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JOBS ACT IMPLEMENTATION UPDATE

HEARING

BEFORE THE

SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT AND REGULATIONS

OF THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

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JOBS ACT IMPLEMENTATION UPDATE

THURSDAY, APRIL 11, 2013

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT AND REGULATIONS,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:00 a.m., in Room 2360, Rayburn House Office Building. Hon. David Schweikert [chairman of the subcommittee] presiding.

Present: Representatives Schweikert, Bentivolio, McHenry, Luetkemeyer, and Clarke.

Chairman SCHWEIKERT. Let us call this hearing to order.

Good morning. I have a wonderfully written opening statement but I was going to do something slightly different. Being someone who actually bathed and lived in the JOBS Act when it was individual bills moving through the system and the once we actually consolidated it and ran it up, think of this. In the previous years it really was in many ways our only really great bipartisan success. There was great optimism, great hope, on, April 12th, when the president signed it. Now we are this much time, a year beyond some of the rule sets, and yet I go around the country and I've spoken to different groups that are very optimistic and looking forward to an opportunity to use this new path of options to raise capital for small businesses. Our bottleneck right now is within the rule writing. I accept there are great difficulties. You have had leadership transitions.

So I am going to ask for my friends who are on the Committee, today's goal is not to beat up the SEC. It is to have a dialogue on what do you need? What are our expectations both in drafting and time that you are able to share with us? Are there any things we should be doing as members of Congress? Do you need us to provide a piece of legislation that provides more detail? Do you need us to stay out of your way for a while? What gets it done? In many ways the goal here is actually to have the positive that will come, I believe, once the rule sets are done and the crowdfundings, the Reg A's, the others are able to start to stimulate a tier of our economy and our small business access to capital. And with that I hand over to the ranking member for an opening statement.

Ms. CLARKE. Thank you, Mr. Chairman. I am going to stick to the script.

I would like to welcome everyone to this morning's hearing. For the past two years our nation's economy has experienced positive private sector job growth. However, these gains have not been

enough to overcome our nation's above average unemployment which currently stands at 7.6 percent. Minority unemployment for African-Americans and Latinos, while retreating, remains at a 13.3 and 9.2 percent, respectively.

These facts, along with last week's job numbers illustrate the work we have yet to complete. Creating nearly two-thirds of all new jobs, our small businesses must remain front and center to our recovery. For our national economy to experience a more robust recovery, our entrepreneurs and small businesses must play their traditional job-creating role, and for that we must have access to capital.

For entrepreneurs who have a solid business plan yet lack immediately marketable products, equity capital has been a crucial aspect of getting their businesses off the ground. Many are turning to crowdfunding to finance their businesses, however, the number of small businesses that can access capital is severely limited due to the prohibitions on equity investing via crowdfunding.

In response, Congress has passed the Jumpstart our Business Startups or JOBS Act in 2012, which provided a new exemption from SEC requirements to register public offerings for equity investing via crowdfunding. This exemption has the potential to unlock the virtually untapped resources of millions of ordinary investors to small businesses; however, as evidenced by the rigorous congressional debates before passage of the act, a balanced approach to investor protection must be in place before allowing the general public in this inherently more risky realm of small business investing. Pursuant to the JOBS Act, the SEC was mandated to create rules to do just that. However, the SEC has yet to complete the rulemaking process; thus, preventing full implementation of the JOBS Act, missing several congressionally mandated deadlines.

In today's hearing, we will discuss the SEC's delays in implementing the JOBS Act and the needs of our small business community. While no one is happy waiting for these rules to be drafted, we must remember that it is vitally important that the SEC strike the appropriate balance between investor protection and producing a functional system that provides the capital for small businesses and entrepreneurs to create jobs.

I want to thank you again, Mr. Chairman, for holding this important hearing, and I yield back the balance of my time.

Chairman SCHWEIKERT. Thank you, Ranking Member Clarke. Maybe I should have stuck with the script.

Our first two witnesses representing the SEC, Mr. Nallengara and Mr. Ramsay. You are both probably very familiar with the lighting system. My understanding is you are going to be sharing your five minutes on the opening statement. When you hit yellow, just talk faster.

Mr. Nallengara, please.

STATEMENTS OF LONA NALLENGARA, ACTING DIRECTOR, DIVISION OF CORPORATION FINANCE, UNITED STATES SECURITIES AND EXCHANGE COMMISSION; JOHN RAMSAY, ACTING DIRECTOR, DIVISION OF TRADING AND MARKETS, UNITED STATES SECURITIES AND EXCHANGE COMMISSION

STATEMENT OF LONA NALLENGARA

Mr. NALLENGARA. Thank you. Good morning, Chairman Schweikert, Ranking Member Clarke, and Members of the Subcommittee. My name is Lona Nallengara. I am the Acting Director of the Division of Corporation Finance of the Securities and Exchange Commission. Joining me today is John Ramsay. John is the Acting Director of the Commission's Division of Trading and Markets.

Thank you for the opportunity to testify on behalf of the Commission. Implementing the JOBS Act is one of the Commission's top priorities. As you know, the JOBS Act made significant changes to the federal securities laws. While certain provisions of the JOBS Act were effective immediately, others required Commission rulemaking. In addition, the JOBS Act required the Commission to conduct several studies and send reports to Congress.

Since enactment, the Commission staff has taken steps to inform the industry of how the JOBS Act operates. For instance, the staff provided guidance about the IPO on-ramp provisions by publishing answers to frequently asked questions. These questions address such things as how emerging growth companies could use these new provisions, including those related to research reports, test the waters materials, and scaled disclosures. The staff also provided guidance on the amendments to the registration requirements of 12(g) of the Exchange Act.

With respect to rulemaking, the JOBS Act required the Commission to adopt rules that revised Rule 506 of Regulation D to allow general solicitation and advertising for offers and sales of securities under that rule and to implement a new crowdfunding exemption and a new exemption from broker-dealer registration for funding portals that facilitate crowdfunding transactions. And finally, to create a new exemption for offerings of up to $50 million.

To fulfill this responsibility, we have formed rule-writing teams consisting of staff from across the Commission, including economists from our Division of Risk, Strategy and Financial Innovation, who are considering the potential economic impact of the rules we are considering.

To aid the rulemaking process and increase the opportunity for public comment, we have allowed interested parties to submit comments and recommendations on the JOBS Act provisions through the Commission's website even before we have proposed rules. The Commissioners and staff have participated in numerous meetings with a wide array of interested parties. The input the Commission and the staff have received in these written submissions and these meetings has been very helpful to the rule-writing teams as we consider the implementation of these mandates.

As you may know, there has been significant interest in the provisions requiring the Commission to revise Rule 506 to allow for general solicitation and advertising. Under the rule proposal the

Commission issued last August, companies issuing securities in an offering conducted under Rule 506 would be permitted to advertise and solicit potential purchasers provided that the company takes reasonable steps to verify that the purchasers of those securities are accredited investors.

The proposing release explains that issuers should consider the facts and circumstances of the transaction when determining the reasonableness of the steps to take to verify that a purchaser is, in fact, an accredited investor. Prior to and after issuing this proposal, the Commission received significant public comment, and the staff is now developing recommendations for the Commission's consideration as to how to move forward on the implementation of this mandate.

The JOBS Act also required the Commission to submit several reports to Congress. First, it required a report on how decimalization has impacted the number of initial public offerings. That report, which was submitted to Congress in July, recommended that the Commission conduct a roundtable to discuss the impact of decimalization. That roundtable took place in February. Second, the JOBS Act required a report on how our disclosure requirements could be modernized and simplified to reduce the costs and burdens for emerging growth companies. The staff is in the process of completing that report. And finally, it required a report examining the Commission's authority to enforce the anti-evasion provisions of Rule 12g5–1 of the Exchange Act. That report was submitted to Congress in October.

In addition, the JOBS Act mandated the Commission to provide information and conduct outreach to small- and medium-size businesses and businesses owned by women, veterans, and minorities about the changes made in the JOBS Act. The staff is working to develop and implement an outreach plan tailored specifically to these business communities. The Commission and staff continue to work diligently to implement the JOBS Act mandates, and we look forward to completing the remaining provisions as soon as possible.

Thank you for inviting us to appear today, and we would be happy to answer any of your questions.

Chairman SCHWEIKERT. Thank you. I will start with the first five minutes and have a couple questions.

Mr. Ramsay, one of the big questions that I get around me, what should our expectations be on rule sets coming out and what do you think will be the first ones we see?

Mr. RAMSAY. Thank you, Chairman Schweikert. And again, we appreciate the constructive tone that you have set for the hearing.

It is very difficult for staff to create any specific expectations in terms of timing, and so I will not attempt to do that here. We understand there is a lot of interest. We understand that there is a fair amount of frustration with the pace at which the rulemaking process has taken. I will say that, from the people that I talk to within the Commission, there is a shared sense of interest in moving this forward. Our new chairman, Chairman White, indicated in her recent testimony that she saw this as a high priority, and so I will resist the urge to make any specific predictions in terms of timing, but certainly stress that this is a very high priority for us.

Chairman SCHWEIKERT. Is my being unrealistic that by October, by fall? Part of this is I feel like many of us have gone out around the country talking about the crowdfunding and, a year later I feel like I am breaking people's hearts by getting them excited and enthused and trying to line up capital. Any window of the time of year?

Mr. NALLENGARA. Chairman, those are questions that we hear as well from some of the same parties interested in taking advantage of these new rules. And these are important rules. These are important rules because you gave us a mandate, but also important rules because of what is underlying that mandate. What is underlying it is providing new ways for businesses, but really focused on small businesses, to raise capital and grow their companies, create jobs, and strengthen the economy.

But what is also important about these rules is these rules are in many respects fundamental changes to the way private offerings have been conducted, and the rules—some were very specific but some also provide discretion for the Commission.

Chairman SCHWEIKERT. Mr. Nallengara, in that case, what do you think will be the first to come out understanding the actual date is unknowable at this point?

Mr. NALLENGARA. Chairman, it would be hard for me to tell you which would be the first to come out. Chairman White has indicated that all congressional mandates are her priority and specifically, the JOBS Act provisions are her priority. And the three main rulemakings that we have are the Title II General Solicitation, the Title III Crowdfunding, and the Title IV Reg A+ Rulemaking. Those are all a priority. We have issued a proposal already with respect to the General Solicitation provisions, so that has already been proposed, and we have received comment on that. The sequence of those rulemakings—that will be for the Chairman and the other Commissioners to determine. But the staff is working—we have independent rule-writing teams on each one of those and the staff for each one of those rulemakings is working as if their rulemaking is the first one to go. So the staff is working very hard to get these in place to get recommendations.

Chairman SCHWEIKERT. Mr. Nallengara, is there any way I could organize like an X prize; the first one to get it done wins something?

Mr. NALLENGARA. What would be the prize, Chairman?

Chairman SCHWEIKERT. Exactly.

Mr. NALLENGARA. Exactly.

Chairman SCHWEIKERT. Last one and then I will turn to the ranking member. I would love some guidance because many of us are starting to work on what should be the next act in the, JOBS Act 2.0. Is there something we, as members of Congress can do in the way we write it, in the way we ask for rule sets, to make it run smoother? Do we need to provide more direction? Do we need to provide substantially more detail? What would make this process that our bottlenecks and the timing become compressed? What do we do to do this better?

Mr. NALLENGARA. Chairman, the mandates you give us, we look at them as you give us—as you give them to us, and we do our best to implement the mandates you give us and the intent un-

derlying those mandates. So some of the mandates you give us, and even within an individual title within the JOBS Act, have specific requirements and some give us discretion. We look at all of those questions that you provide us in the rules and implement them in a way that, both the ones that are specific and both the ones that give us discretion in a way that allows us to further the purpose of legislation.

Chairman SCHWEIKERT. This is more than just an academic discussion. It really is affecting people's lives. The next generation of entrepreneurs, folks out there whose businesses, as we will hear on the second panel, who are trying to get to that next level where they can hire people and grow and help both as a nation and their own futures. I hope you feel the same sort of weight on your shoulders as we do on this side that yes, getting it right is important, but getting it done is crucial.

Mr. NALLENGARA. Absolutely, Chairman. The staff feels that way and the direction from the Chairman and the Commissioners is to get these rules done. And that is what we are committed to do.

Chairman SCHWEIKERT. All right. We may end up with a second round if we go fast enough.

Ranking Member Clarke.

Ms. CLARKE. Thank you very much, Mr. Chairman.

I want to do a follow-up to the chairman's question, Mr. Nallengara and Mr. Ramsay. Can you give us an idea of the work volume you are dealing with in concurrently developing the rules for the JOBS Act while still engaged and fully implementing Dodd-Frank?

Mr. NALLENGARA. Ranking Member, the Commission is facing an unprecedented workload when you factor all of the congressionally mandated rulemakings. There are over 90 Dodd-Frank provisions that have rule-writing requirements and over 20 studies. Although we have completed 80 percent of those and 17 of those studies, there is still plenty to do. And some of the rulemakings that are left to do, particularly the ones in John's division, are related to systemic risk. And then when you add the JOBS Act rulemakings, the three main rulemakings but there are ancillary rulemakings and studies and reports to do, that is an unprecedented level of work. And the ones related to the JOBS Act, as I mentioned earlier, those are fundamental changes to the way the capital markets—the private offering markets—will work. Those are mandates you have given us, but for us to implement them and implement them in a way that achieves the goals that you mentioned in your statement, which are to provide an efficient and effective way for small business to raise capital but at the same time ensure that investors feel safe and feel like they are getting a secure investment and they are investing in a real business that provides opportunity for return and growth to them, that requires us to make sure that we are getting the rules done right.

That being said, we need to get them done. We appreciate that you gave us deadlines and those deadlines have passed, but we are focused on getting those rules done.

Mr. RAMSAY. If I may, yes, Ranking Member Clarke, I think just from the standpoint of my division, Title VII of Dodd-Frank

and all the derivatives reforms, which require us essentially to adopt a whole new regulatory regime that did not exist before over a huge international market, is an effort that is consuming and has consumed huge amounts of resources and continues to over a period of time. And this is all mandated rulemaking as well. So we would ask people to understand that we do not expect much sympathy for it, and we are not really asking for any sympathy for it. As Lona said, regardless of what else is on our plate, we know this particular set of rules, as Chairman Schweikert said, is something that is affecting people's lives and ability to raise capital currently; it ought to be prioritized accordingly and we take that to heart.

Ms. CLARKE. Yeah. I just thought, excuse me, it was important to sort of put things in context. This is not happening in isolation of many other responsibilities and obligations of rulemakings that you are currently engaged in, so I think it was just sort of important for us to get a sense of the universe that you are working within. And, you know, I think one of the things that would be helpful for all of us, and maybe even for yourselves, is, you know, for you to sort of set a timeframe for yourselves. Maybe it is an internal timeframe but one that sort of drives this process to a timely conclusion given the fact that things have already passed deadlines. It is going to be important that there is some motivating factor to really get this done.

Mr. Nallengara, some experts are concerned that a conflict of interest could arise between funding portals and the companies seeking funding, specifically financial interests of the funding portals could lead to more lucrative, yet risky deals receiving preferential treatment when presented to potential investors. How does the SEC plan to address this concern in the final crowdfunding regulations?

Mr. NALLENGARA. Ranking Member, I will start with the answer and then I will turn it to John whose division has primary responsibility for the funding portals. But the legislation you provided us in the JOBS Act lays out a regulatory regime for funding portals. It provides oversight by FINRA and the rules that FINRA will adopt will be able to monitor and watch those activities. Funding portals are intended to be a portal between the investor and the companies seeking money. They are intended to present the picture and the idea of that entrepreneur, of that business, and let the entrepreneur tell the story. But also serve as a gatekeeper, serve as someone ensuring that both the company knows what they are doing but also that investors understand what they are investing in—understand the risks associated with the investment and also understand the security they are investing in.

