first time in more than 80 years. This public investment crowdfunding must take place on SEC-sanctioned funding portals—think of it like Kickstarter, but for investing." The basics include:
– Companies being able to raise up to $1 million every 12 months.
– "Investors are limited in what they can invest each year (to $2,000 or 5% of net worth or income if net worth or annual income is less than $100,000; or 10% of net worth or annual income (whichever is lesser) if those measures are $100,000 or greater."
– "Offering must be conducted via an SEC-sanctioned intermediary, either a funding portal or a broker/dealer platform."
– "Communications between issuers and potential investors must primarily take place on the funding platform."
– "Issuers must file Form C with the SEC at least 21 days prior to launching an offering."
– "Once the offering is complete, companies must update shareholders on an annual basis."

The impact? "To be seen! Title III is expected to have a slow ramp up as portals, investors and entrepreneurs get comfortable with the new law. In the meantime, the long wait for Title III has inspired at least 30 states to create their own exemptions allowing investment crowdfunding within their state borders, which may offer some issuers and investors a more attractive option." (Emphasis added.)

• Title IV ("Small Company Capital Formation (aka Regulation A+)) "required the SEC to boost the offering amount allowed under Regulation A from $5 million and fix some of its drawbacks, namely the need to register with both

> federal and state regulatory authorities. The new Reg A+ rules create two tiers of offerings: Tier 1 allows issuers to raise up to $20 million in a 12-month period; Tier II, up to $50 million. Significantly, the SEC preserved the ability for unaccredited as well as accredited investors to participate in Reg A+ offerings, making it a true public offering. And it added a valuable tool: the ability for companies to 'test the waters' with potential investors before committing to an offering. This is a capital-raising tool for high-growth companies with large capital needs. And it is not inexpensive. Issuers need to file a thick offering document (Form 1-A) with the S.E.C. for approval. Tier 1 preserves the need for state by state "Blue Sky" registration and review, which is costly and time consuming. And Tier 2 imposes on companies an ongoing reporting burden, including audited financials, much like the reporting requirements of a public company." The rules went into effect in June 2015.
>
> ***The impact? Reg A+ has been the sleeper of the JOBS Act. In less than a year, it has attracted bold and innovative entrepreneurial ventures that might have lacked suitable funding in the past. Examples include next generation electric cars, sci-fi aircraft, media and medical marijuana ventures. In addition, crowdfunding platforms and online lenders have used it to extend investment opportunities to unaccredited investors." (Emphasis added.)***

Regarding Title III going into effect in May 2016, SBE Council Karen Kerrigan told Crowdfundinsider.com in October 2015 that the impact on entrepreneurship "will be significant." She explained:

> "First, as entrepreneurs in search of start-up or growth capital, Title III crowdfunding releases an immense pool of capital that has been locked away due to archaic thinking and laws. For many of our members who are locked out of networks or don't have access to Venture Capital networks or Angels, this next phase of investment crowdfunding blows the market wide open. For women entrepreneurs, the potential is quite significant as online platforms will continue to grow, diversify and serve niche markets. Investors will be in search of quality businesses to invest in – regardless of gender or race. Second, small businesses will be stronger once they grasp what it takes to raise capital via equity and debt-based crowdfunding. The knowledge they will absorb by going through the fundraising process, and preparing for it – including the vetting and feedback – will make for stronger and more competitive businesses. This is not only good for the entrepreneur, but for our economy as a whole. Third, more small business owners and entrepreneurs will become investors themselves. This will be tremendously powerful for the ecosystem."

Meanwhile, Sherwood Neiss, a partner at Crowdfund Capital Advisors who co-authored *Crowdfund Investing for Dummies* and played a key role in making the JOBS Act happen though his education, advocacy and working with SBE Council, noted in VentureBeat.com in October 2015 that the U.S. has a lot of catching up to do on the crowdfunding front. He noted, for example, developments in the United Kingdom and China:

• **The United Kingdom.** "Since 2012, the four types of crowdfunding — donation, rewards, debt (peer-to-peer and peer-to-business), and equity — have been reclassified as Alternative Finance. The United Kingdom led the way by crafting policy that was data intensive and prescriptively light. Rather than regulating the industry out of business due to fear, the U.K.'s Financial Services Authority (FSA) decided to understand how these online platforms are digitally storing data on companies that never existed in the private capital markets before, providing transparency and immediate access to company data, performance, and disclosures so investors can make informed decisions, and efficiently facilitating the flow of capital at very cost-effective rates. In response, both the debt and equity markets for crowdfunding skyrocketed, companies and individuals that didn't qualify for traditional bank financing were receiving access to capital, fraud turned out to be nonexistent, and default rates are averaging lower than those experienced by banks. To substantiate this, an Alternative Finance Market report by the University of Cambridge and Ernst & Young found that in 2014 €2.34 billion ($ 3.61 billion) worth in crowdfunding was transacted in the U.K., making up nearly 75 percent of the total value of the online alternative finance market in Europe."

• **China.** "Asia saw the explosion of peer-to-peer lending in China, with one platform originating over $16 billion in loans last month alone!... In China, one of the P2P lenders raised $93 billion in deposits in less than a year. All banks globally didn't accomplish that last year. And the default risk of P2P lenders is half that of banks. P2P lending platform Zopa, for example, has a default rate of .005 percent. Why? Because it has better data."

Looking at the U.S. and what lies ahead after the "Securities and Exchange Commission finally decides to stop playing politics and start helping small businesses by okaying securities-based crowdfunding," Neiss pointed to the following five expected developments:

- **"Transparency**: Companies that tend to be successfully funded have spent a significant amount of time prepping for the raise, preparing their financials for review, and creating necessary disclosures for investors to vet."
- **"Access to capital**: Companies have access to short-term financing that the banks have been unwilling or unable to finance."
- **"Sophistication**: Companies tend to follow a path of management discipline, internal governance, and external communication."
- **"Deal flow**: Companies that are transparent, leverage this capital smartly, and execute on their plans are seen as quality deal flow for follow-on investments, VCs, and even traditional banks."
- **"Diversification:** Investors have access to a broader and more diverse set of investment opportunities within a regulated and transparent environment at attractive yields."

Work To Do

Even given the significant and positive changes being brought about for entrepreneurs and investors with the JOBS Act, there are areas in need of improvement. A serious concern persists regarding extra government regulation or placing too many limitations on the ability of entrepreneurs to gain access to capital, and/or on investors' abilities to make investments in entrepreneurial ventures.

Indeed, few better understand the costs of government regulations, rules and restrictions than small businesses owners. After all, they are on the frontlines of having to deal with the very real costs of regulation, whether that means dealing with added costs of running a business day to day, or if it means reduced access to financial capital.

On the crowdfunding front, in his October 30, 2015, statement, Securities and Exchange Commission (SEC) Commissioner Michael S. Piwowar observed:

> "While crowdfunding was intended to be a treat for the smallest and least sophisticated companies seeking to raise capital, today's rules are full of tricks. The rules will spin a complex web of provisions and requirements for compliance. I fear that many traps for the unwary are hidden in the regulations, creating potential nightmares for small business owners that fail to place regulatory compliance at the top of their business plans. Such burdens will spook many small businesses from pursuing crowdfunding as a viable path to raising capital.
>
> "A number of concerns have already been raised as to whether our rules are too restrictive or too burdensome. In fact, many of these restrictions are embedded in the statute itself. For instance, even if you are Warren Buffet or Bill Gates, you are limited to investing no more than $100,000 during any 12-month period in all crowdfunding investments.
>
> "In other cases, the majority of the Commission has exercised discretion to make capital raising using crowdfunding even more difficult. In a change from the proposal, the rules will limit the ability to invest in crowdfunding opportunities based on the lesser of annual income or net worth. Because the majority of the Commission cannot trust ordinary Americans – the non-accredited investors – to be able to exercise appropriate judgment in how to spend or invest their resources, our rules will now place smaller limits on the amounts that can be invested. Rather than actually protecting investors, these smaller limits will discourage legitimate companies from engaging in crowdfunding, while simultaneously encouraging less reputable actors to use affinity-based solicitation methods akin to multi-level marketing, a development that could stifle crowdfunding efforts."

Neiss worries about the following: "The question remains, will the SEC regulate the opportunity to death, or will it foster the development of this ecosystem and position the United States as the leader that will live up to President Obama's statement that this is 'game changing'?"

Also, consider, what David Burton, a senior fellow in economic policy at the Heritage Foundation, in a February 2014 analysis noted:

> "'Going public' now costs a company about $2.5 million. This money is spent on lawyers, accountants, and other expenses to meet the registration

> requirements of the Securities Act. Moreover, it costs more than $1 million annually to remain public. Any company issuing stock is subject to these burdensome requirements unless an exemption applies…
>
> Even the SEC's own figures, however, put the crowdfunding compliance costs (including the cost of lawyers, accountants, filing fees, and so on) at 20 percent to 50 percent of the amount raised for offerings of less than $100,000, about 15 percent for those between $100,000 and $500,000, and 11 percent–12 percent for offerings between $500,000 and the $1 million annual cap. This makes crowdfunding a very expensive way to raise money and will limit its usefulness."

In terms of making headway toward reducing the costs for entrepreneurs to gain access to financial capital, SBE Council supports the four legislative initiatives being considered at this hearing.

• H. R. 4852 Private Placement Improvement Act of 2016

The Private Placement Improvement Act (H.R. 4852) would amend federal securities laws to ensure that small businesses do not face complicated and unnecessary regulatory burdens when attempting to raise capital through private securities offerings issued under SEC Regulation D.

The Regulation D capital market is a critical one for the U.S. economy. In 2012, Regulation D offerings ($903 billion) accounted for over half of all private offerings. It is the primary means by which startups and growth companies raise equity capital, according to the SEC. Still, raising this capital is expensive.

The strong bipartisan passage of the JOBS Act should have sent a very clear message to the SEC. That is, outdated and excessive regulatory impediments must be addressed to encourage capital formation for our most promising entrepreneurial firms.

As noted in the CRS summary, H.R. 4852 would direct

> "the Securities and Exchange Commission (SEC) to revise the filing requirements of Regulation D (which provides exemptions from securities registration requirements) to require an issuer that offers or sells securities in reliance upon a certain exemption from registration (for limited offers and sales without regard to the dollar amount of the offering [Rule 506]) to file, no earlier than the date of first sale of such securities, a single notice of sales containing the information required by Form D (used to file a notice of an exempt offering of securities under Regulation D) for each new offering of securities.
>
> "The SEC shall not: (1) require the issuer to file any notice of sales containing the information required by Form D except for this single notice; (2) condition the availability of the Rule 506 exemption upon the filing of a Form D or similar report; or (3) require issuers to submit written general solicitation materials in connection with a limited offering subject to Rule 506, except when it requests such materials pursuant to specified authority.

"The SEC shall revise a specified rule, regarding a Rule 506 offering of a private fund, to characterize as an accredited investor a 'knowledgeable employee' of that private fund or the fund's investment adviser."