Mr. RAMSAY. Yes, Congresswoman, an awful lot of the time that we have been spending in our division has been devoted to meeting with representatives of various funding portals or of that part of the community that are interested in investing in the space. As Lona said, many of the JOBS Act provisions are intended to ensure that intermediaries for crowdfunding offerings operate in a way that protects investors' funds, that takes account of the privacy interests of investors, that makes sure that investors get the right kind of disclosures that they need, where there is a contingency on the amount, minimum amount of offering that is a sub-

scription that is required, that that all takes place. These are all critically important provisions and I would just say that our sense is there is a lot of very capable, smart, creative people in this space who want to do the right thing and who have an interest, as we do, in making sure that the rules are written in a way that excludes the bad actors as much as possible because I think they would agree with us is my sense that nothing would undermine the ability to use this as a capital-raising tool faster than if the rules were written in such a way that they do not exclude the bad actors as much as possible. So that is part of the reason we want to be very careful about how they are written.

Ms. CLARKE. Very well. Thank you both. Mr. Chairman, I yield back.

Chairman SCHWEIKERT. Thank you, Ranking Member Clarke.

And I would like to extend a welcome to Patrick McHenry, who is the chairman of the Financial Services Oversight Committee and I appreciate you spending a moment or two with us.

Mr. Luetkemeyer, you are next.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

I had a number of questions from some of my constituents with regards to the delay on issuing the Rule 506 Reg D situation. Can you explain what happened there? That should have been done last summer and here it is almost nine months later and we are still not anywhere near it. What is going on.

Mr. NALLENGARA. You are correct, Congressman. You provided us a deadline, which was 90 days after enactment, and we did not meet that deadline. We did issue a proposal in August. That proposal, as I outlined in my opening remarks, provided a framework for the implementation of the rule. We received significant comments before and after the proposal, and the Commission is considering those comments right now. We have had some transition in our Chairman's office, but our Chairman, Chairman White, has indicated that the JOBS Act rulemakings, and in particular the one related to 506, are a priority to be moved forward.

Mr. LUETKEMEYER. Why would the transition of a new chairman change the ability of you to be able to do your job? How many people do you have working on this project? Let me start there.

Mr. NALLENGARA. We have a number of people in my division who are principal rule writers. We have economists in our Division of Risk, Strategy and Financial Innovation.

Mr. LUETKEMEYER. Do you have a particular group that works on just this rule or they work on all sorts of other rules as a whole?

Mr. NALLENGARA. On this particular rule we have a group of attorneys in our chief counsel's office.

Mr. LUETKEMEYER. Is this their full-time job that they work on just this one rule?

Mr. NALLENGARA. It is not their full-time job to work on just this rule.

Mr. LUETKEMEYER. How much time do they spend on this then?

Mr. NALLENGARA. They spend as much time as is necessary.

Mr. LUETKEMEYER. Well, they are not spending very much if it is nine months later and we still have not got a rule; are they?

My concern is that it does not seem to have the attention of the SEC. And this is a real big deal because, you know, we as a Congress have not agreed on a heck of a lot over the last two or three or four years here. And we actually finally got to agree on something. This is a way to help small business. And we are very concerned about the lack of action here because we have small business groups out there that would love to be able to put together offerings, expand their businesses, buy new businesses. Entrepreneurs are sitting on the sidelines.

I can tell you from the past two weeks of going around and talking to a lot of my constituents, they are sitting on the sidelines waiting to get into some of these businesses but cannot because the rules are not there. And I know you proposed it a long time but yet it was pulled. The chairman, I guess, killed the rule, so what is the problem with it? Why did you kill the rule once it was proposed?

Mr. NALLENGARA. Congressman, I do not think anyone killed the rule. I think what you are referring to——

Mr. LUETKEMEYER. It was proposed and then it was withdrawn; okay?

Mr. NALLENGARA. I think what you are referring to is at one point the Commission was considering moving forward on the rule with an adopted rule immediately, rather than proposing the rule for public comment and considering that comment. And just to frame how our rule-writing process works, almost all of our rules, virtually all of our rules are proposed and adopted in a manner where——

Mr. LUETKEMEYER. You withdrew your proposal; correct?

Mr. NALLENGARA. No. No, we did not withdraw our proposal. The Commission considered it in August, considered a proposed rule.

Mr. LUETKEMEYER. The Commission withdrew it?

Mr. NALLENGARA. No, the Commission did not withdraw it.

Mr. LUETKEMEYER. We do not have one. How come it has not gone forward. Put it that way.

Mr. NALLENGARA. Congressman, we do have a rule proposal. Almost all of our rules are proposed and provide a comment period for the public. The public gets to look at the rules and comment on it, give us their ideas.

Mr. LUETKEMEYER. When do you think you are going to get this one finalized?

Mr. NALLENGARA. Our new Chairman has indicated——

Mr. LUETKEMEYER. Is he going to give you 90 more days? Is it a priority?

Mr. NALLENGARA. She has indicated it is a priority. So if she has indicated it is a priority, it is a priority for us.

Mr. LUETKEMEYER. So what is a priority? Is it 90 days or 9 months?

Mr. NALLENGARA. I cannot say.

Mr. LUETKEMEYER. We are at a year on this now. I mean, it does not seem to be a priority of the SEC. This is a big deal. This is how we are going to get our economy going. I do not think you see the importance of your job. You help create economic activity in this country, sir. Your agency does. And I do not think—and now

you are standing in the way of it, and I think that is a big problem. And if you hear frustration in my voice it is there because I am only venting to you what is being vented to me. And I think that we have to find a way to get things back on track.

I see my time is up and I appreciate you being here this morning. Thank you.

Mr. NALLENGARA. Thank you.

Chairman SCHWEIKERT. Thank you, Mr. Luetkemeyer.

Mr. Bentivolio.

Mr. BENTIVOLIO. Chairman, Ranking Member, thank you for holding this very important hearing.

Our country has a jobs crisis, and in my district it breaks my heart to drive through industrial parks and office parks and see "For Sale," "For Lease," or "Available" signs rather than "Help Wanted Signs." Last year both parties recognized that the creativity and ingenuity of our citizens could be unleashed if they had greater access to capital. They recognized the power of start-up businesses to create opportunity and jobs, and the result was the JOBS Act. The SEC has the important job of creating rules and regulations that walk a fine line between creating access to capital and protecting investors. I have a few short questions. Thank you very much for being here.

Companies that are required to file reports with the SEC are given deadlines; correct?

Mr. NALLENGARA. Yes.

Mr. BENTIVOLIO. Are there consequences for missing those deadlines?

Mr. NALLENGARA. Yes.

Mr. BENTIVOLIO. So would it be correct to say that the SEC understands the concept of deadlines?

Mr. NALLENGARA. Yes, Congressman.

Mr. BENTIVOLIO. Well, I am not sure I agree. The JOBS Act became law over a year ago and you have missed two important deadlines. One was more than nine months ago. Does the SEC believe they can miss deadlines stated in law because they are too busy?

Mr. NALLENGARA. Congressman, all the deadlines that you provide us in the legislation that you mandate are important deadlines. We work as hard as we can to meet those deadlines.

Mr. BENTIVOLIO. Does the SEC believe they can miss deadlines because of changes in leadership; yes or no?

Mr. NALLENGARA. No. I am not sure the question you can answer with a yes or no, but the closest I can get is to no. How about that?

Mr. BENTIVOLIO. Great. The SEC expects reporting companies as the regulator to respect their deadlines. Congress is your regulator. Is it fair for us to expect you to respect our deadlines?

Mr. NALLENGARA. We do, Congressman.

Mr. BENTIVOLIO. Well, it is debatable. And I think it is reasonable for Congress to be more than a little upset about a federal agency's failure to meet the deadlines set forth in the laws we create, especially when it has a big impact on our economy and job creation.

I have a question about the modification of Reg A, which increases the limit to $50 million from $5 million. There was no deadline in the act about this change, which is probably good for you or it would have been strike three. Are you in this process and when should we expect the rules to be finished? Can I have a date?

Mr. NALLENGARA. Congressman, I cannot provide a date. I am not the one who is setting the dates. I can say that Chairman White has indicated that getting rules proposed and completed on Regulation A+ is a priority for her, so it is a priority for us.

Mr. BENTIVOLIO. No date? No real deadline? Just when you get around to it? That is the impression I am getting. I am getting a lot of verbal moonwalking but I am not getting anywhere.

Mr. NALLENGARA. Congressman, I cannot provide you dates but I can provide you that we are committed to get the rules done as quickly as we can.

Mr. BENTIVOLIO. Mr. Ramsay, regarding crowdfunding, what are you doing to ensure the cost of compliance is not too high, especially when many investors may only want to invest $20 or $50?

Mr. RAMSAY. Well, Congressman, in terms of the requirements on intermediaries I will defer to Lona on the rest of it, but I think that we have been, as I said earlier, talking to—have had dozens of meetings with people who are in this community currently to understand what practices they follow now, what best practices are in their area, what kinds of requirements might pose a significant cost burden issue for them. That certainly is an issue that we have been looking at closely in terms of looking at the comment letters that have already come in. So on issues like how do intermediaries—what do they have to do in order to protect privacy interests; what kind of arrangements can they have for holding customer funds; what obligations do they have in terms of providing issue disclosure and how can that be provided? A significant part of our focus has been on trying to make sure that that is done in as cost-effective a way as possible.

Mr. BENTIVOLIO. Thank you very much.

Mr. Chairman, I yield back my time.

Chairman SCHWEIKERT. Thank you, Congressman.

Mr. McHenry.

Mr. MCHENRY. Mr. Chairman, thank you for allowing me to step in and visit your Subcommittee. Thank you for your leadership on financial services issues and your interest here, especially your offering within the JOBS Act the piece dealing with Reg A in particular.

Chairman SCHWEIKERT. You had something to do with this I think somewhere.

Mr. MCHENRY. Well, crowdfunding is my deep and abiding interest within the JOBS Act. Reg D rules as well. That is certainly something we care about. The crowdfunding piece. Certainly, you will have heard from me and from my staff.

Mr. Ramsay, Mr. Nallengara, thank you for your service to our government. I certainly appreciate it. I am certainly aware, as members of Congress are, that you are the lead staff in terms of your divisions within the SEC. However, the SEC, with the five Senate-confirmed members of that board, set the agenda. In particularly the chairman sets the agenda for your agency, your very

important agency, that is supposed to facilitate capital formation and protect investors. Of course, that is a balancing act, and I certainly do appreciate your willingness to testify today.

But Mr. Nallengara, in terms of my colleague, Mr. Luetkemeyer's questions, I do want to give you an opportunity, and there was some hesitation with his questions, but just to correct the record and make sure that this is accurate. According to my understanding, the staff recommendation to the board last summer when it dealt with Reg D rulemaking, the staff recommendation was to offer a final rule during the August SEC Commissioner's meeting. Is that true?

Mr. NALLENGARA. That was our initial recommendation. Yes, Congressman.

Mr. MCHENRY. And there was a decision made to pull back and open back up for comments on that what then became a proposed rule. Is that correct?

Mr. NALLENGARA. Yes.

Mr. MCHENRY. Okay. I just want to make sure that is correct because in terms of these questions, the staff recommendation was for a final rule. The comments have been heard. Based on the e-mail traffic that I have now received, these are documents that have been provided to Congress. That was clearly the case and the then chair, Chairman Shapiro, had an enormous pullback and a huge change of approach based on being contacted by the consumer federation lobbyists. I wrote a letter to Mary Shapiro to that regard at the end of last year, and I am certain that you all are aware of that. So, I just want to make sure that record is corrected.

Mr. Ramsay, in terms of intermediaries when it comes to crowdfunding, broker-dealers are allowed to participate and there are pure intermediaries that are allowed as well under the law. I just want to confirm that the intention is to time the rulemaking for both those entities is the same. The date will be the same for both those different types.

Mr. RAMSAY. Yes, Congressman. I believe that is the intent. The registered broker-dealers, since they are already registered as broker-dealers would not need any further authorization. Firms who would be operating as funding portals would need to register with the Commission and with FINRA. We have been working closely with FINRA to make sure that their program will be in place so, as you say, firms will be in a position to choose which of those paths they want to go down.

Mr. MCHENRY. So there is a cap on the amount—and back to you, Mr. Nallengara—in terms of the rulemaking, SEC has to write rules when it deals with capping individual investors, the amount that they can invest in a crowdfunding offering; right?

Mr. NALLENGARA. Yes.

Mr. MCHENRY. And so looking at the cost of crowdfunding offerings, this is a tricky issue based on what the final senate language came back with, with a cap of $2,000 or 5 percent of a person's income. It is segmented out. Is the SEC looking at having a very simple way of tracking individuals' crowdfunding investments?

Mr. NALLENGARA. Congressman, that is a question that we have received from many of the crowdfunding or the future crowdfunding participants asking how are they going to be able to

track investments because that cap is intended to be across any crowdfunding investment you made. There are a number of ways to proceed. One of the ways that proponents have recommended to us is self-certification. You tell the issuer, you tell the crowdfunding portal how much you may have invested. That is something we are certainly considering and certainly that is what the Commission will consider as well.

Mr. NALLENGARA. So that is on the table as one of the ways to implement that provision.

Mr. MCHENRY. Are there other ideas on the table?

Mr. NALLENGARA. Well, I mean, as part of our rulemaking, when there are choices we need to consider all the choices. We need to look at those choices and look at the costs and look at the benefits of every choice. And I know you all want us to do that. So we will do that.

Mr. MCHENRY. Yes. I, in particular, want you weigh both the costs and the benefits. Yes. I have been a major proponent of that. But thank you for acknowledging it.

Mr. Ramsay, I am sorry.

Mr. RAMSAY. No. So Congressman, with respect to costs on funding portals, certainly, on questions of how do you—how does one ascertain whether the investors are within the limits or not, it certainly has been an important focus of our discussions with them and the rule-writing efforts to think of those costs. We are certainly cognizant of the concern that, if there were a significant new structure that would be required to be put in place, that they would have to fund it in order to do that, that that could create some significant costs that would deter them from participating.

Mr. MCHENRY. Thank you. Thank you both for your service, and thank you for testifying. We have the acting chair testifying next week to the Oversight Subcommittee on Financial Services, Elise Walter, so we will follow up on some of these questions there. I know that your staff sitting behind you will pass that along I am sure.

Chairman Schweikert, thank you so much for your graciousness in allowing me to sit in, and thank you for your leadership.

Chairman SCHWEIKERT. Chairman McHenry, is this the nicety language? I am still working on that southern thing.

Mr. MCHENRY. The bowtie is southern enough; right?

Chairman SCHWEIKERT. Patrick, thank you for giving us some of your time. It is appreciated.

We are now heading towards the lightning round. My understanding is it was last year court ruled that they were not particularly happy with how the SEC was doing its cost benefit analysis; is that correct?

Mr. NALLENGARA. I think, Chairman, you are referring to the proxy access decision.

Chairman SCHWEIKERT. Yeah, actually, it is on top of my desk and I wish I had grabbed it. I know it was D.C. Circuit, which would be everything.

Mr. NALLENGARA. Right. I think from that decision our Commission, led by our economists in our Division of Risk, Strategy and Financial Innovation and our General Counsel's office, put out

new guidance on how we are supposed to conduct our economic analysis.

Chairman SCHWEIKERT. Where I am heading is what has that done to the timeline internally within the process?

Mr. NALLENGARA. I think the role of economic analysis in our rulemaking has always been there. What we have done with the new guidance is we have put a framework around it, and we have provided it to everyone. It is on our website. The questions we ask and the considerations we make with respect to costs and benefits, with respect to identifying the baseline, with respect to identifying the regulatory fix or the market failure that your mandates are trying to achieve, all of those questions were questions we asked in our rulemaking before. What we have now done is formalize them in the form of that guidance.

Chairman SCHWEIKERT. And that puts you in compliance with what you believe the D.C. Circuit requested?

Mr. NALLENGARA. We think the guidance that the Commission has provided related to our economic analysis keeps us in compliance with what the APA requires for our rulemaking.

Chairman SCHWEIKERT. This is going to be probably closer to a statement than a question. One of the reasons parts of the JOBS Act that I believe are really important, whether it be within the crowdfunding, some of the broker-dealer solicitation mechanics, is when I look at small business, it is not only the business side of the ledger but there are also small investors. We have this habit of, in particular even the design of our Committee, we fixate on business as we should. But if I do not have a million dollars—actually on one of the definitions, you know, when we start saying, okay, you get to be a qualified investor, qualified to assess the risk and could bear such risk. If I am the young electrical engineer, I may not have accumulated my million dollars to be a qualified investor, but I am an expert in that. So if I am going to invest in a business that is doing that, it is my fear you are bifurcating the society. You are polarizing parts of the society. Here is the folks that are there, they get to be qualified, they get to know what is out there, they get to invest. Because you have not met a threshold that is defined by wealth, you do not get to participate. One of my great hopes that things like crowdfunding actually created a much more egalitarian access to participate in ultimately the American dream. So this is more than just the access to capital for businesses. This is the access to financial security and growth for a huge portion of our nation's population.

Ranking Member.

Ms. CLARKE. Thank you, Mr. Chairman.

Along those lines, Mr. Ramsay, sophisticated investors typically have protections in place and distribute their funding over time to protect their financial interests. Due to the nature of crowdfunding, investors are less likely to be sophisticated and lack the ability to negotiate similar protections. What steps has the SEC taken to address the shortcoming of the crowdfunding model as regulations are being drafted?

Mr. RAMSAY. I appreciate the question, Congresswoman.

I think there are a number of measures that are in the legislation which will be important parts of the rules that we provide in

this area to make sure, number one, that investors are given very clear risk disclosures; that intermediaries take steps in order to make sure that they fully understand all of the risks that are provided; that they receive appropriate disclosure from the issuers that allow them to evaluate the investment in a reasonable way. It's particularly important that the customers' funds and securities are adequately protected. In this regard, the legislation was clear that broker-dealers who are fully registered are able to handle customer funds and securities. Funding portals would not by themselves. They need to have a separate bank escrow agent to hold those funds. We think that is an important protection as well. Certainly, making sure that customers' personally identifiable information is protected and that their privacy interests are protected as well. All of these are respects in which we are trying to make very sure, as I said before, that this is a capital-raising tool that investors will want to use because we are very concerned that, if there is, particularly at the outset, bad experience in a few significant cases, that that could deter people from using this mechanism, and that is something that would not be in accord with what the congressional intent is.

Ms. CLARKE. Mr. Nallengara, clearly much of the debate over crowdfunding regulation comes down to investor protection versus access to capital for small business, again, along the lines of the chairman's rationale. Has the SEC investigated current platforms, like Kickstarter for predictors of fraud to incorporate into the equity-based crowdfunding rules?

Mr. NALLENGARA. Ranking Member, we have had the opportunity to meet with a number of non-securities-based crowdfunding proponents. There are a number. Kickstarter is one, but we have met with a wide variety of them. And what we found, what we learned is that the evidence of fraud or the existence of fraud on those platforms is very low. The ability for people participating in the offerings, the crowd, their ability to comment on a potential campaign, as they call them is a remarkably powerful way to determine whether this idea is something that is viable. And that will be a part of the rules that the Commission proposes. An ability for the crowd and to provide the wisdom of the crowd, as crowdfunders like to refer to it, to provide their idea on whether this is a good business, whether it is viable, whether it has a real opportunity for success. And that vetting by the crowd has been very powerful in the non-securities-based crowdfunding. And the crowdfunding proponents are hoping that will be the diligence tool for investors. So you will have people who are smart in that area be able to look at what this business venture is offering and be able to ask questions and be able to give their views on whether that is a viable opportunity.

Ms. CLARKE. Mr. Chairman, I have one final question.

The JOBS Act explicitly mandates an effort by the SEC to reach out to the minority veteran-owned small businesses. Can you give us an update on this ongoing process?

Mr. NALLENGARA. Yes, Ranking Member. Our Office of Minority and Women Inclusion, as well as my division, and in particular, our Small Business office, are focused on implementing that mandate. So there are a number of ways we hope to do that. Our

OMWI office has a number of ways which, through Commission activities, we reach out to those communities. We are going to piggy back on those same outreach efforts and use those as opportunities to explain what the JOBS Act will bring. Much of this effort will come when we get the rules in place so there is something to talk about that is more tangible, but we are beginning that process. And we have a number of ways through our Small Business office where we provide information and discuss what the JOBS Act has done. And as the rules come online we will be able to be more meaningful in that regard.

Ms. CLARKE. Thank you very much, Mr. Chairman. I yield back.

Chairman SCHWEIKERT. Thank you, Ranking Member.

You touched on one thing there. I will encourage you in more simple language. I love the idea of there are crowdfunding platforms; that there is also associated, absolutely open discussion, whether you refer to it as blogs, where if I am an expert in that area, if I am not, if I am just, passing by, but that access to information, it is sort of the new world of ratings. I mean, how many of us these days before we buy a product go on and look at customer reviews. It is sort of the new era of egalitarian access to reviews and information.

Gentlemen, thank you for your time. I appreciate it. As you start to get windows on timelines, I know a number of members on the panel would be just elated to hear it.

And with that we will seat our second panel. Thank you.

I am going to do each introduction. So I will introduce Ms. Peters, have her give her testimony, and we will actually work our way down the line.

So shall we now call the second panel up? I do not know if you heard it before. The lighting system is a five-minute clock, as is sort of the humor around here. When you see yellow, just talk faster.

I would like to introduce the second panel of witnesses here with us today.

First up we will have Jean Peters, managing director of Golden Seeds, Angel Capital Network. Jean Peters is an angel investor based out of Richmond, Virginia. Through Golden Seeds Angel Network, Ms. Peters invests her own money and time to support women-owned entrepreneur start-up business. Jean also serves as a board member for the Angel Capital Association which she is testifying on behalf of. Welcome to the Committee. We actually look forward to hearing what you have to say.

Ms. Peters.

STATEMENTS OF JEAN PETERS, MANAGING DIRECTOR, GOLDEN SEEDS; WILLIAM KLEHM, PRESIDENT AND CEO, FALLBROOK TECHNOLOGIES; KEVIN RUSTAGI, CEO, EVOLUTIONS OF NOISE; JAMES J. ANGEL, ASSOCIATE PROFESSOR, MCDONOUGH SCHOOL OF BUSINESS, GEORGETOWN UNIVERSITY

STATEMENT OF JEAN PETERS

Ms. PETERS. Thank you, Chairman Schweikert, Ranking Member Clarke, and the Subcommittee members. Thank you for inviting the Angel Capital Association to speak.

I am Jean Peters. I am a managing director of Golden Seeds, the fourth largest angel group in the country. Our 280 members collectively have funded more than $50 million in equity to 60 women-led startups. Golden Seeds is a charter member of the Angel Capital Association on whose behalf I am testifying today.

ACA is the world's leading association of accredited angel investors. We have 200 angel groups from across the continent and there are 8,500 individual angel members. We share the Committee's concern with the length of time the SEC is taking for rules, but also with the substance of the prepared rules.

So let me briefly describe angel investing. By definition, angels are accredited investors who invest from our personal pocketbooks. Most are former entrepreneurs, or were successful in business, and we want to help others up that ladder. We invest in the most primal point of capital formation—small business startups with high growth potential.

We also speak for the 250,000 accredited investors across the U.S. who already fund startups each year. These are just a subset of 8 million people who meet that definition and are an untapped source of capital that could become active.

Angels are the only source of equity for most startups and supply up to 90 percent of all outside equity for seed-stage companies according to the Kauffman Foundation. In fact, angels fund 20 times as many startups as venture capital. In 2011, angels provided $23 billion of capital to 66,000 startups, while VCs put a couple of billion into 1,800 startups in total.

Angels work for Main Street, not Wall Street. And angel-funded companies are crucial for job growth. According to the Census Bureau, startups make up less than 1 percent of all companies, but they create 10 percent of all new jobs in a given year. Without angel funding, these companies would never get off the ground.

We bring disciplined due diligence and deep experience to the table. We have to. Capital comes out of my own pocket. We understand that what we do is highly risky and extremely illiquid. We give our time and expertise without compensation and often without liquidity for 8 to 10 years. We do this to make a return, but we also do it to give back, to keep up with our industries, and because entrepreneurs value what we do.

So this brings me to a key part of the JOBS Act, Title II, which ends the ban on general solicitation for issuers who sell securities only to accredited investors, angels.

We understand entrepreneurs desperately need capital. Companies that could get bank loans or at least small business credit

cards are now shut out. So the potential for crowdfunding and general solicitation are exciting. We also understand that these vehicles have high risks for the unwary, and we appreciate the efforts to safeguard those risks. But the rules provide the issuer to take reasonable steps to verify that investors are accredited. The problem is the SEC has not provided any clarity on what those steps are. Instead, they say they will determine that on a case-by-case basis.

This lack of any safe harbor leaves investors and entrepreneurs in a deeply uncertain position. The ACA surveyed its investors who said they are likely to not invest if they have to turn over financial records to entrepreneurs. Their lawyers are telling them not to invest. This would cause a dramatic slowdown in angel funding. We recommend that the final rules specify safe harbors.

At last fall's SEC Forum on Small Business Capital Formation there was a unanimous recommendation to make reputable angel groups a safe harbor for general solicitation.

Angels have a history of disciplined due diligence, deal screening, governance, and almost total absence of fraud. As investors enter this class, the ACA will lead in providing those professional standards. We will be the adult supervision for crowdfunding and general solicitation and social networks. We will be there when companies that crowdfund need that extra capital. We will be the sorting mechanism for these startups that are most promising. We will ensure that companies seeking funding are legitimate, appropriately structured, managed, and valued, and that will mean that the innovation that is now bubbling up on every professional district and job-seeking community will stand the better chance for success for the entrepreneur, for its employees, and for the investor that is willing to take that risk.

I thank you.

Chairman SCHWEIKERT. Thank you, Ms. Peters. That is interesting.

Bill Klehm, the next witness with us is—do you prefer Bill or William?

Mr. KLEHM. Bill is fine.

Chairman SCHWEIKERT. Bill Klehm is CEO of Fallbrook Technologies. Fallbrook Technologies is an automotive company focused on the development and manufacturing of energy-efficient vehicle transmissions. I actually spent some time on the Internet looking at some of your technology. It is fascinating what you have accomplished. Prior to joining Fallbrook, Bill served in various executive positions in the automotive industry with Visteon.

Mr. KLEHM. Excuse me, Visteon.

Chairman SCHWEIKERT. Visteon Climate Control Systems at Ford Motor Company. Bill is testifying on behalf of CONNECT, a San Diego-based California innovation trade organization.

Bill.

STATEMENT OF WILLIAM KLEHM

Mr. KLEHM. Thank you. Good morning, Chairman Schweikert and Ranking Member Clarke, as well as other Committee members.

First of all, thank you for the invitation to be here. It is an honor to appear before this Committee today and testify on the challenges those of us have raising capital for early stage innovative new companies in the face of this financial and regulatory environment. I commend you for calling this hearing to check up on the status of the JOBS Act implementation to ensure the goals of the JOBS Act get accomplished, namely to increase access to capital for America's innovators.

My name is Bill Klehm. I am the Chairman and CEO of Fallbrook Technologies. I have served as Fallbrook's CEO since 2004 and have over 20 years of automotive-related experience.

We are a private company based in San Diego, California and Austin, Texas. We manufacture and market proprietary continuously variable transmission products and support our global partners in the design and development of our proprietary transmission technology.

Fallbrook currently holds over 500 patents and 15,000 patent claims. Our mission is to deliver the best performing, most versatile and most reliable mechanical power transmissions on the planet. We employ 133 people in the U.S., including approximately 25 of the best transmission engineers in the sector.

We have passed the commercial test of physics and economics. We have partnered with worldwide industry leaders, including national leaders like Allison Transmission of Indiana, Dana Holding Corporation of Ohio, and TEAM Industries of Minnesota. Our proprietary variable transmission technology is potentially applicable to any product that uses a transmission. It replaces conventional transmission technology that uses gears to transfer raw power to managed power.

As you might imagine, transmissions are ubiquitous. They are in virtually every electromechanical system today on the planet. The most obvious examples are motor vehicles, but they exist everywhere. The range of applications should give you a sense of the size of the opportunity we are trying to address. Today, for the market opportunities that we are currently investing in, it is about a $30 billion market opportunity for us. Our technology allows the next generation transmissions to increase fuel efficiency, reduce emissions, and improve overall vehicle performance, serving as an important function in protecting the environment.

Our great country prides itself on entrepreneurship and innovation. In my opinion, Fallbrook is the poster child for those values. From an idea starting in San Diego in 1998 with negligible revenue through 2009, to over $43 million in revenue last year and all that money being poured back into the business to help it grow sounds like a good start, but the maze in which small business and innovative companies must navigate to acquire capital is becoming increasingly challenging. We have an opportunity to grow faster and drive innovation faster. The only thing preventing us today is access to affordable capital. Our ability to access capital is the most significant challenge we face as a business. I personally spend 50 percent of my time on it.

With additional capital we could expand our manufacturing base in Texas, build out our engineering and development team which would create new high-tech jobs, accelerate our product develop-

ment and partnership opportunities. It is important to note that expansion would also have a significant impact outside of our particular company in that both our suppliers and customers would also benefit from that job growth. This Committee should remember that high-tech engineering and manufacturing jobs are the kind of jobs this economy needs, not only because they enhance America's competitiveness but they also pay above average wages compared to other sectors. That is why Congress's bipartisan work to pass the JOBS Act was so important and why regulatory hurdles should not slow us down now. The jobs and innovation will materialize once the JOBS Act is fully implemented.

The changes enacted by the JOBS Act will make acquiring capital less challenging for America's new innovators. The current Regulation A cap of $5 million is outdated and unworkable, and Congress was absolutely right to modernize that for today's innovation climate.

To meet our needs at Fallbrook an incremental $5 million round simply would not fund the type of development and growth we are targeting at Fallbrook. Additionally, the opportunity cost to file a registration statement with the SEC, including legal accounting fees and printing costs for a company our size amounts to hundreds of thousands to millions of dollars. Middle and large cap companies that raise public equity benefit from their scale of the transactions relative to their administration costs but small and emerging companies across this country in various tech sectors are robbed of that benefit until the Reg A rules are implemented. This means that new well-paying jobs are not created, new technologies sit dormant, and new products do not affect lives for the common good.

The changes in the JOBS Act will enable Fallbrook to accelerate our development and commercialization, driving innovation growth, which creates jobs.

Thank you very much.

Chairman SCHWEIKERT. Thank you very much, Mr. Klehm.