This legislation is consistent with the goals of Title II of the JOBS Act by ensuring that small businesses do not face complicated and unnecessary regulatory burdens when attempting to raise capital through private securities offerings under Rule 506, while at the same time preserving important investor protections. If the SEC followed the clear intent of Congress, H.R. 4852 would not be necessary. But unfortunately, the proposed rules make Regulation D more expensive, complex and burdensome for small businesses, which was not the purpose of the JOBS Act.

While the SEC adopted a rule lifting the ban on general solicitation and advertising for certain private securities offerings under Rule 506 of Regulation D, as mandated under Title II of the JOBS Act, the separate rule proposal would impose a number of new regulatory requirements on small companies seeking to utilize amended Rule 506, including proposals to submit additional Form D filings to the SEC in advance and at the conclusion of an offering, and to file written general solicitation materials with the SEC. In essence, one regulatory filing would be replaced with three, plus any written general solicitation materials. This means higher costs for small businesses.

As stated in a letter to the SEC chairman in July 2013, U.S. Rep. Garrett and Patrick McHenry from North Carolina:

"Regulation D 506(c) offerings, which benefit from the lifting of the ban on general solicitation, provide opportunities to raise capital from investors that can afford to take risk, can afford advisors and, under the vastly expanded information technology of today as compared to 1933, have an improved ability to investigate investment opportunities and investment managers…

"The primary concern arising from the Proposed Rules results from an apparent error that the Commission made when drafting this proposal. Proposed Rule 503 requires a fifteen day waiting period, after filing Form D, before allowing advertisements- this restriction appears to violate the law by imposing a fifteen day ban on general solicitation. Title II of the JOBS Act lifted the ban on general solicitation for Regulation D 506 offerings to accredited investors. As a result, the Form D pre-filing requirement effectively violates Title II of the JOBS Act.

"This ban on solicitation imposed via a pre-filing requirement would extend substantially longer than fifteen days, particularly for smaller businesses that have reduced access or experience with complex legal matters. If a business decides to proceed with advertising a 506 offering, it must first file an expanded Form D, which will require hiring qualified counsel and require considerable time to complete. Upon submission of a completed Form D, the issuer must then wait fifteen days prior to posting an advertisement.

"As a result, the Form D pre-filing requirement imposes a lengthy waiting period between the day that an issuer decides to advertise under Rule 506(c), and

> the day of the actual advertisement. Congress specifically required the Commission to lift the ban on general solicitation for those Rule 506 offerings that solely target accredited investors and qualified institutional buyers. Congress did not say that the Commission can delay free speech for fifteen days."

From our perspective, the statute clearly states that any marketing an issuer does must point prospective investors to the funding portal or broker's site where the listing is posted. The point of this is to make sure that issuers limit the information about their offering to only the objective criteria laid out in the statute. Having issuers file general solicitation materials only adds unnecessary red tape, time and cost to the process. An issuer who is already limited in what they can "say" would need to incur the extra legal expense of a counsel review prior to sending it to the SEC, then wait for any feedback from either counsel or the SEC. This extra step does not provide any extra investor protection but unnecessarily increases costs for capital-strapped entrepreneurs.

H.R. 4852 is a common-sense measure that would align the rules governing Title II of the JOBS Act with the clear intention of Congress, and would reduce costs and enhance the abilities of entrepreneurs to raise capital.

• H. R. 4850 Micro Offering Safe Harbor Act

The Micro Offering Safe Harbor Act (H.R. 4850) would define the "non-public offering" exemption under the Securities Act of 1933, and thereby provide small businesses the confidence needed to know that they are not violating the law. Since the federal securities laws were first enacted in 1933, "transactions by an issuer not involving any public offering" have been exempt. One or more of the following requirements need to be met for the non-public offering exemption:

- pre-existing relationship: each investor has a substantive pre-existing relationship with an officer, a director or a shareholding of 10 percent or more of the shares of the issuer;
- 35 or fewer purchasers;
- small offering - the total amount of securities sold by the issuer during the 12-month period does not exceed $500,000.

SBE Council agrees with Congressman Tom Emmer of Minnesota, who introduced this bill, in his statement: "Entrepreneurs will be able to more easily launch their startups and existing businesses will have better prospects for growth. By simply clarifying an old law, more small businesses will raise capital through non-public offerings, easing the burdens of red-tape, onerous paperwork, and the threat of lawsuits."

SBE Council believes this legislation would appropriately scale federal rules and regulatory compliance for small businesses, thus providing another practical option for entrepreneurs to raise the capital they need to startup or grow their firms. Small private companies would not have to incur formidable legal costs and uncertainties, and the SEC would not have to take any action. With fraud protection still in place, this legislation stands out as a sound, much-needed legislative step that reduces regulatory costs and legal risks.

• H. R. 4855 Fix Crowdfunding Act

While SBE Council remains enthusiastic about the future of equity crowdfunding and the upcoming date of May 16 when Title III officially goes live, we support fixes that will lower the cost of raising capital, and allow for the growth of a dynamic and diverse funding portal marketplace. H.R. 4855 provides key fixes that are needed.

As reported by CrowdfunderInsider.com, "The proposed legislation addresses some of the problematic portions of Title III crowdfunding. Specifically the bill, as it stands now, allows for 'Special Purpose Vehicles' (SPVs) and increased the amount of the possible raise to $5 million. The proposed law also clarifies several aspects of the existing law such as the liability risk attributed to funding portals. These issues, among others, have been cited as many in the industry as crippling a potentially powerful exemption. Retail crowdfunding is widely viewed as a unique opportunity to improve access to capital for smaller companies across the country. The exemption should give a boost to under-banked sectors of the economy such as minority and women entrepreneurs."