Our next witness is Kevin Rustagi, CEO of Evolutions of Noise and cofounder of Inc. Magazine's 2012 Coolest College Startup, Ministry of Supply.

Mr. RUSTAGI. Yes, that is correct.

Chairman SCHWEIKERT. Kevin graduated from MIT Technology in 2011 with a degree in mechanical engineering. Prior to graduating, Kevin cofounded Ministry of Supply, a dress shirt company with MIT classmates in 2010. Kevin is currently CEO of Evolution of Noise, a product development company that is working on several new customer products, including a re-engineering of business cards using laser etching.

Mr. RUSTAGI. That is correct.

Chairman SCHWEIKERT. I was teasing Kevin earlier that when I run into someone as brilliant as he is at his age I am always fearful I am going to wake up one day and be working for you.

Kevin, share with us.

STATEMENT OF KEVIN RUSTAGI

Mr. RUSTAGI. Good morning, Chairman Schweikert, Ranking Member Clarke, members of the Subcommittee. I am so glad to be

meeting with you and that you will take the time to hear my testimony.

As Chairman Schweikert mentioned, I graduated from MIT in 2011 with a degree in mechanical engineering focused on product design. My senior year I got into Stanford Business School. I have deferred that for three years to work on interesting new high-tech and high-growth startups. I have had experience with different types of funding, family and friends' loans, angel investors, and most recently donation crowdfunding through Kickstarter.com.

The company I last founded, Ministry of Supply creates high-tech business apparel for men. I am actually wearing one of the shirts right now. I just want to talk a little bit about on what we did on Kickstarter. Our goal was to raise $30,000 last July. You have to meet or exceed that goal to maintain those funds. We raised in a little over a month a grand total of $429,000.

The JOBS Act will greatly increase an entrepreneur's chance of success by going beyond things like crowdfunding and really talking about crowd investing when you need further access to capital as we did, and I will talk about it today.

With Kickstarter, it is very interesting. For consumer-packaged goods what I focus in, it has really become a preorder destination. And what was phenomenal about our product and service is that we did what in the start-up world is known as "going viral." So our global viral PR strategy enabled us to get over 100,000 views of our videos with preorders from over two dozen countries.

Unfortunately, what ended up happening afterwards, what was so exciting is we had so much funding that we began to rapidly scale a supply chain and hire new employees. However, the money that we were offered from multiple investors around the world, many of whom were smaller investors, we were unable to take based on lack of legal precedent and vetting tools. We experienced the deep irony of having a great business opportunity and having to turn investors away.

I just want to delineate the difference between equity-based and donation-based. Donation-based crowdfunding is a great opportunity. However, it is not nearly as reliable as equity-based as dictated through the JOBS Act. One of the interesting things as well with high-tech hi-growth startups is dilution. When you have a limited number of investors, say an angel investor community, surrounds the entrepreneur or venture capital associations, you deal with smaller potential valuations. Simply, the entrepreneur is subject to whatever valuations the market will bear, given the number of investors they have. If you open it up to the crowd, I believe this will have a leveling smoothing effect that will enable further growth.

The timing of the JOBS Act is very important with regards to the global stage. MassChallenge, a Boston-based startup competition—it is one of the largest in the world—actually received applications last year from 35 countries. MassChallenge, like the marketplace, is judged solely based on traction and market adoption. Competition is now a highly global democracy. It is very important that America matches the speed of global competition. I believe the JOBS Act will help us do that.

I believe also that crowd investing would be used. There are limitations on other types of investing. Angel investing, you are talking about connections in the liquid market surrounding the entrepreneur. Venture capital, it is the idea of being "proven." They reject 98 percent of startups that walk in their door. In crowd donation you are really dealing with the time window. Does your product exactly match that window? As far as I know in terms of entrepreneurs that I have met over the past six years, given new effective crowdfunding tools we would make quick use of them.

In conclusion, crowd investing within the JOBS Act clearly demonstrates or will demonstrate America's continued commitment to developing the next generation of small businesses and startups. It remains vital to consider all elements of supporting startups, especially other items that are caught up in legislation, including the Startup Visa.

New businesses are very difficult ventures to undertake. There are a ton of risks, and I have found, as well as my colleagues, that we spend a lot of our time fund-raising as Bill mentioned.

As I have noted, I have used a variety of tools to create new ventures, both for product design and business development. My hope is that my colleagues and I can continue to create new ventures in a way that leads and inspires the world. I eagerly await the day that I can fully utilize crowdfunding and crowd investing to help create successful new ventures.

I thank you for this opportunity to explain the concerns of the startup community and welcome any questions.

Chairman SCHWEIKERT. Kevin, thank you for sharing with us.

I would like to yield to the ranking member. Ranking Member Clarke.

Ms. CLARKE. Thank you very much, Mr. Chairman.

It is my pleasure to introduce James Angel. He is an associate professor of finance at Georgetown University's McDonough School of Business. He currently is on leave where he is serving as a visiting associate professor at the Wharton School of the University of Pennsylvania. He specializes in the structure and regulation of financial markets and has expertise in the IPO process and capital formation. Dr. Angel's current academic research focuses on market regulation and he has previously testified before Congress about issues relating to the design of financial markets. He holds degrees from Cal Tech, Harvard, and Cal Berkeley. Welcome, Mr. Angel.

STATEMENT OF JAMES J. ANGEL

Mr. ANGEL. Thank you. It is an honor to be here, and I want to thank the Committee for taking the time to investigate this very, very important topic.

Now, as you know, the JOBS Act was passed in reaction to the twin crises we face. First, there is the jobs crisis of the Great Recession, but there is also a crisis in capital formation. The most obvious symptom of this is what is happening in our public equity markets. We have less than half as many public companies as we used to have 15 years ago.

You may have heard of the Wilshire 5000 index that represents all the U.S. exchange-listed companies. Well, guess what? There are no longer 5,000 companies there. There are no longer 8,000 like

there used to be. Now there are less than 3,600 companies in the Wilshire 5000. Our markets have been steadily shrinking.

Now, there are many contributing factors to this crisis, and I would be more than happy to sit down with any of you or your staff and go into it in a lot of detail, but it is something that was one of the things that was addressed in the JOBS Act with many of these contributing factors.

Now, and I want to thank Congress for really doing such a good bipartisan job of addressing many of these different factors. You know, there is no one silver bullet that affects everything. But many of the parts of the JOBS Act make it easier to avoid becoming a public company because of the burdens we have placed on public companies. Well, that is fine for smaller companies, but I think we really need to pay attention to also fixing the public markets and not just making it easier to avoid the public market.

Now, a lot of the stuff in the JOBS Act could have very easily been done by the SEC on its own authority. The SEC has very broad rulemaking authority, very broad exemptive authority. They could have done almost everything in the JOBS Act by themselves without needing an act of Congress. So the real question to ask is "Why did they not?" How is it that this specialist agency, which is tasked with making this tradeoff between consumer protection, economic growth, competition, capital formation, market efficiency—they are told to make the right tradeoff. How is it that they have consistently failed over the years to do this? And it is not the fault of any one commissioner or any one staff member. Congress really needs to take a look at the big regulatory picture and say "Why is this agency not getting it right? Why did we have to step in with this very precise law and here a year later why did we have to grill these staff members as to why they have not implemented the law?

Well, if you think about it for a minute, the SEC had long ago decided that they did not want to do any of the things the law said, so it is not really a surprise that they have been dragging their feet. And indeed, despite their protestations that it is a high priority, they have been spending their time on other things that were not mandated by Congress in either Dodd-Frank or the JOBS Act. For example, they just released a 377-page rule finding on Regulation SCI, which yes, it is an important area. No doubt about it. But it is not one of the things that Congress mandated with specific deadlines to get done now while we have 11 million people standing in an unemployment line.

So anyhow, let us look at the other issues here, like crowdfunding. Simple idea. And yes, there are serious consumer protection concerns there. We do not want the fraudsters running in and ripping off Aunt Sally. But we do not want to study it to death either. No matter what they do, they are never going to get it perfect. No human is going to do that. There will be unintended side effects that nobody has thought about. And like good regulators, they are paralyzed by the fear that that is what is going to happen.

Now, there is a common sense solution to this. The common sense solution is to put out interim temporary rules, learn from the experience, and then fix it. They are not going to get it right the first time or even the second time. So we need to adopt an attitude

of innovation, try it, see what works, and when we find a problem, fix it.

The same thing on tick size. Again, another technical matter I would be more than happy to sit down with you or your staff to talk about the pros and cons. But one thing we know is that the optimal tick size is not the same for every company. So the real public policy question is not, oh, let us study it for five years. No, the real question is who decides? Do we let the SEC come up with a "one tick fits all" policy like they did in Rule 612? I do not think that is the right approach. Who has the incentive to get it right? The issuers do. So why do we not let the companies themselves fix it?

So anyway, thank you very much, and I look forward to your questions.

Chairman SCHWEIKERT. Thank you. I hope you will forgive me for throwing this in but I find this just fascinating what you are all doing.

Kevin, something I have been trying to partially get my head around and also I am trying to encourage the SEC and others is let us say you and I have an equity crowdfunding platform.

Mr. RUSTAGI. Great.

Chairman SCHWEIKERT. If you were designing it or your personal experience of out there raising money using technology, is access to information, you know, my comment before of affiliated blogs, how would you do that? Because if I am a believer that information is the ultimate regulator and vetter, what would you do?

Mr. RUSTAGI. So I completely agree, Chairman Schweikert, that information is key. So this is very important. With Kickstarter we had over 1,000 conversations with different potential customers given that it is a preorder facilitator. So if we were to make and create a crowdfunding platform, there would have to be a couple things that we would do. One, we would have to have transparency about who is involved in the company, especially at the managing partner level. For instance, if Bill is going to go on a crowdfunding platform and create a company, a cupcakery as was mentioned in the briefing here, we would have to know who is his main baker, who are any past financiers, as well as who is really managing the team. Specifically, I completely agree with the idea of a blog detailing progress about the company and also basic financials.

Chairman SCHWEIKERT. Okay. Ms. Peters, when you are actually out there working with your Angel Network—just as a side question and this sort of passes back to what Kevin was just saying—information on the management, the individuals, when you are weighing, how much are you all investing in the concept or investing in the people?

Ms. PETERS. Well, with startups, a lot of time there is no revenue. There is a very nascent business model and you are really investing in the jockey very much. And so angels do get together in groups and we do a very substantial amount of due diligence. We end up looking at everything, from management capabilities, from the competitive arena, from past history of the management. We do reference checks. Angel Capital Investing and Accredited Investor investing is not something you do on PayPal. I mean, it is negotiated. You work very closely with the companies. We go on

their boards and we offer advice. We offer strategic advice. We spend time with those companies throughout their history.

So transparency is just imperative. We require information rights with any company that Golden Seeds invests in and most angel groups do that.

Chairman SCHWEIKERT. Thanks, Ms. Peters.

Mr. Angel, being someone who is actually very interested in the tick size mechanic. Not only seeing the crisis of the number of publicly traded equities out there, but also how the curve seems to be pulling further and further out. The big caps are traded and the smaller ones are orphans. Obviously tick size, are we to the point now where I need to try to put together a bipartisan piece of legislation and drive it through our process? Because many of us have had the discussion of do you do a sliding scale? Do you just allow the company, the exchange, the interested parties to basically pick a tick and say, hey, we are going to be a five cent, we are going to be a 10 cent. The last part of that is would you go 5 to 25? How much range would you create?

Mr. ANGEL. Why thank you. Thank you.

For those watching on TV who are not as familiar with the tick size, the tick is the minimum price variation. Now, you can trade a stock right now at $10 or $10 and a penny, but you cannot trade it at $10 and a half penny. And it sounds like a very technical issue, and it is, but what that really indicates is how much you have to pay to jump ahead of other people who are bidding the same price you want to pay. So if right now other people are out there bidding $10, if you want to jump to the front of the line you have to bid $10 and a penny.

Now, it sounds very technical. It sounds like a minor thing, but it has a big impact on the way people trade. And the real question is what is the optimal tick size? I have published papers with mathematical formulas of this and it is really a function of many different things—everything from the size of the company to how many people know about it, and it is not the same for every company. So if we try to have a "one formula fits all," we would miss a lot of stuff and we probably would not get it perfectly right. So I am of the opinion that the best thing to do is to ask who has the right incentive? That is what good economic analysis is all about. It is not about did the SEC properly manage or properly count how many paperclips will be used in implementing a law or a rule; it is the question of did they get the economics right to make the right tradeoff between consumer protection, capital formation, market efficiency, and competition.

Now, if you make the tick too wide, that puts a floor on the bid-ask spread. That is a transaction cost. So if you make the tick too wide you are driving up costs. That is going to hurt the stock price. On the other hand, if you make the tick too small you are not providing enough protection to people who provide liquidity in the market and that will hurt the stock price.

Chairman SCHWEIKERT. Would you use a sliding scale? Would you use a volume adjustment? Would you just allow the company and the Exchange to pick a number and then review it on velocity of trade?

Mr. ANGEL. Right. I would let the companies pick their own tick size because they have the incentive to get it right. It is their stock that is being traded, and if they get the wrong number they should have the flexibility to experiment with different stock.

Chairman SCHWEIKERT. We may be calling you because I am frustrated on this one and maybe actually trying to draft——

Mr. ANGEL. Happy to assist.

Chairman SCHWEIKERT. Mr. Klehm, you have a great interest in what we refer to as the Reg A. You know, it is now a $50 million offering, a simplified process, and as you and I have talked about. The $50 million allows you to be on the big exchanges and the great hope of then becoming a covered stock where researchers are following you, which makes additional offerings possible. In a company like yours with the growth and the technology and the capital intensive you need, is $50 million an appropriate threshold?

Mr. KLEHM. We are actually a capital light business. So we run a mix of intellectual property licensing as well as manufacturing. So the business model that we employ has the flexibility to be able to do all those things. So a $50 million capital raise—so for the first time in nine years my angel investors, my 203 angel investors, I do not have to go out and raise money because we are going to be a cash flow positive business this year. So this is the time to raise money. But what we will require money for is that next jump in growth. We went from $8.7 million in revenue to $43 million in revenue in one year.

Chairman SCHWEIKERT. Tell us where you are going. Let us say you had the 50 million in new capital. You were able to go—what does that do to your employment base? What does that change in your local economy?

Mr. KLEHM. So for us we have relied on licensing and contract manufacturing. We have small manufacturing in Austin, Texas, and what this would allow us to do is to expand that manufacturing base. So as I think about the business, I think about the business as a triangle. So the base of the business is the manufacturing and creating of products, so that covers the expenses for the business. Then the licensing, we go into markets that we are not organized or capitalized to be able to address, like full-blown automotive transmissions. We license those to other markets. But for the markets that we can get our great return for our shareholders and be very economically efficient, we would look to manufacture that. So the capital we would look to employ is to bring that manufacturing capability in-house and build manufacturing jobs.

Chairman SCHWEIKERT. Okay. Thank you, Mr. Klehm.

Ranking Member Clarke.

Ms. CLARKE. Thank you, Mr. Chairman. This testimony is truly fascinating. I want to thank all of you for your testimony here today.

My first question is for Dr.—is it Angel or Angel?

Mr. ANGEL. You can call me Jim.

Ms. CLARKE. Well, thank you. Excuse me.

The JOBS Act included some investor protections, including restrictions on the amount ordinary investors can invest in each company based on income levels. As you know, the SEC has grappled with balancing capital raising by small businesses with investor

protections in the past. In your opinion, are investment caps enough to protect investors with limited wealth and financial knowledge from crowdfunding issuers?