Expanding investment levels for Title III crowdfunding and limiting the potential liability risks to funding portals again mean reduced costs, expanded opportunities for both entrepreneurs and investors, more innovation in the marketplace, and greater choice for small businesses.

Suggested Amendment

Finally, by way of suggestion, SBE Council is concerned with the application of anti-money laundering (AML) requirements to funding portals. AML compliance is quite costly, and since portals are prohibited from holding customer funds, imposing such mandates on funding portals would be duplicative and unnecessary. FINRA dropped this requirement in its final funding portal rules. However, it is our understanding that now Treasury wants to pursue it.

In a February 2014 letter on the issue, David Burton, senior fellow in economist at the Heritage Foundation, observed:

> "Proposed rule 300(b) would require funding portals to comply with Anti-Money Laundering (AML) and the associated 'Know Your Customer' requirements, to file suspicious activity reports (SARs) and comply with other aspects of the Bank Secrecy Act. This is a mistake of the first order. These rules are so complex and expensive to comply with that many European banks are now unwilling to accept U.S. customers and are terminating their relationship with existing U.S. customers.
>
> "Funding portals do not handle customer funds. The JOBS Act prohibits them from doing so. The banks and broker-dealers that do handle customer funds must comply with these rules. It is inappropriate to require funding portals to

comply with these rules because the ability to engage in, or facilitate, money laundering does not exist to any meaningful degree and the costs of complying with these rules are likely to be so high as to make funding portals uneconomic. It will result in a situation where the only intermediaries are broker-dealers. It will frustrate the intention of Congress to establish a more lightly regulated intermediary class."

The Fix Crowdfunding Act could be amended to make it clear that funding portals are not subject to the AML rules given that they are prohibited from holding customer funds.

• H. R. 4854 Supporting America's Innovators Act of 2016

The purpose of the Supporting America's Innovators Act of 2016 (H.R. 4854) is to "amend the Investment Company Act of 1940 to expand the investor limitation for qualifying venture capital funds under an exemption from the definition of an investment company." For a venture capital fund, the exemption would include funds with fewer than 500 stakeholders, and the "'term "qualifying venture capital fund" means any venture capital fund ... that does not purchase more than $10,000,000 in securities of any one issuer, as such dollar amount is annually adjusted by the Commission to reflect the change in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics of the Department of Labor'"

To the extent that this legislation would reduce the costs, it would be another positive step for further enhancing the incentives and resources for investing in entrepreneurial ventures.

Conclusion

In conclusion, it's worth highlighting whom exactly benefits from increased regulation. The assumption too often is that the average person – in this case, the small investor – is helped. But in reality, increased regulatory costs tend to protect large, established businesses, while raising costs of entry for new, entrepreneurial, small businesses. That certainly is not good news for the average investor. Consider what was reported by *The Wall Street Journal* editorial page in February 2015:

> "On Tuesday at an investor conference, the Goldman Sachs CEO explained how higher regulatory costs are crushing the competition.
>
> "More intense regulatory and technology requirements have raised the barriers to entry higher than at any other time in modern history," said Mr. Blankfein. "This is an expensive business to be in, if you don't have the market share in scale. Consider the numerous business exits that have been announced by our peers as they reassessed their competitive positioning and relative returns." ...
>
> "While the Goldman boss wasn't endorsing all of the added directives from Washington, he said his bank is 'prepared to have this relationship with our regulators'—and the regulators are prepared to have a deep relationship with Goldman—'for a long time.'
>
> "None of this will surprise our readers, who understand that one goal of Dodd-Frank was to turn big banks into the equivalent of financial utilities...

> Goldman can afford to hire battalions of lawyers and lobbyists to commune with regulators…"

The JOBS Act amounted to a clear push in the opposite direction, that is, in the direction of reduced regulation and lower costs expanding opportunity for entrepreneurs to raise much-needed financial capital, and to expand opportunities for investors, lenders and crowdfunding facilitators. The idea is to expand entrepreneurial opportunities in the financial arena, and in the broader economy. These four legislative measures – H.R. 4850, H.R. 4852, H.R. 4854, and H.R. 4855 – would make further headway in a positive, pro-entrepreneur direction.

Thank you for your time and attention. I look forward to your questions and further discussion.

Written Testimony
Kevin Laws
Chief Operating Officer and Chief Investment Officer
AngelList

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

90 Gold St., Floor 3, San Francisco, CA 94133 https://angel.co

Written Testimony of Kevin Laws
AngelList
April 14, 2016
Page 1 of 3

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

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

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

UNIVERSITY of DENVER
STURM COLLEGE OF LAW

April 11, 2016

Analysis

Micro Offering Safe Harbor Act
Private Placement Improvement Act of 2016
Fix Crowdfunding Act
Supporting America's Innovators Act of 2016

J. Robert Brown, Jr.[1]

Micro Offering Safe Harbor Act. The proposed legislation would add a number of new exemptions to the Securities Act of 1933 ("1933 Act"). Adoption of these exemptions would result in a significant change in the operation of the 1933 Act.

The legislation would exempt from registration sales of securities by an issuer that met one or more of the following requirements: (1) purchasers had a "substantive" preexisting relationship with an officer, director or 10% shareholder of the issuer; (2) there were no more than, or the issuer "reasonably believes that there are no more than", 35 purchasers during a 12 month period; or (3) the "aggregate" amount of securities sold by the issuer during a 12 month period did not exceed $500,000.