Mr. ANGEL. By itself, no. Whenever you have money, money attracts flies just like garbage attracts fleas. And so that is why there are other good things in the JOBS Act, for example, that require criminal background checks of the people running these operations because we do not want the fraudsters to come in, set up bogus operations, sell them on the Internet, and run away with the proceeds. So definitely this is something that is contemplated in the Act, and we just need to move forward with it.

Ms. CLARKE. I want to follow up on a question from your written testimony. You pointed out the challenges public companies face with regards to possible litigation and how that can be a disincentive for private companies to go public. Given that litigation can at times be an investor's only recourse, how would you mitigate that concern for private companies who may want to go public?

Mr. ANGEL. Well, one thing is that Congress and the SEC can create various safe harbors for disclosure in that whenever something bad happens to a company that not only do the stockholders suffer because the price goes down, but then the strike suits come in and basically the shareholders end up suing themselves and paying twice. So better safe harbors I think are one very important thing. But you are right. We need to strike a balance and that is a tricky thing to do.

Ms. CLARKE. Let me thank you.

To Mr. Rustagi, as someone who has successfully used the Kickstarter platform to raise capital for your small business, what recommendations would you make to the SEC to ensure that new equity-based crowdfunding rules are workable for both investors and issuers?

Mr. RUSTAGI. So I think that is really interesting. With Kickstarter, what happens is a lot of it is centered around the companies themselves and the videos that create. And so as Chairman Schweikert was mentioning, a lot of it is very review-based. So there is a lot of back and forth there.

I think the SEC would have to create something very simple. If they were to—just from the company's perspective or from the investor's perspective, I would want a lot of that regulation bottled up into the crowdfunding or crowd investing platforms themselves. It is imperative that the system is very, very simple. The biggest thing in startups is time. So the longer something takes, the longer the process takes, the more you spend on legal, the less likely it is that you are to use that. And so a lot of friends and colleagues of mine have been coming to me asking about Kickstarter advice, because it is such a simple and elegant tool. There is a large backend for the companies and there should be for investors as well.

Ms. CLARKE. And my final question to you is what is high-tech apparel?

Mr. RUSTAGI. That is the eternal question.

So we create synthetic materials that have specific properties. So the easiest one to explain is the dress shirt that I am wearing. So a regular dress shirt has issues with wrinkling and holds moisture;

this one does not. So it has special properties, like you can wear it for four or five days because it does not smell. It has an antimicrobial coating. It has a phase-change material inside of it, which is the same thing used in space suits. So it can hold your body heat, store that, so if you are out on a hot day it will pull that heat away. And if you go into a cool environment it will release it back to you. So it is basically, as the blog dog tech crunch put it, a magic shirt.

Ms. CLARKE. The magic shirt.

Thank you Mr. Chairman.

Chairman SCHWEIKERT. It just sets your mind a racing, does it not it?

Mr. Bentivolio.

Mr. BENTIVOLIO. Thank you very much, Mr. Chairman. I think it is more appropriately named the "smart shirt."

Mr. RUSTAGI. Thank you.

Mr. BENTIVOLIO. It is a very good idea.

Actually, my questions are for Ms. Peters. I am sorry I was not here to hear your initial testimony, but I got the gist of it and I have a few quick questions.

A startup. Somebody wants to raise money for a good idea what they think is a good idea, they should put together a business plan I am assuming. Do you help them with that? Do you have a format or a style?

Ms. PETERS. There are a number of tools that startups use. There are some technological systems that they can go on that show them what they need to do, how to put up an executive summary, a business plan. They need a business plan for their business. I mean, we do not write that for them. If they are not capable of writing that, that is one of the signals we would have about how likely they are to succeed. They need to be able to understand and provide us with financials and financial projections and the basis for those projections.

So there are a whole array of templates that you can see on the Angel Capital Association site for entrepreneurs. There are a number of other sites that do that as well. These have been around for many years. Then also, entrepreneurs come through economic development, through incubators in their towns, through accelerators, through tech transfer offices of colleges and universities, and frankly, a lot of the schools that used to promote their MBAs are now promoting their masters in business entrepreneurship, not administration. So you are finding entire course curriculum around how to create a startup and develop the sources of capital that you need.

Mr. BENTIVOLIO. That is great. That is great.

One other thing, Mr. Rustagi?

Mr. RUSTAGI. Rustagi.

Mr. BENTIVOLIO. In another Committee we were discussing military uniforms. Is there any chance you could get involved with us on that, in developing a smart uniform?

Mr. RUSTAGI. I could speak with my former partner about it. There is an SBIR out about a year and a half ago that we were going to apply to, but certainly. Yeah.

Mr. BENTIVOLIO. That would be great.

And just one last question. How can I get you to come to my district and give a seminar on how to do a startup?

Mr. RUSTAGI. My e-mail is just my full name at gmail.com.

Mr. BENTIVOLIO. Great. Thank you very much. Thank you. I yield back my time, Mr. Chairman.

Chairman SCHWEIKERT. Oh, it is not fair. We wanted to get him to our district first.

Mr. BENTIVOLIO. He is going to be sought after.

Chairman SCHWEIKERT. Thank you. This was one of those unique occasions. I have sat through hundreds of hearings from my time in the state legislature to here in Congress. As a collection of witnesses, you are singularly the most interesting group I think I have ever had in front of me. It is rare for me to look out and say I would love to sit down and have a coffee with each one of you. So thank you for joining us today. You may find that we may send you some questions to put into the record, so let me make sure I do the proper closing. Okay.

And with that I ask unanimous consent that the members have five legislative days to submit statements and supporting materials for the record. Without objection, so ordered. The hearing is now adjourned.

[Whereupon, at 11:42 a.m., the Subcommittee was adjourned.]

APPENDIX

Testimony on "JOBS Act Implementation Update"
by
Lona Nallengara, Acting Director
Division of Corporation Finance
and
John Ramsay, Acting Director
Division of Trading and Markets

U.S. Securities and Exchange Commission

before the
Subcommittee on Investigations, Oversight and Regulations
Committee on Small Business
U.S. House of Representatives

April 11, 2013

Chairman Schweikert, Ranking Member Clarke and Members of the Subcommittee:

We appreciate the opportunity to testify today on behalf of the U.S. Securities and Exchange Commission (Commission) regarding the Jumpstart Our Business Startups Act (JOBS Act). Implementation of the JOBS Act is one of the Commission's top priorities, and our testimony will discuss the efforts of the Commission and staff since enactment of the JOBS Act last year.

The JOBS Act made significant changes to the federal securities laws, including:

- changing the initial public offering process for a new category of issuer, called an "emerging growth company," by, among other things, permitting certain of these companies to submit draft registration statements for review on a confidential basis, providing exemptions for such companies from various disclosure and other requirements for up to five years following their initial public offerings and relaxing certain restrictions on communications by issuers and their underwriters;

- requiring the Commission to modify the prohibition against general solicitation and general advertising in Rule 506 of Regulation D and Rule 144A under the Securities Act of 1933 (Securities Act);

- requiring the Commission to implement exemptions under the Securities Act for crowdfunding offerings and for unregistered public offerings of up to $50 million; and

- increasing the number of holders of record that triggers public reporting under Section 12(g) of the Securities Exchange Act of 1934 (Exchange Act) and increasing the number of holders that permits deregistration and suspension of reporting under the Exchange Act for banks and bank holding companies.

The JOBS Act also required the Commission to conduct several studies and prepare reports to Congress. In addition, the JOBS Act mandated that the Commission provide online information and conduct outreach to small and medium-sized businesses and businesses owned by women, veterans and minorities about the changes made by the new statute.

As you know, certain provisions of the JOBS Act became effective immediately upon enactment, while others require Commission rulemaking. These rulemaking mandates are in addition to a significant volume of Commission rulemaking required by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The Commission staff has taken steps to inform the industry about the operation of the JOBS Act, beginning immediately after enactment. On the day of enactment, for example, staff in the Division of Corporation Finance provided information on the Commission's website that explained how emerging growth companies could submit draft registration statements for confidential non-public review as permitted by the JOBS Act.[1] On the same day, the staff received the first confidentially-submitted registration statement from an emerging growth company that used these new procedures.

Soon after enactment, the staff prepared and posted on the Commission's website answers to what the staff anticipated would be interpretive and implementation questions that companies and their advisors would have regarding the initial public offering "on-ramp" and the changes to the requirements for Exchange Act Section 12(g) registration and deregistration. The

[1] *See* http://www.sec.gov/divisions/corpfin/cfannouncements/draftregstatements.htm.

staff has continued to provide guidance, including by providing answers to frequently asked questions about the JOBS Act and its effect with respect to rules relating to research and research analysts and about the crowdfunding and other provisions of the JOBS Act.[2] In addition, the staff has discussed and answered questions relating to the provisions of the JOBS Act with companies, their advisors and other interested parties at conferences and seminars.

For the JOBS Act provisions requiring Commission rulemaking, rule writing teams have been formed consisting of staff from across the Commission, including economists from the Division of Risk, Strategy and Financial Innovation (RSFI). As discussed below, these teams have been working on rulemaking recommendations, including the assessment of their potential economic impact, for the Commission's consideration.

To aid the rulemaking process and increase the opportunity for public comment, the Commission established a page on its website through which, prior to the issuance of proposed rules, interested parties are able to submit comments on the various provisions of the JOBS Act.[3] Since the webpage was established last April, a wide range of interested parties have provided helpful feedback and insights relating to the Commission's implementation of the JOBS Act, and these comments are publicly available on the Commission's website.[4] Commissioners and staff also have participated in meetings with a wide array of interested individuals and groups regarding the implementation of the JOBS Act.[5] The input the Commission and the staff have

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[2] *See* http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm, http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-12g.htm, http://www.sec.gov/divisions/marketreg/tmjobsact-researchanalystsfaq.htm, http://www.sec.gov/divisions/marketreg/tmjobsact-crowdfundingintermediariesfaq.htm and http://www.sec.gov/divisions/marketreg/exemption-broker-dealer-registration-jobs-act-faq.htm.

[3] *See* http://www.sec.gov/spotlight/jobsactcomments.shtml.

[4] *See id.*

[5] As of April 8, 2013, the Commission has received 221 comment letters relating to the provisions in Title I, 77 comment letters relating to the provisions in Title II, 188 comment letters relating to the provisions in Title III,

received through these written submissions and meetings has been very helpful to the rulemaking teams as they work to comply with the JOBS Act's mandates.

Below is a more detailed description of the efforts taken to date to implement the various provisions of the JOBS Act.

Title I

Title I of the JOBS Act created a new category of issuer called an "emerging growth company," which is defined as a company with total annual gross revenues of less than $1 billion during its most recently completed fiscal year. Only companies whose first registered sale of common equity securities occurred after December 8, 2011 may be considered emerging growth companies. A company retains its status as an emerging growth company until the earliest of the following:

- the last day of its fiscal year during which its total annual gross revenues are $1 billion or more;
- the date it is deemed to be a large accelerated filer under the Commission's rules;
- the date on which it has issued more than $1 billion in non-convertible debt in the previous three years; or
- the last day of the fiscal year following the fifth anniversary of the first registered sale of its common equity securities.

As referenced above, emerging growth companies may confidentially submit draft registration statements to the Commission prior to the company's initial public offering date. All such submissions and amendments to those submissions must be filed publicly no later than 21

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19 comment letters relating to the provisions in Title IV, 22 comment letters relating to the provisions in Titles V and VI and four comment letters relating to Title VII. The comment file for each title provides information about JOBS Act-related meetings in which the Commission and the staff participated. *See* http://www.sec.gov/spotlight/jobsactcomments.shtml.

days before the date the issuer conducts a road show, as that term is defined in Securities Act Rule 433.

Under Title I, emerging growth companies can take advantage of scaled disclosure and other requirements, including with respect to the Commission's financial statement and selected financial data requirements and certain executive compensation disclosures. Emerging growth companies are exempted from the audit of internal controls required under Section 404(b) of the Sarbanes-Oxley Act of 2002 and from any potential future rule the Public Company Accounting Oversight Board issues with respect to mandatory audit firm rotation or the auditor reporting model. In addition, under Title I, emerging growth companies cannot be required to comply with any new or revised financial accounting standard until the date that a non-issuer would be required to comply.

Title I also makes important changes with respect to communications around securities offerings, the provision of research and securities analyst communications. The law provides a Securities Act exemption for emerging growth companies and persons authorized to act on their behalf to "test the waters" for an offering by communicating with potential investors that are qualified institutional buyers or institutional accredited investors prior to or following the filing of a registration statement. In addition, Title I provides an exemption under the Securities Act for the issuance of research reports before, during and following initial public offerings and other offerings for emerging growth companies by underwriters engaged in such offerings. It also prohibits the Commission and national securities associations from adopting or maintaining rules:

- restricting, based on functional role, which associated persons of a broker-dealer, or member of a national securities association, may arrange for communications between a securities analyst and a potential investor;

- restricting a securities analyst from participating in communications with an emerging growth company's management team that also are attended by any other associated person of a broker-dealer, or member of a national securities association, whose functional role is not that of a securities analyst; and

- restricting broker-dealers, or members of a national securities association, from publishing or distributing research reports or making public appearances with respect to the securities of an emerging growth company within a specified time period after the emerging growth company's initial public offering or prior to the expiration of a lock-up agreement.

The provisions of Title I were effective upon enactment without Commission rulemaking.[6] As noted above, immediately following enactment of the JOBS Act, the staff developed and published procedures for emerging growth companies to submit draft registration statements for confidential non-public review.[7] The staff has continued to work to simplify that process, and, since October 2012, companies have been required to submit their draft registration statements electronically on the Commission's EDGAR system.[8] To date, the Commission has received approximately 175 confidentially-submitted draft registration statements for non-public review as permitted under Title I. As noted above, through the issuance of responses to frequently asked questions, the staff has provided guidance on the application of Title I in light of the Commission's existing rules, regulations and procedures. The staff is continuing to work with companies and practitioners when questions arise concerning the application of Title I.

Title I also required the Commission to submit two reports to Congress. Section 106(b) required that the Commission, within 90 days of enactment of the JOBS Act, conduct a study and report to Congress on the transition to trading and quoting securities in one penny increments – also known as decimalization – and the impact decimalization has had on the number of initial

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[6] *See* http://www.sec.gov/comments/jobs-title-i/general/general.shtml for comments on Title I.

[7] *See* http://www.sec.gov/divisions/corpfin/cfannouncements/draftregstatements.htm.

[8] *See* http://www.sec.gov/divisions/corpfin/cfannouncements/drsfilingprocedures101512.htm.

public offerings since its implementation.[9] Section 106(b) also permitted the Commission, if it determined that the securities of emerging growth companies should be quoted and traded using a minimum increment of greater than $0.01 to designate, by rule, a minimum increment for emerging growth companies that is greater than $0.01 but less than $0.10.

The report to Congress on the staff's study under Section 106(b) was submitted on July 20, 2012.[10] In conducting the study, the staff reviewed empirical studies regarding tick size and decimalization, considered the views expressed about market structure at a June 2012 open meeting of the Commission's Advisory Committee on Small and Emerging Companies and surveyed tick size regimes in non-U.S. markets. Based on the review, the staff found that "[a]lthough mandating an increase in tick sizes to levels greater than those that are presently dictated by market forces may provide more incentives to market makers in certain stocks, the full impact of such a change, including whether or not an increased tick size would indeed result in more IPOs, and whether there would be other significant negative or unintended consequences, is difficult to ascertain."[11] The staff, therefore, recommended at that time that the Commission should not proceed with rulemaking to increase tick sizes, but should consider the steps needed to determine whether rulemaking should be undertaken in this area in the future. In this regard, the report noted the staff's belief that the Commission should solicit the views of interested parties on the broad topic of decimalization, how to best study its effects on initial public offerings, trading and liquidity for small and middle capitalization companies and what, if

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[9] *See* http://www.sec.gov/comments/jobs-title-i/tick-size-study/tick-size-study.shtml for comments on Section 106(b) of Title I.