First, although the proposed legislations refers to "micro" offerings, there is no guarantee that offerings under the exemptions will in fact be "micro." With respect to sales to persons with preexisting relationships and sales to no more than 35 investors, there is no limit on the dollar amount that can be raised. As a result, the dollar amounts may be significant.[2] With respect to sales to persons with preexisting relationships or in offerings raising less than $500,000, there is no limit on the number of investors. Particularly in the case of preexisting relationships, promoters could raise an unlimited amount of capital from an unlimited number of investors.

Second, nothing in the proposed exemptions ensures that sales are made to persons who understand the risks of the investment or who have the financial ability to withstand the loss. Investors are not required to be accredited or sophisticated or to be given information about the

[1] Professor of Law and Director of the Corporate & Commercial Law Program, University of Denver Sturm College of Law; Secretary, Investor Advisory Committee, Securities and Exchange Commission.
[2] Offerings involving a small number of investors can still raise significant sums. *See In re Daspin*, Exchange Act Release No. 74799 (admin proc. April 23, 2015) (allegations that unregistered offering "raised a total of $2.47 million from seven investors").

risks associated with the investment. Unlike the crowdfunding exemption[3] or Regulation A+,[4] nothing in the proposed legislation seeks to cap the amount of losses that an unaccredited or unsophisticated investor may incur in connection with an exempt offering.

The proposed exemption for those with a "substantive" preexisting relationship does apparently require some type of nexus between the investor and the company. Nonetheless, the term is not defined and does not guarantee that, as a result of the relationship, investors will be knowledgeable about the business of the company or will understand the risks of the investment. The exemption could apply, for example, to offerings made by bad actors who create relationships by joining affinity organizations (such as churches) and then sell unregistered securities to the members.[5]

Third, exemptions are unaccompanied by any requirements designed to protect investors.[6] There is, for example, no restrictions on the use of general solicitations (blast emails and social media). Where general solicitations are otherwise permitted, they are usually accompanied by other requirements designed to protect investors. Rule 506(c) allows general solicitations but requires that purchasers be accredited and that issuers take "reasonable steps" to ensure that they have such status.[7]

No similar protections are included in the proposed legislation. Those relying on the exemptions, including unscrupulous promoters, could, therefore, use general solicitations to target unsophisticated investors. The Commission in the 1990s allowed general solicitations for offerings under Rule 504 of Regulation D (offerings up to $1 million).[8] The SEC, however, became concerned that the changes facilitated fraud[9] and, as a result, re-imposed the prohibition on general solicitations.[10]

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[3] Exchange Act Release No. 76324 (Oct. 30, 2015) ("under the final rules, an investor will be limited to investing: (1) The greater of: $2,000 or 5 percent of the lesser of the investor's annual income or net worth if either annual income or net worth is less than $100,000; or (2) 10 percent of the lesser of the investor's annual income or net worth, not to exceed an amount sold of $100,000, if both annual income and net worth are $100,000 or more.").

[4] Rule 251(d)(2)(i)(C), 17 CFR 230.251(d)(2)(i)(C). *See also* Securities Act Release No. 9741 (March 25, 2015) (under Regulation A+, "nonaccredited, non-natural persons are subject to the investment limitation [in Tier 2 offerings] and should calculate the limitation based on no more than 10% of the greater of the purchaser's revenue or net assets (as of the purchaser's most recent fiscal year end)").

[5] For a discussion of affinity fraud, see https://www.sec.gov/investor/pubs/affinity.htm

[6] For example, unlike Rules 505 and 506 of Regulation D, Regulation Crowdfunding, and Regulation A+, the exemptions are not subject to the bad actor provisions.

[7] Rule 506(c), 17 CFR 230.506(c).

[8] *See* Securities Act Release No. 7644 (Feb. 25, 1999) ("The [1992] amendments eliminated all restrictions on the manner of offering and on resales under Rule 504. As a result, a non-reporting company could offer up to $1 million of securities in a 12-month period and be subject only to the antifraud provisions of the federal securities laws. General solicitation and general advertising were permitted for all Rule 504 offerings.").

[9] *See* Exchange Act Release No. 8828 (Aug. 3, 2007) ("The Commission had been concerned for some time with abusive practices in Rule 504 offerings, many of which involved 'pump and dump' schemes for securities of non-reporting companies that traded over the counter."); *see also* Securities Act Release No. 7644 (Feb. 25, 1999) ("Unfortunately, there have been recent disturbing developments in the secondary markets for some securities initially issued under Rule 504, and to a lesser degree, in the initial Rule 504 issuances themselves.").

[10] *See* Securities Act Release No. 7644 (Feb. 25, 1999) ("As amended, the rule establishes the general principle that securities issued under the exemption, just like the other Regulation D exemptions, will be restricted, and prohibits general solicitation and general advertising, unless the specified conditions permitting a public offering are met.").

Fourth, the adoption of the proposed legislation will likely result in the migration of a significant number of offerings currently made under exemptions that provide investors with some transparency and some protection to those that do not. SEC data shows that "the vast majority of Regulation D offerings" likely involve investors with preexisting relationships with the company or management.[11] Similarly, many offerings under Regulation D involve less than 35 investors.[12] The proposed exemptions could and often would likely be used in place of offerings currently made under Rule 506 or Section 4(a)(2) of the 1933 Act.

Private Placement Improvement Act of 2016. The proposed legislation would essentially prohibit the SEC from requiring more than a single Form D in connection with an offering under Rule 506. The proposed legislation would also prohibit the SEC from conditioning the availability of "any" exemption under Rule 506 on the filing "with the Commission" of a Form D "or any similar report" and from requiring the filing of general solicitation materials under Rule 506(c) except when the Commission requested the materials under specified sections of the securities laws.[13]

The proposed legislation raises a number of concerns.

First, the approach is inflexible and narrow in application.[14] While the SEC only requires a single Form D and currently does not condition the exemption on the filing of the Form, the proposed legislation would lock in this approach, depriving the SEC of the flexibility to respond to changed circumstances.[15]

Second, the proposed legislation seeks to regulate the timing of the filing of the Form D by prohibiting the filing of a notice "no earlier than the date of first sale of securities in the

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[11] *See* Securities Act Release No. 9416 (July 10, 2013) ("the vast majority of Regulation D offerings are conducted without the use of an intermediary, suggesting that many of the investors in Regulation D offerings likely have a pre-existing relationship with the issuer or its management because these offerings would not have been conducted using general solicitation.").

[12] *See* Exchange Act Release No. 69959 (July 10, 2013) ("More than two-thirds of these offerings [under Rule 506] have ten or fewer investors, while less than 5% of these offerings have more than 30 investors.").

[13] The proposed legislation would also prohibit the application of the requirements of Rule 156 to "private funds." 17 CFR 230.156. Finally, the legislation compels the Commission to define as an accredited investor a "knowledgeable employee" of a private fund or the fund's investment adviser "for purposes of a Rule 506 offering of a private fund with respect to which the person is a knowledgeable employee." Whatever the merits to the proposed change in the definition of accredited investor, revisions should be left to the Commission as part of a comprehensive reexamination of the definition. *See* J. Robert Brown, Jr., *Reforming the Definition of Accredited Investor and Business Development Companies*, Testimony before the House Subcommittee on Capital Markets and Government Sponsored Enterprises, June 16, 2015, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2619739

[14] The proposed legislation, for example, applies for the most part to offerings under Rule 506. As a result, nothing in the proposed legislation regulates the SEC's authority with respect to Rules 504 or 505 under Regulation D. In those cases, the SEC could require the filing of multiple versions of Form D and could condition the availability of the exemption on the filing of the forms.

[15] Indeed, these initiatives would have the effect of preventing the adoption of amendments to Rule 506 proposed by the SEC in 2013. *See* Securities Act Release No. 9416 (July 10, 2013).

offering."[16] As a result, the Commission will be unable to collection information on issuers that engage in offerings but do not actually sell securities.[17] The lack of information will interfere with the SEC's understanding of the use of Regulation D and potentially interfere with the SEC's ability to effectively regulate offerings under Rule 506.

Third, by providing that the failure to file the Form D cannot result in the loss of the exemption under Rule 506 (which is currently the case but the SEC's rule proposal could change that), the proposed legislation eliminates a significant mechanism for ensuring that issuers in fact file the Form D. The current absence of meaningful penalties for the failure to file the Form D[18] has resulted in substantial noncompliance with the filing requirement.[19]

Noncompliance raises substantial concerns. It creates significant gaps in the data provided to the SEC about the actual use of Rule 506 and interferes with the development of efficient and effective regulation. The Commission has indicated a desire to "develop risk characteristics regarding the types of issuers and market participants that conduct or participate in Rule 506(c) offerings. . ."[20] With substantial noncompliance in the filing of the Form D, these characteristics will be much harder, if not impossible, to develop.

Noncompliance also affects investors. The Form D may provide the only available source of public disclosure about the issuer or the offering.[21] Form D includes information about the size of the issuer, the industry group, the principle place of the business, sales commissions and finders fees, and the identities of directors and executive officers.[22] The failure to file the Form, therefore, can deprive investors of important information useful in making an informed decision on whether to participate in an offering under Rule 506.

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[16] The requirement applies to notices filed "with the Commission." Presumably, the requirement does not apply to filings with other agencies or self-regulatory organizations such as FINRA. *See* FINRA Rule 5123 (requiring members to file certain materials in connection with private placements).

[17] Securities Act Release No. 9416 (July 10, 2013) ("Currently, Form D is required to be filed only after the first sale of securities, which means that issuers that offered securities, but did not complete a sale, are not required to file a Form D, thereby limiting the Commission's ability to determine which issuers are facing challenges raising capital under Rule 506(c) and whether further steps by the Commission are needed to facilitate issuers' ability to raise capital under Rule 506(c)."). Similarly, the prohibition on the filing of general solicitation materials would likewise deprive the SEC on information about ongoing practices that could facilitate more effective regulation.

[18] The failure to file the Form can result in the loss of the exemption only if the issuer is subject to a court order. *See* Rule 507, 17 CFR 230.507.

[19] *See* Securities Act Release No. 9416 (July 10, 2013) ("We understand that some issuers are not making a Form D filing for Rule 506 offerings because the filing of Form D is not a condition of Rule 506."). The Division of Economic and Risk Analysis (DERA) did a study and found substantial noncompliance with the filing of the Form. DERA concluded that approximately 9% of the offerings disclosed in FINRA filings by brokers "did not have a corresponding Form D" while "as many as 11% of the private funds advised by registered investment advisers did not file a Form D when relying on the Regulation D exemption." *Id.* The statistics likely understate the degree of noncompliance. *See* Brown, *supra* note 13.

[20] Securities Act Release No. 9416 (July 10, 2013).

[21] Exchange Act Release No. 57280 (Feb. 6, 2008) ("Form D filings also have become a source of information for investors."). Most companies relying on Rule 506 are not public and, as a result, do not file periodic reports. *See* Securities Act Release No. 9416 (July 10, 2013) ("Reporting companies account for 2% of the total amount sold through Regulation D, on average, although this varies significantly by year.").