[10] *See* http://www.sec.gov/news/studies/2012/decimalization-072012.pdf.

[11] *Id.* at 22.

any, changes should be considered. The staff also recommended that a roundtable be convened to determine how to best structure a potential pilot program.

In February 2013, the staff held a roundtable to discuss the impact of decimal-based stock trading on small and middle capitalization companies, market professionals, investors and U.S. securities markets.[12] The staff is still considering the comments received at the roundtable, including those suggesting that the Commission evaluate the current "one-size-fits-all" approach to tick size through the implementation of a pilot program that would alter the minimum tick size for a control group of stocks of different types of companies. Although panelists expressed different views on the impact of tick sizes on initial public offerings, research coverage and market liquidity, most panelists supported the idea of a pilot program to empirically test the effects of increasing tick sizes to greater than one penny for the less-liquid stocks of smaller capitalization companies.[13] As a result, the staff is consulting with the exchanges and other interested parties to consider how a pilot program, if one were to be implemented, could be structured to best inform the Commission of the policy choices in this area.

Section 108 of the JOBS Act required the Commission, within 180 days of enactment of the JOBS Act, to conduct a review of Regulation S-K to determine how it may be modernized

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[12] For further information about the decimalization roundtable, *see* http://www.sec.gov/spotlight/decimalization.shtml.

[13] A cross-section of panelists expressed support for instituting a pilot program for a subset of small and middle capitalization companies. Some panelists focused on the impact of spreads on trading activity and believed it was possible that a larger tick size may result in more liquidity for the securities of small and middle capitalization companies, while other panelists drew a connection between tick size and the availability of research and initial public offerings. A smaller number of panelists questioned the utility of a pilot program, believing that it may not be able to generate data that would measure the impact of wider spreads on initial public offerings for small and middle capitalization companies. Others have expressed concerns that there could be negative consequences of an increased tick size, such as increased costs to investors or increased over-the-counter trading.

and simplified to reduce the costs and other burdens for emerging growth companies.[14] The Commission also is required to transmit a report to Congress on this review, including specific recommendations. The Commission's staff is in the process of preparing its recommendations and is working to complete the review in the near future.

Title II

Title II of the JOBS Act requires the Commission to revise the Rule 506 safe harbor of Regulation D[15] from registration to allow general solicitation or general advertising for offers and sales made under Rule 506, provided that all securities purchasers are accredited investors.

The rules the Commission adopts pursuant to Title II must require issuers to take "reasonable steps to verify that purchasers of the securities are accredited investors, using such methods as determined by the Commission." Title II also states that Rule 506 will continue to be treated as a regulation issued under Section 4(a)(2) of the Securities Act, and that offers and sales under Rule 506 as revised will not be deemed public offers under the federal securities laws as a result of general solicitation or advertising.

The Commission also is required to revise Securities Act Rule 144A[16] to provide that securities sold under the revised rule may be offered to persons other than qualified institutional

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[14] *See* http://www.sec.gov/comments/jobs-title-i/reviewreg-sk/reviewreg-sk.shtml for comments on Section 108 of Title I.

[15] 17 CFR 230.506. Rule 506 of Regulation D under the Securities Act is a non-exclusive safe harbor under Section 4(a)(2) (formerly Section 4(2)) of the Securities Act, which exempts transactions by an issuer "not involving any public offering" from the registration requirements of Section 5 of the Securities Act. Under existing Rule 506, an issuer may offer and sell securities, without any limitation on the offering amount, to an unlimited number of "accredited investors," as defined in Rule 501(a) of Regulation D, and to no more than 35 non-accredited investors who meet certain "sophistication" requirements. The availability of the existing safe harbor is subject to a number of requirements and is conditioned on the issuer, or any person acting on its behalf, not offering or selling securities through any form of "general solicitation or general advertising."

[16] 17 CFR 230.144A. Rule 144A is a non-exclusive safe harbor exemption from the registration requirements of the Securities Act for resales of certain "restricted securities" to qualified institutional buyers, or QIBs.

buyers, including by means of general solicitation or advertising, provided that the securities are sold only to persons reasonably believed to be qualified institutional buyers.

The Title II rulemaking was required to be completed within 90 days of enactment of the JOBS Act. In August 2012, the Commission issued for public comment proposed rules to implement Title II.[17] Under the proposed rules, companies issuing securities in an offering conducted under Rule 506 of Regulation D would be permitted to use general solicitation and general advertising to offer securities, provided that the issuer takes reasonable steps to verify that the purchasers of the securities are accredited investors. The Proposing Release explains that, in determining the reasonableness of the steps that an issuer has taken to verify that a purchaser is an accredited investor, issuers should consider the facts and circumstances of the transaction, such as the type of purchaser and the type of accredited investor that the purchaser claims to be, the amount and type of information that the issuer has about the purchaser and the nature of the offering. The proposed rules would preserve the existing portions of Rule 506 as a separate exemption so that companies conducting Rule 506 offerings without the use of general solicitation and general advertising would not be subject to the new verification rule.

The Commission also proposed that securities sold pursuant to Rule 144A could be offered to persons other than qualified institutional buyers, including by means of general

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Although Rule 144A does not include an express prohibition against general solicitation, offers of securities under Rule 144A currently must be limited to QIBs, which has the same practical effect. A QIB is defined in Rule 144A and includes specified institutions that, in the aggregate, own and invest on a discretionary basis at least $100 million in securities of issuers that are not affiliated with such institutions. Banks and other specified financial institutions also must have a net worth of at least $25 million. A registered broker-dealer qualifies as a QIB if it, in the aggregate, owns and invests on a discretionary basis at least $10 million in securities of issuers that are not affiliated with the broker-dealer.

[17] Securities Act Release No. 33-9354 (Proposing Release) 77 Fed. Reg. 54464 (August 29, 2012), *available at* http://www.sec.gov/rules/proposed/2012/33-9354.pdf.

solicitation, provided that the securities are sold only to persons whom the seller and any person acting on behalf of the seller reasonably believe are qualified institutional buyers.[18]

The comment period for the proposal ended in October 2012. There has been significant interest in this provision of the JOBS Act and the proposed rules. The Commission received more than 65 comment letters prior to issuing a proposal,[19] and has received more than 220 comment letters on the proposal to date.[20] Staff in the Divisions of Corporation Finance and RSFI are developing recommendations for the Commission's consideration as to how best to move forward with implementation of Title II.

Title II also amends Section 4 of the Securities Act to provide a narrow exemption from the requirement to register with the Commission as a broker-dealer in connection with certain limited activities related to Regulation D[21] offerings. In February 2013, the Commission's Division of Trading and Markets posted on the Commission's website answers to frequently asked questions about these provisions, including confirming that the exemption does not require the Commission to issue or adopt any rules.[22]

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[18] In the Proposing Release, the Commission proposed only those rule and form amendments that, in the view of the majority, were necessary to implement the mandate in Title II. Commissioner Luis Aguilar dissented from the Commission's action, stating his view that the proposal presented a framework that was not balanced and did not consider the alternatives suggested by commentators. *See* Commissioner Luis A. Aguilar, Statement at SEC Open Meeting, August 29, 2012, *available at* https://www.sec.gov/news/speech/2012/spch082912laa.htm. Certain of the written comments received by the Commission, both before and after the proposal, urged the Commission to consider and propose other amendments to Regulation D or to Form D that the commentators believed to be appropriate in connection with the implementation of Title II. The Proposing Release did not request comment on any of such recommendations, and did not address whether a proposal incorporating any of such recommendations in conjunction with removing the prohibition on general solicitation and advertising would be a reasonable alternative to the approach in the proposed rule.

[19] *See* http://www.sec.gov/comments/jobs-title-ii/jobs-title-ii.shtml.

[20] *See* http://www.sec.gov/comments/s7-07-12/s70712.shtml.

[21] 17 CFR 230.500 through 230.508.

[22] *See* http://www.sec.gov/divisions/marketreg/exemption-broker-dealer-registration-jobs-act-faq.htm.

Title III

Title III of the JOBS Act provides a new exemption from Section 5 of the Securities Act for offers and sales of securities through crowdfunding. Crowdfunding is an evolving method to raise capital using the Internet. Crowdfunding using donation-based or reward-based models has been used by small and start-up businesses to raise capital to start a business or develop a product and by individuals or entities seeking financial contributions to support artistic and charitable projects or causes. An entity or individual raising funds through donation-based or reward-based crowdfunding typically seeks relatively small, individual contributions from a large number of people.

To implement Title III, the Commission must create a new regulatory regime for issuers seeking to engage in crowdfunding transactions, including ongoing reporting requirements, and for intermediaries seeking to facilitate crowdfunding transactions. The new exemption provided in Title III would allow businesses to use crowdfunding to offer and sell securities without registration under the Securities Act, subject to certain conditions. Among its many conditions, Title III limits the maximum amount that may be raised by an issuer and the maximum amount that an individual investor may invest in a 12-month period. Title III also requires that an offering made in reliance on the exemption be conducted through an intermediary that is either a registered broker or a registered "funding portal." A funding portal, which is a new entity under the federal securities laws, would be subject to a conditional exemption from broker registration.

Title III includes other requirements for issuers and intermediaries, including disclosure obligations and restrictions on advertising the terms of the offering. The Commission also is required to establish disqualification provisions for certain bad actors and exempt securities

issued in reliance on the crowdfunding exemption from the calculation of record holders for purposes of Section 12(g) of the Exchange Act.

Under Title III, the Commission was required to adopt rules implementing the new crowdfunding provisions within 270 days of enactment of the JOBS Act. The Commission has received over 180 pre-proposal submissions on the crowdfunding provisions of the JOBS Act.[23] Staff in the Divisions of Corporation Finance, RSFI and Trading and Markets are working to develop recommendations for the Commission's consideration. In addition, the staff published responses to frequently asked questions to provide guidance on the implementation of Title III.[24]

Title IV

Title IV of the JOBS Act requires Commission rulemaking to create a new exemption from Securities Act registration, similar to existing Regulation A,[25] which would allow certain "small issue" offerings of up to $50 million in a 12-month period.[26] Title IV specifies that the exemption include certain terms and conditions, including, among others, that the securities may be offered and sold publicly, the securities sold under the exemption will not be restricted securities and issuers of the securities will be required to file audited financial statements annually with the Commission. The Commission may add other terms, conditions and requirements that it determines necessary in the public interest and for the protection of investors, which may include electronic filing of the offering documents, periodic disclosures by the issuer or disqualification provisions. Title IV also requires the Commission to review the

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[23] *See* http://www.sec.gov/comments/jobs-title-iii/jobs-title-iii.shtml.

[24] *See* http://www.sec.gov/divisions/marketreg/tmjobsact-crowdfundingintermediariesfaq.htm.

[25] 17 CFR 230.251 through 230.263.

[26] *See* http://www.sec.gov/comments/jobs-title-iv/jobs-title-iv.shtml for comments on Title IV.

offering limit under the new exemption not later than two years after enactment of the JOBS Act and every two years thereafter. Staff in the Divisions of Corporation Finance and RSFI are working to develop rule recommendations under Title IV for the Commission's consideration.

Titles V and VI

Titles V and VI of the JOBS Act amend Section 12(g) of the Exchange Act, which sets forth certain registration requirements for classes of securities.[27] Prior to enactment of the JOBS Act, Section 12(g) and the rules issued thereunder required a company to register its securities with the Commission within 120 days after the last day of its fiscal year, if, at the end of the fiscal year, the securities were held of record by 500 or more persons and the company had total assets exceeding $10 million.[28]

Title V amends Section 12(g) to raise the threshold for registration from 500 holders of record to either 2,000 holders of record or 500 holders of record who are not accredited investors. Title V also excludes from the calculation of the number of holders of record shares held by persons who received the shares pursuant to employee compensation plans, and requires Commission rulemaking to provide a safe harbor for the determination of whether such a holder is to be excluded.

Title VI applies only to banks and bank holding companies. It amends Section 12(g) to raise the registration threshold from 500 holders of record to 2,000 holders of record, and also changes the threshold for exiting the reporting system from 300 holders of record to 1,200

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[27] *See* http://www.sec.gov/comments/jobs-title-v/jobs-title-v.shtml and http://www.sec.gov/comments/jobs-title-vi/jobs-title-vi.shtml for comments on Titles V and VI, respectively.

[28] *See* 15 U.S.C. §78*l*(g) and 17 CFR 240.12g-1.

holders of record. Title VI requires the Commission to write rules to implement this provision within one year of enactment of the JOBS Act.

Titles V and VI were effective immediately upon the enactment of the JOBS Act. In the days following enactment, the staff prepared and posted guidance on the Commission's website addressing anticipated questions related to the JOBS Act changes to the requirements for Section 12(g) registration and deregistration. To date, approximately 78 bank holding companies have deregistered.[29] The staff is in the process of preparing recommendations for rule proposals for the Commission's consideration to address the new requirements of Titles V and VI.

Title V also requires the Commission to examine its authority to enforce the anti-evasion provisions of Exchange Act Rule 12g5-1[30] and submit recommendations to Congress within 120 days following enactment of the JOBS Act. Staff from the Division of Corporation Finance worked with staff from the Divisions of Enforcement, RSFI and Trading and Markets to review the anti-evasion provision in Rule 12g5-1(b)(3) and the Commission's related enforcement authority and tools, and, on October 15, 2012, submitted their report to Congress.[31] The staff concluded that the current enforcement tools available to the Commission are adequate to enforce the anti-evasion provision of Rule 12g5-1 and determined not to make any legislative recommendations regarding enforcement tools relating to Rule 12g5-1(b)(3).

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[29] This reflects filings made with the Commission, which does not include deregistrations by banks that report to banking regulators.

[30] 17 CFR 240.12g5-1.

[31] *See* http://www.sec.gov/news/studies/2012/authority-to-enforce-rule-12g5-1.pdf.

Title VII

Effective upon enactment, Title VII requires the Commission to provide online information and conduct outreach to inform small and medium-sized businesses, as well as businesses owned by women, veterans and minorities, of the changes made by the JOBS Act.[32] Staff from the Division of Corporation Finance and the Office of Minority and Women Inclusion (OMWI), in collaboration with other Divisions and Offices, is leading the Commission's efforts in developing and implementing an outreach plan tailored to these business communities. For example, OMWI is expanding the content of existing programs for small, minority-owned and women-owned businesses to provide information about the JOBS Act and its potential benefits for businesses. The staff is working to finalize an outreach plan that complements and augments the content of existing outreach programs, providing targeted, user-friendly communications and developing a longer-term strategy for engagement at conferences and community events.

Conclusion

While there is still much to be accomplished, the Commission and the staff have made progress on, and continue to work diligently in, implementing the JOBS Act mandates. By providing interpretive guidance on the JOBS Act provisions that became effective upon enactment, the staff enabled interested parties to begin immediately using a number of the provisions of the JOBS Act to achieve their business objectives. The staff has either completed or is in the process of completing the studies mandated by the JOBS Act. The Commission and staff are moving forward on the various rulemakings required by the JOBS Act. We look forward to completing the remaining provisions as soon as practicable.