[22] A copy of the Form is here: https://www.sec.gov/about/forms/formd.pdf

Finally, the benefit of the proposed legislation to issuers is unclear. The filing of the Form D imposes no meaningful burden on issuers. The Form is executed online, is designed to be easy to fill out and file,[23] and provides information "quickly, reliably, and securely."[24] The cost savings arising from the elimination of multiple filings of the Form D are, therefore, likely to be negligible.

Fix Crowdfunding Act. The proposed legislation would amend the existing exemption for crowdfunding offerings by: (1) increasing the offering cap from $1 million to $5 million, (2) increasing the limits on the amount investors can annually invest in crowdfunding offerings, (3) reducing the standard of liability for funding portals, (4) defining circumstances that will constitute a "reasonable basis" for disqualifying issuers on a portal, (5) clarifying the obligations to reduce the risk of fraud, (6) reducing the risk of liability for funding portals, (7) reducing Commission discretion with respect to the applicability of Section 12(g)(6) to crowdfunding securities, (8) allowing single purpose funds, and (9) authorizing issuers to engage in "solicitations of interest."

The title of the legislation suggests the need to "fix" the existing crowdfunding exemption. The implementing rules, however, have not yet gone into effect.[25] As a result, the decision about what to "fix" is not influenced by actual practice. Legislation in this area should wait until empirical evidence more clearly demonstrates the areas, if any, that need legislative revision. This is particularly true with respect to the changes in liability for funding portals, the elimination of SEC rulemaking authority under Section 12(g)(6) of the Exchange Act (15 U.S.C. 78l(g)(6)), and the allowance of single purpose funds to engage in crowdfunding offerings.

Nonetheless, there are some provisions in the proposed legislation that raise immediate concerns. Foremost, the proposed addition of "the greater of" language has the potential, at least in some cases, to increase the investment limits currently in place in a manner that can impair retirement assets.

The most significant protection for investors in the crowdfunding exemption is the limit on the amount that can be invested over a 12 month period. The limit is expressed as a percentage (either 5% or 10%) of an investor's income or net worth.[26] Regulation Crowdfunding provides that, in calculating the percentage, the percentage should be based upon "the lesser of" the investor's income or net worth. As a result, an investor with $50,000 in income and $750,000 in retirement assets can invest 5% of the lesser of the two amounts. An investor could, therefore, invest 5% of $50,000 ($2500).

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[23] Fillable forms have been descried as "convenient," see Securities Act Release No. 9741 (March 25, 2015), and "easy to fill out . . ." Securities Act Release No. 9497 (Dec. 18, 2013) (noting that proposed fillable form under Regulation Crowdfunding "would capture key information about the issuer and its offering using an easy to fill out online form, similar to Form D").

[24] *See* Securities Act Release No. 8891 (Feb. 6, 2008) ("We believe these system features, among others, will help facilitate a relatively easy-to-use filing process that will deliver accurate information quickly, reliably, and securely.").

[25] The rules and forms were made effective on May 16, 2016. Exchange Act Release No. 76324 (Oct. 30, 2015).

[26] *See supra* note 3.

The proposed legislation would reverse this approach and allow the percentage to be calculated on the basis of "the greater of" the net worth or income.[27] The investor with $50,000 in income and $750,000 in retirement assets would, therefore, be able to invest up to $37,500 (5% of $750,000). In these circumstances, an investor with modest income seeking to invest the maximum amount would at least sometimes replace conservative retirement assets with securities in high risk crowdfunding ventures. This possibility would be of particular concern for elders, retirees, and others who have amassed significant retirement assets while maintaining modest income levels.

The provision in the proposed legislation that would permit a non-binding "solicitation of interest" also raises concerns. The authority has the potential to circumvent the prohibition on general solicitations under Section 4(a)(2) of the 1933 Act and Rule 506(b). The existing rules in Regulation Crowdfunding permit issuers to make a general solicitation by advertising a crowdfunding offering.[28] Issuers can do so through the use of a "tombstone" style notice.[29] The advertisement, however, applies to an actual offering and must direct investors to the online platform where the offering is taking place.[30]

The "solicitation of interest" would allow issuers to broadly advertise the sale of securities in the absence of an actual crowdfunding offering. Thus, expressions of interest would presumably be directed to the issuer rather than an online platform. An issuer deciding not to engage in a crowdfunding offering would be in a position to sell securities to these investors under other exemptions, including Section 4(a)(2) or Rule 506(b).

Supporting America's Innovators Act of 2016. The provision would provide that "venture capital funds" that were "beneficially owned by not more than five hundred persons" would be exempt from registration under the Investment Company Act of 1940 ("1940 Act"). The "venture capital fund" cannot, however, "purchase more than $10,000,000 in securities of any one issuer".[31]

Section 3(c)(1) exempts from registration under the 1940 Act certain investment companies with fewer than 100 beneficial owners.[32] The number represents a balance between the burdens placed on an issuer in complying with the 1940 Act against the benefits to investors

[27] The Commission considered both standards when adopting Regulation Crowdfunding. *See* Exchange Act Release No. 76324 (Oct. 30, 2015) ("some commenters supported a 'greater of' approach to implementing the two statutory investment limits, while others supported a 'lesser of' approach. After considering the comments received, we have decided to adopt a 'lesser of' approach.").
[28] Securities Act Release No. 9416 (July 10, 2013) ("the final rules do not impose limitations on how the issuer distributes the notices. For example, an issuer could place notices in newspapers or post notices on social media sites or the issuer's own website.").
[29] 17 CFR § 227.204.
[30] 17 CFR § 227.204(b).
[31] Qualifying venture capital fund is defined in the proposed legislation as "any venture capital fund (as defined pursuant to section 203(l)(1) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(l)(1)) that does not purchase more than $10,000,000 in securities of any one issuer".
[32] 15 U.S.C. § 80a-3(c)(1). In addition, the fund cannot be "making and does not presently propose to make a public offering of its securities".

from registration.[33] The proposed legislation would alter this balance by significantly increasing the threshold for one type of fund, qualified venture capital funds.

The increase to 500 raises concerns. Exempt funds were recently permitted to use general solicitations to sell securities in offerings under Rule 506(c).[34] Investors can qualify as accredited with a net worth of $1 million, something that can include farmland or retirement assets. Moreover, to the extent learning about an offering through a general solicitation, investors will likely have no preexisting relationship with the fund. Such investors will not necessarily understand the risks associated with an investment in a venture capital fund. As a result, they will likely need and benefit from the substantive protections that accompany registration under the 1940 Act.

[33] *See* Paradise & Alberts, 1975 WL 9516 (October 27, 1975) ("This policy reflects a determination that, on balance, the burden placed upon an issuer of complying with the Act together with the administrative burden on the Commission of regulating the issuer outweigh the benefits to the public to be derived from registration.").

[34] Securities Act Release No. 9415 (July 10, 2013)("As we stated in the Proposing Release and reaffirm here, the effect of Section 201(b) is to permit private funds to engage in general solicitation in compliance with new Rule 506(c) without losing either of the exclusions under the Investment Company Act.").

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April 13, 2016

The Honorable Scott Garrett
Chairman
Subcommittee on Capital Markets and
Government Sponsored Enterprises
United States House of Representatives
Washington, DC 20515

The Honorable Carolyn Maloney
Ranking Member
Subcommittee on Capital Markets and
Government Sponsored Enterprises
United States House of Representatives
Washington, DC 20515

Dear Chairman Garrett and Ranking Member Maloney:

On behalf of the Credit Union National Association (CUNA), thank you for holding this week's hearing on "The JOBS Act at Four: Examining Its Impact and Proposals to Further Enhance Capital Formation." CUNA represents America's credit unions and their more than 100 million members.

Today, there are over 28 million small businesses in America that create the majority of our nation's new jobs. Unfortunately, the current environment has made it increasingly difficult for America's small businesses to obtain credit. As you consider issues surrounding small businesses and job growth, we encourage your support for two pieces of legislation: H.R. 1188, the "Credit Union Small Business Job Creation Act," and H.R. 1422, the "Credit Union Residential Loan Parity Act."

Credit unions across the country want to be a greater resource to help consumers and our members stand ready to support small businesses with increased access to capital. In order to do so, Congress needs to remove the arbitrary barriers that severely restrict the ability of credit unions to provide loans to small businesses, namely the statutory lending limits and a disparity in the treatment of certain residential loans.

Under current law, credit unions are restricted from member business lending in excess of 12.25 percent of their total assets. H.R. 1188, the "Credit Union Small Business Job Creation Act," introduced by Representatives Royce (R-CA) and Meeks (D-NY), would permit credit unions to more fully meet the credit needs of America's Small Businesses by increasing the statutory credit union member business lending (MBL) cap to 27.5 percent.

The current cap severely restricts the ability of credit unions to provide loans to small businesses at a time when small businesses are finding it increasingly difficult to obtain credit from other types of financial institutions, especially larger banks. A Small Business Administration report showed that 80 percent of lending created by increasing the cap would be new lending. In other words, credit unions are offering small business loans that large banks simply will not provide.

In June 2015, the National Credit Union Administration (NCUA) issued a rule that will modernize the antiquated and cumbersome MBL rule. These welcome changes to the rule allow for the installment of modern commercial lending practices and streamline a credit union's ability to serve their members commercial credit needs. However, the rule does not lift the statutory cap that is currently in place; only Congress can accomplish that goal.

Chairman Scott Garrett
Ranking Member Carolyn Maloney
April 13, 2016
Page Two

Congress can also correct a disparity in the treatment of certain residential loans made by banks and credit unions. When a bank makes a loan to purchase a 1-4 unit non-owner occupied residential dwelling, the loan is classified as a residential real estate loan; however, if a credit union were to make the same, it would be classified as a business loan and therefore would be subject to the cap on member business lending under the Federal Credit Union Act.

H.R. 1422, the "Credit Union Residential Loan Parity Act," introduced by Representatives Royce (R-CA) and Huffman (D-CA), would amend the Federal Credit Union Act to provide an exclusion from the cap for these loans. While we disagree that any statutory business lending cap is appropriate for credit unions, surely if there is such a cap, it ought to be focused on business loans, not residential real estate loans. The exclusion provided by this bill would be consistent with the treatment of these loans proposed under the National Credit Union Administration's pending risk-based capital regulation. In addition, H.R. 1422 would authorize the National Credit Union Administration to apply strict underwriting and servicing requirements for the loans.

Enactment of this legislation would not only correct this disparity but it would also enable credit unions to provide additional credit to borrowers seeking to purchase residential units, including low-income rental units. If this important legislation were enacted, credit unions would be better able to meet the needs of their members and affordable rental housing would become available for more Americans.

Credit unions understand that in order for the economy to fully recover, small businesses need access to credit. Credit unions have capital to lend because of a history of prudent and safe small business lending, and a mission to help provide access to credit to their members, including their small business-owning members. To help small businesses thrive, Congress needs to pass H.R. 1188 and H.R. 1422.

On behalf of America's credit unions and their more than 100 million credit union members, thank you for your consideration.

Sincerely,

Jim Nussle

Jim Nussle
President & CEO