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[32] *See* http://www.sec.gov/comments/jobs-title-vii/jobs-title-vii.shtml for comments on Title VII.

U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT AND REGULATIONS
HEARING:
JOBS ACT IMPLEMENTATION UPDATE

TESTIMONY
JEAN PETERS
BOARD MEMBER, ANGEL CAPITAL ASSOCIATION
MANAGING DIRECTOR, GOLDEN SEEDS ANGELS
APRIL 11, 2013

Chairman Schweikert, Ranking Member Clarke and subcommittee members, thank you for inviting the Angel Capital Association to speak on the progress of the JOBS Act.

My name is Jean Peters, and I am a managing director of Golden Seeds, the country's 4th largest angel group. Our 280 members are among the most active angels in the U.S. Collectively, we have funded more than $50 million of equity over the past 8 years in 60 women-led startups. Golden Seeds is a charter member of the Angel Capital Association, on whose behalf I am appearing today.

ACA is the world's leading professional association of accredited investors. We have 200 angel groups from across the continent and their 8,500 individual members.

ACA has watched, waited and worked with the SEC to help promulgate successful rules. We know the process is complex, but recent jobs statistics underscore the need for a fluid flow of angel capital to startups, and we share the subcommittee's concerns over the delay by the SEC in laying out a clear playing field which promotes investment opportunities, protects investors and creates jobs for Americans.

Angels Fund Majority of Early Stage Deals

Let me briefly describe angel investing: Angels are accredited investors whose capital comes from our personal pocketbooks. Most are former entrepreneurs, or were successful in business – and want to help others up that ladder. We invest at the most primal point of capital formation -- small startups with high growth potential.

These companies come out of university research, local business incubators and economic development efforts. They reflect the entrepreneurism that is addressing the business, education and health care challenges we face as a nation today.

ACA also speaks for the 250,000 accredited investors across the country who fund startups each year. And, these are just a subset of the 8 million-plus people who meet the accredited investor definition and could become active.

That is the intent of the JOBS Act – to broadly expand capital access for the startup economy, and to give investors new opportunities to support this growth.

Angels are the only source of capital for most startups, and supply up to 90% of outside equity raised by seed-stage companies after they exhaust any resources from friend and family, according to Kauffman Foundation estimates.

In fact, angel investors fund 20 times the number of seed-stage companies than venture capital. In 2011, angels invested $23 billion dollars in 66,000 early-stage companies, while VCs put a few billion into 1,800 startups, plus $20 billion in 2,000 later stage companies.

Angel-funded companies are in every state and industry sector. They are crucial for job growth. According to Census Bureau data, startups comprise less than 1% of companies, but generate 10% of new jobs in any given year.

Without angel funding, these businesses would simply never get off the ground.

Angel Groups Take Professional Approach

Startup investing is a disciplined and long-term process. Angels bring careful due diligence, negotiations and experience to the table.

We have to: angel capital comes from our own pockets. We are not investing other peoples' money. We invest our own, and more often than not use our successes to fund the next round of startups.

We understand that what we do is highly risky and extremely illiquid. Angels give time and expertise, without compensation, and often without liquidity for 8 to 10 years. We do this to make a return – but also to give back, to keep up with our industry -- and because start-ups value what we do. As a result of the thoughtful work of angel groups, the strong growth in angel financing over the past decade has remained virtually free of fraud or abuse.

Rule 506c will allow issuers to advertise

This brings me to a key part of the JOBS Act – Title Two, which ends to the ban on general solicitation for issuers who sell securities only to accredited investors.

ACA well understands that entrepreneurs have a desperate need for capital. Companies that once could get bank loans, or at least a small business credit card, are now shut out. So, the potential for both crowdfunding and general solicitation to fuel investment is a crucial and exciting development.

We also understand that these new vehicles come with risks for the unwary – just like any other investment, from a public stock to a home mortgage. We appreciate that Congress and the SEC want to safeguard small investors, in particular, from that risk.

But, the proposed rule requires issuers using solicitation to "take reasonable steps to verify" that investors are accredited. This is problematic, because the SEC has not provided clarity on what are "reasonable steps." Instead, the SEC says it will determine whether the test has been met "on a case by case basis."

This leaves both investors and entrepreneurs in a deeply uncertain position.

In a survey of members, ACA identified that angels are likely to not invest if they find a cumbersome, expensive verification process acting as a "gate" against the extraordinary work that

angels do. And, many legal experts have advised their clients through alerts not to invest in advertised offerings if there is no safe harbor.

This lack of safe harbors could cause a dramatic slowdown in angel funding – the exact opposite of Congressional intent.

ACA recommends that the final rule ensure that startups *and* accredited investors can act with confidence. At last fall's SEC Forum on Small Business Capital Formation, the advisory group unanimously recommended that "membership in a reputable angel group" be made a safe harbor. We encourage the SEC to take this approach, and suggest that the professionalism of ACA membership serve as a benchmark standard.

We recommend additional safe harbors, including a detailed self-certification questionnaire that would give further assurance – an approach ACA already employs.

Conclusion

Angels have a long history of adhering to disciplined due diligence, deal screening, term sheets and corporate governance. As more accredited investors come into this class, ACA will play an expanding role in helping high-growth startups and investors intelligently and successfully come together.

ACA will continue to provide adult supervision in this shifting landscape of social media, general solicitation, and the nascent conduit of crowdfunding.

We will be there when companies that are crowd-funded need additional capital.

We will continue to be the primary sorting mechanism for those startups that are most promising.

We will help ensure that companies seeking funding are legitimate, appropriately structured, managed and valued.

Angel groups can provide a substantial barrier to the types of hazards that might face accredited investors – and others trying to sift through advertising or crowdfunding to identify great entrepreneurs and startups.

And that will mean that the innovation now bubbling up in every congressional district and job-seeking community will stand a far better chance of success for the entrepreneur, for its employees, and for the investor willing to take that risk.

Thank you very much.

SUPPLEMENTAL INFORMATION FROM THE ANGEL CAPITAL ASSOCIATION

U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT AND REGULATIONS
HEARING:
JOBS ACT IMPLEMENTATION UPDATE
APRIL 11, 2013

National Angel Investing Landscape

Angel investors are high-net-worth individuals as defined by the Securities and Exchange Commission, who provide money for start-up firms with growth potential. Many angels started, built and sold their own companies and are now in a position to invest their money and equally important, their time and expertise, in new or early stage businesses.

The nation's leading expert on entrepreneurship, the Ewing Marion Kauffman Foundation, estimates that angel investors may be responsible for up to 90% of the outside equity raised by start-ups after the capital resources of founders, friends, and family are exhausted. These firms rarely have the collateral to receive bank loans and they are generally too small and too young to receive venture capital.

The University of New Hampshire's Center for Venture Research estimates that angels invested $22.5 billion in 66,230 companies in 2011.

One of the trends in the field over the last decade is the growth of angel groups, in which investors join together to invest in and mentor companies, pooling their capital to make larger investments and developing best practices for investing and mentoring. ACA estimates there are more than 350 angel groups, located in every state, more than a three-fold increase from about 100 groups ten years ago.

The HALO Report, the leading assessment of angel investing nationwide, describes the investments angel groups made in 2011:

- Median round size of $700,000
- 58% of investments were in healthcare/life sciences and Internet/IT sectors
- Two-thirds of the investment rounds were syndicated, often with multiple angel groups
- Investments were distributed broadly across the country – two-thirds of the deals were outside of traditional startup equity centers of California and Boston.

Angel investors are proud to be an important resource for the startup companies that have created the large majority of net new jobs in the United States over a 25 year period. Angel-backed companies have been some of the most prolific job creators and innovators in recent times: Google, Facebook, and Starbucks are just a few examples.

Thousands more companies supported by angel groups and individual angels are less known, but significant in the innovative products and jobs they have created.

For example, Golden Seeds, which has 280 members from more than two dozen states, has invested in technology, life sciences, retail and other sectors in companies including:

- Cognition Therapeutics, a Pennsylvania-based novel drug discovery company developing a potential cure for Alzheimer's
- Crimson Hexagon, a Boston-based company that provides social media monitoring and analytics
- Flixmaster, a Colorado-based company that provides a technology platform for dynamic video editing

Risk and Angel Investment

Returns to Angel Investors in Groups, the first ever dataset and analysis of angel group returns, confirmed what many investors thought about their success:

- 52% of all exit returns less than the capital the angel had invested in the venture (with 35% of all exits losing all of the money invested)
- 7% of the exits achieved returns of more than ten times the money invested, accounting for 75% of the total investment dollar returns
- 31% of the exits returned the investment between 1 and 5 times the investment.

The study, which looked at 1,137 exits from angel investors connected to angel groups in many areas of the United States, also provided data to support that best practices in angel investment lead to better results for investors and the entrepreneurs they invest in. This includes matching investor expertise with the company, mentoring and monitoring of company progress, and conducting due diligence in reviewing investment opportunities.

It is conventional wisdom that small business is responsible for the majority of net new job creation in the country in any given year. A growing body of focused research, using the Census Bureau's *Business Dynamics Statistics* database, dramatically illustrates that it is a smaller subset of dynamic, high-growth startups that make up the vast majority of that job growth

- According to a Kaufman study, these so-called "gazelle" firms (ages three to five years) comprise less than 1% of all companies, yet generate 10% of all new jobs in any given year.
- A similar study from the National Bureau of Economic Research using the same database, found that, after controlling for age of a small business, startups account for almost 20% of gross job creation in any given year.

These are exactly the businesses that angel investors – and mostly only angel investors -- invest in. The true shift in job creation has moved away from publicly-traded companies to the realm of startups that are funded almost entirely by private capital.

Sources

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ANGEL CAPITAL ASSOCIATION

December 11, 2012

Ms. Elizabeth M. Murphy, Secretary
US Securities and Exchange Commission
100 F St NE
Washington, DC 20549-1090

Subject: Proposed Rule Eliminating the Prohibition against General Solicitation and General Advertising in Rule 506

Dear Ms. Murphy:

As the Commission continues to work on rules related to general solicitation, the Angel Capital Association (ACA) appreciates the opportunity to provide further comment on your proposed Rule 506(c) for offerings that use general solicitation and to offer suggestions for what should constitute "reasonable steps to verify" accredited investor status, so that issuers and investors can act with confidence within specific non-exclusive "safe harbors" when seeking to complete a financing for these high-risk, high-growth startups.

Per our earlier letters, ACA believes:

- The final rule should provide more clarity on what constitutes "reasonable steps" in 506(c) offerings in which natural persons are involved ("angel" investments), and should establish safe harbor standards on which issuers may rely when using Rule 506(c). If not clearly articulated, the uncertainties that are inherent in the proposed rule have the potential to chill investment by angels – the exact opposite of Congressional intent.
- There is not a current issue regarding angels' compliance with accredited investor standards. The SEC's report, "Capital Raising in the US: The Significance of Unregistered Offerings Using the Regulation D Exemption" (Ivanov and Bauguess, February 2012) underscores the lack of fraud.
- If the verification process is too costly, complex, time-consuming, and/or violates investor privacy, issuers and investors face an intractable dilemma in determining whether to take advantage of this innovative change to the Act. Both sides could be frozen into inaction by a lack of clarity or safe harbor provision in 506(c) rules. This would clearly be a missed opportunity that the JOBS Act recognized.
- Rules for safe harbors should be simple and compliance should not require additional costs for investors, and should minimize costs and burdensome administrative difficulties for issuers.

Recommendations for safe harbors were previously suggested in comment letters by ACA and others. We recommend the Commission consider including multiple examples in a final rule in order to ensure a robust capital pool for startups and that none of the safe harbors are exclusive. We endorse those safe harbors that take advantage of existing resources, such as public data and minimum investment size as a presumption of accreditation.

In this letter, we want to explore further two ideas that would provide safe harbor, while ensuring simplicity, continued angel investment, and the requisite protection of investors and issuers:

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Use of an expanded investor suitability questionnaire – The existing form has worked well for a generation of startups funded by accredited investors using Rule 506(b), so should be the basis of a going-forward solution for Rule 506(c). There should be a simple solution that involves adding a few questions to the existing accredited investor questionnaire to clearly meet the "reasonable assurance" intent of the JOBS Act. If the investor completes an answer to any one of the following questions, the issuer should have reasonable belief the investor is accredited (noting that the Commission may want to formalize the language of the concepts presented below):

- Have you made at least one equity investment of $25,000 or more in a given Rule 506 offering in the past three years? If yes, please state the year and name of the issuer for one investment.
- Have you invested in three or more private investments of any size? If yes, please include the year and issuer name for any three such investments.
- Are you a member of the Angel Capital Association, either as an individual or through a membership in your angel group? ACA could provide a "proof of membership" letter or card to individuals who belong to ACA directly or to one of its member angel groups that could be submitted with the form.
- If you do not meet the criteria of any of the preceding questions, please provide an independent reference to support that you meet the wealth or income definitions of an accredited investor. Provide name, contact information and type of entity (with check boxes for type – broker-dealer, attorney, insurance broker, certified financial planner, bank, etc.)

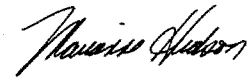
Membership in ACA – During the SEC's November 15th Government-Business Forum on Small Business Capital Formation, participants in the "Exempt Securities Offerings" breakout session recommended that "membership in reputable angel groups" should be established as a reliable safe harbor. We endorse this proposal and believe that membership in groups that are part of ACA and have access to our best practices materials and other extensive resources should be presumed to meet this safe harbor standard. Membership in ACA would be a straightforward and simple means for categorizing a reputable angel group. In addition individual angels who belong to ACA but are not associated with an angel group are also required to meet accreditation standards and should be included in this safe harbor provision.

ACA is uniquely positioned to appreciate the important balance of a healthy capital pool and protection from fraud. Members of ACA member angel groups must be accredited investors. This requirement is a core part of the ACA membership application and agreement for all group and individual members. More importantly, member groups are essentially self-policing – angel groups are comprised of local associates who are familiar with their members' financial acumen and capacity. Our members take advantage of professional development and best practices training. They know each other and strengthen relationships among individual investors and also across angel organizations for syndication purposes. Issuers, promoters and investors who act badly are not welcome.

ACA promotes active member participation in all parts of the investment process. With ACA's educational partner, the Angel Resource Institute, we offer a comprehensive combination of seminars, conferences, webinars, and other training on everything from investment screening, due diligence, participation in portfolio company boards, mentoring and preparation for exit. We have established a code of conduct for individual investors and angel groups. We promote good processes and guidelines for groups to select and document new members and are continually refining best practices and educating angel investors.

Thanks for your consideration of these non-exclusive safe harbors, which we believe will help ensure a vital and robust early-stage investing environment as contemplated by the JOBS Act. If we can provide any additional information or clarification, please do not hesitate to contact the Angel Capital Association.

Regards,



Marianne Hudson
Executive Director

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Testimony of

William G. Klehm III

Chairman and CEO of Fallbrook Technologies

on behalf of CONNECT

U.S. House of Representatives

Committee on Small Business

Subcommittee on Investigations, Oversight and Regulations

Hearing on

JOBS Act Implementation Update

April 11, 2013

Good Morning Chairman Schweikert and Ranking Member Clarke. It is an honor to appear before the committee today and testify on the challenges those of us raising capital for early stage, innovative new companies face in this financial and regulatory environment. I commend you for calling this hearing to check up on the status of JOBS Act implementation to ensure the goals of the JOBS Act, namely to increase access to capital for America's innovators, get accomplished.

I am Bill Klehm, Chairman and CEO of Fallbrook Technologies. I have served as Fallbrook's CEO since 2004 and have over 20 years of automotive related experience. I have held several positions with management responsibilities in the automotive business, including finance, marketing, sales, product development, and manufacturing operations.

We are a private technology company based near Austin, Texas and San Diego, California, dedicated to improving products relying on mechanical transmissions. We both manufacture and market proprietary continuously variable transmission products, and support our global partners in the design and development of our proprietary transmission technology.

Fallbrook currently holds over 500 patents and pending applications worldwide.

Our mission is to deliver the best performing, most versatile and most reliable mechanical power transmissions in the world. We believe the next generation of transmissions including our technology will be less expensive and more effective.

We employ 133 people in the U.S., including approximately 25 of the best engineers in the transmission sector.

We have secured major partnerships with global players in the automotive sector to design and develop applications of our transmission technology. We have passed the commercial tests of physics and economics and have partnered with industry leaders like Allison Transmission of Indiana, Dana Holding of Ohio and TEAM Industries of Minnesota. Our proprietary continuously variable transmission technology is potentially applicable to any product that uses a transmission. It replaces conventional transmission technology that uses gears to transform raw power to managed power with a mechanism that seamlessly provides an unlimited number of ratios within its ratio range.

Transmissions are ubiquitous in anything that has a power source, from your bicycle or vacuum to the most obvious example, the motor vehicle. That range of applications should give you a sense of how big an opportunity we have in front of us—more than $30 billion in just the markets we are active in today. Our technology allows next-generation transmissions to increase fuel efficiency, reduce emissions, and improve overall vehicle performance.

We've grown from negligible revenue in 2009 to more than $43 million last year. And that is money that we are investing back into the business to grow. This is a good start, but we have an opportunity to grow faster and to drive innovation faster. *The only thing preventing us from doing this is affordable capital.* Our ability to access capital is one of the MOST significant challenges we face. I spend over 50 percent of my time on it.

We have raised more than $15 million in capital. Our early investors were angels from California, individuals that recognized the benefits our technology could bring to the mechanical transmission sector. VC investors from California came in next, followed by a VC from Switzerland and more recently corporate investors from Canada, Indiana and Ohio.

The maze through which small innovative companies, like Fallbrook, must navigate to acquire capital is becoming increasingly challenging. Our great country prides itself on entrepreneurship and innovation. Fallbrook is a poster child for those values. From an idea in San Diego in 1998 to the launch of our first commercial product, right through to the automotive development agreements we signed last summer.

With additional capital we could *expand* our manufacturing base in Texas and *build-out* our engineering and development team which would *create new high technology jobs* to accelerate our product development and partnership opportunities. We also believe there would also be a *significant impact* on new job opportunities

within both our suppliers and end user customers, such as automobile manufacturers. This committee should remember that high-tech engineering and manufacturing jobs are the kinds of jobs this economy needs because not only do they enhance America's competitiveness, but they pay above the average salary and wages compared to other sectors. That is why Congress' bipartisan work to pass the JOBS Act was so important and why regulatory hurdles shouldn't slow down the jobs and innovation that will materialize once the JOBS Act is fully implemented.

The changes enacted by the JOBS Act will make acquiring capital less challenging for companies like Fallbrook, specifically the Regulation A change which simply raises the limit on capital a company can currently raise from $5 million to $50 million. Regulation A is already law and is already enforced by the SEC. But the $5 million cap is outdated and unworkable and Congress was absolutely right to modernize the cap for today's innovation climate and to provide more access to capital for America's innovators.

To meet our needs, an incremental $5 million round is simply *not* sufficient to fund the type of development and growth that we are targeting at Fallbrook. Under the status quo, to raise more than $5 million we are required to file a registration statement with the SEC. The opportunity cost of that filing, including the legal and accounting fees and printing costs, is significant for a company of our size, amounting potentially to hundreds of thousands of dollars. Mid and large cap companies that raise public equity benefit from the scale of their transactions relative to the cost of the registration statement. But innovative companies all across the country in various tech sectors that are the size of Fallbrook are robbed of that benefit until the JOBS Act Regulation A rules are implemented. This means that new, well-paying jobs aren't created, new technologies sit dormant, and the public misses out on new products that could change their lives or advance the common good.

The changes in the JOBS Act will increase access to capital for companies like Fallbrook. They will enable us to accelerate our development and commercialization; driving innovation and growth, which creates jobs. New jobs will be created not only local to Fallbrook but also across the nation within the supply and customer chain both upstream and downstream of our proprietary technology. Fallbrook's technology can have a meaningful impact on the mechanical transmission market, using energy more efficiently through the art of simplicity. Fallbrook is not the only company that will benefit from Reg A implementation. I know of several other companies ready to utilize this new option for accessing capital. I encourage the sub-committee to help us in this goal by ensuring the full and speedy implementation of the changes proposed by the JOBS Act. Thank you Mr. Chairman, Ranking Member and Committee Members.

FALLBROOK
TECHNOLOGIES

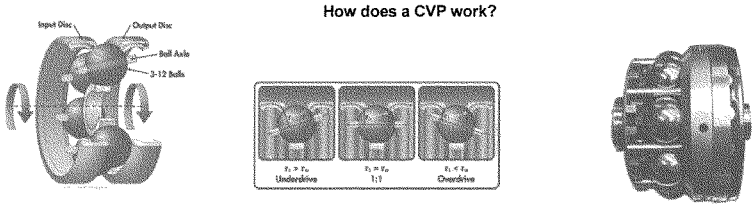
Continuously Variable Planetary Transmissions – A New Technology

Fallbrook Technologies Inc. (Fallbrook) has created a new, scalable transmission that can improve the performance and efficiency of just about any machine with a transmission. For example, this technology can improve vehicle fuel economy, increase wind turbine performance while reducing costs, and even help bicyclists take on steep hills. With the use of rotating and tilting balls between the input and output components of a transmission, Fallbrook Technologies has created the NuVinci® continuously variable planetary transmission (CVP).

***NuVinci* CVP: Revolutionizing Mechanical Transmission-Based Products**

Instead of the traditional gear and clutch mechanisms found in conventional transmission, the *NuVinci* continuously variable transmission can change seamlessly through an infinite number of speed ratios between maximum and minimum values. The technology is applicable to products that use a transmission, including bicycles, electric vehicles, outdoor power equipment, agricultural equipment, automobiles and wind turbines.

How does a CVP work?



The *NuVinci* transmission uses a set of rotating balls between the input and output components of a transmission that tilt and vary the output speed of the transmission. Tilting the balls changes their contact diameters with the discs, which varies speed smoothly and seamlessly. As a result of its infinite number of ratios within its range, the *NuVinci* CVP improves acceleration, performance and powertrain efficiency over conventional transmissions.

Advancing Public Policy Objectives

Improving Fuel Economy: The *NuVinci* CVP is designed to reduce energy consumption through its seamless speed changing characteristics, allowing the power input of any fuel driven engine to operate in its most efficient speed range, leading to improved performance and reliability, as well as reduced fuel costs.

Promoting Renewable Energy Deployment: In wind turbine applications such as those being developed by Fallbrook's spin-off company Viryd Technologies, CVPs are designed to lower the cost of electricity and make small wind turbines affordable and easier to deploy and maintain. We believe this will help move America towards its goal of 20% wind power by 2030.

Government Role in Meeting the Technology Potential
The innovation is here, however government support is critical to help bridge the gap from R&D to commercialization and to provide industry a driver to integrate these cutting-edge transmissions into a new wave of efficient machines.

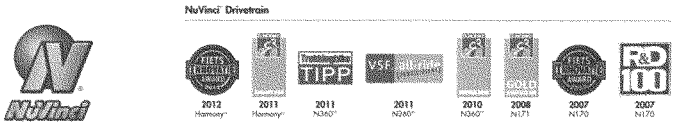
See *NuVinci* technology videos on the Fallbrook website: www.fallbrooktech.com/nuvinci-technology.

Who We Are

Fallbrook Technologies Inc. is a technology development company headquartered in Cedar Park, Texas and has its primary operations and product development activities also located in Cedar Park with employees and other operations in China and Europe. Fallbrook has a comprehensive patent portfolio of 500 patents and pending applications worldwide that has previously been named the #1 patent portfolio in the transportation sector by The Patent Scorecard™.

Fallbrook received the 2012 North American Frost & Sullivan **Growth Capital Investment Opportunity Award** in the Powertrain Market. Frost & Sullivan stated: "The Company exhibits all the features of a superior market participant that deserves close attention from investors looking for opportunities."

Other awards:



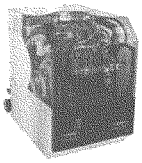
Real-World Implementation

The CVP is widely applicable technology. Fallbrook is targeting the following key markets:

- Automotive-class applications
  - Primary transmissions
  - Variable speed accessory drives (DeltaSeries™)
- Electric vehicles (including low-speed/urban vehicles)
- Bicycles and other 2 wheelers
- Stationary and off-road equipment
- Industrial equipment
- Wind turbines

In Production Now:

- In 2007, Fallbrook introduced the first continuously variable transmission for bicycles now in its second generation (*NuVinci* N360™).
- In 2011, Fallbrook introduced an intelligent automatic shifting system *NuVinci* Harmony™ incorporating the *N360.*
- In March 2011, Fallbrook acquired the business of Hodyon, which now operates as a wholly-owned subsidiary, manufactures auxiliary power units (APUs) and sells/distributes them via a US-based dealer network to the heavy truck industry.



Auxiliary power units (APUs) are used on by the heavy duty trucking industry to replace idling the trucks main engine during a driver's down time. APUs are small diesel or battery powered idle reduction devices that provide the truck's sleeper compartment with heating, air conditioning, and 110v hotel type power. A heavy-duty log-haul truck spends an average of 2,400 hours per year idling during non-driving down time, burning an average of one gallon of diesel fuel per hour. A diesel APU burns an average of .25 gallons of diesel fuel per hour, significantly reducing fuel consumption and diesel emissions.

In an independent evaluation, Southwest Research Institute confirmed that a CVP-enhanced APU will provide up to 24% additional fuel savings versus conventional APUs.

Production of a next generation *NuVinci* CVP-enabled APU is planned.

Recently Signed License Agreements:

- Signed an exclusive licensing agreement for commercial vehicles and certain off-highway primary transmissions with Allison Transmission Holdings Inc. (NYSE: ALSN)
- Signed an exclusive licensing agreement for automotive and certain off-highway primary transmissions with Dana Holding Corporation (NYSE: DAN).
- Signed an exclusive licensing agreement with Team Industries, Inc. for use of *NuVinci* CVP technology in North America and Europe for electric and gasoline light vehicle applications.

Growth Plans: Fallbrook is currently developing a number of additional applications of *NuVinci* technology for other markets with near-term commercial potential. Licensing agreements and/or product launches for one or more entries in each of the following markets are planned for during the period 2012 to 2014:

- *NuVinci* DeltaSeries™ continuously variable accessory drives (CVADs) for automotive (car and truck) alternators, air conditioning compressors and superchargers.
- Industrial equipment where use of the *NuVinci* CVP will allow energy source to operate at its most efficient point, resulting in energy savings while providing variable torque and variable speed output.
- Lawn care equipment where the *NuVinci* CVP will replace hydrostatic drives and offer improved performance and reduced noise.
- Small wind turbines in which the *NuVinci* CVP will provide a variable drive speed to match wind speed with the input speed needed by the generator, capturing more of the power available from the wind and reducing reliance on expensive voltage-regulation power electronics.

For more information and contacts, visit www.fallbrooktech.com.

William G. Klehm III
Chairman and CEO

William G. Klehm III is the Chairman and Chief Executive Officer of Fallbrook Technologies Inc. ("Fallbrook"). Fallbrook is a technology development company that manufactures advanced mechanical transmission-based products and, through a wholly owned subsidiary, manufactures and sells Dynasys™ auxiliary power units (APUs). Fallbrook's core technology is its traction-based NuVinci® transmission – a new class of continuously variable transmission well suited for applications in many mechanical devices that have a transmission or require speed variation. *NuVinci* technology may be used to optimize system efficiency and reduce fuel consumption and emissions.

Mr. Klehm joined Fallbrook in April 2004 with over 20 years of automotive-related experience. He has held several positions with management responsibilities in the automotive business, including finance, marketing, sales, product development, and manufacturing operations. Under his leadership, Fallbrook has grown from six employees to over 150 and taken the Company from startup status to $43.2 million in revenue in 2012. To fund that growth, Mr. Klehm has led various private funding rounds totaling $115 million and most recently established major technology licensing agreements with Allison Transmission Holdings Inc., Dana Holding Corp., and TEAM Industries, Inc.

Prior to joining Fallbrook, Mr. Klehm served as the President and General Manager of Newgen Results Corporation, an automotive customer relationship management firm. He has also served as President and SBU Director for Visteon Climate Control Systems Ltd., collaborating on the development and launch of Visteon's Aftermarket Division. He started his career with Ford Motor Company in 1985 and held a variety of posts within the Ford Customer Service Division where he was responsible for developing and executing the marketing/growth strategy for its customer service parts business.

Mr. Klehm holds a B.A. in Management and Marketing from Northwood University and also participated in the Harvard Business School Executive Education Programs.

"JOBS Act Implementation Update"

Testimony of

Kevin Rustagi

CEO

Evolutions of Noise

April 11, 2013

Before the

Small Business Committee

United States House of Representatives

The Honorable David Schweikert, Committee Chairman

The Honorable Yvette Clarke, Ranking Member

Good morning, Chairman Schweikert, Ranking Member Clarke, and members of the Committee. It is an honor and privilege to be here today to share my experiences and knowledge with the committee.

My name is Kevin Rustagi, and I am an American entrepreneur and product designer.

As an alumnus of the Massachusetts Institute of Technology, I've had the privilege of working with firms such as Apple on the iPhone 5 and GE during my undergraduate career. Over time, the entrepreneurship community at MIT drew me to the world of high-tech, high-growth early stage startups. I opted for a multi-year deferral from Stanford Business School to explore startup opportunities.

Since then, I have been a student of the modern economy and sought to start ventures using highly mobile labor and capital. As such, I have experience with loans from family and business partners, angel investing with accredited investors, and most recently, donation-based funding through Kickstarter.com. I am also an active member of the young startup community, acting as a sounding board in the early venture space.

A recent company that I co-founded, Ministry of Supply (MoS0, creates high-tech business apparel for men and held the record in the fashion category on Kickstarter for the latter half of 2012 by taking pre-orders for our new space-age dress shirts. Our goal was $30,000. In 33 days, we raised over 14 times that for a total of $429,000. Since inception, we have created 14 new jobs.

Though new technologies such as viral marketing and rapid prototyping are highly effective, the need for accessible funding and backing remains as pertinent and challenging as ever.

Today, I aim to discuss how funding has played a role in my ventures as of late, and how access to new methods of fundraising, as cited in the Jumpstart Our Business Startups Act, or the JOBS Act, would greatly increase every entrepreneur's chance of success in starting new ventures, thereby stimulating the creation of new jobs and economic growth.

Kickstarter and 'going viral'

Kickstarter is one of the web's primary curated crowd-donation sites, and is known for taking only a 5% cut of donations to a project. As with MoS's high-tech dress shirts, the site has in part evolved into a pre-order destination for new consumer products.

Despite its focus on early creative projects, launching on Kickstarter requires substantive concept development. For example, multiple prototypes are generally required for market adoption. Started in late 2010, MoS raised angel funding before going on Kickstarter to increase our odds of success. We waited one-and-a-half years to launch on Kickstarter, engaging a viral PR strategy using social media to raise awareness. Surprisingly effective, our story was featured online in Australia, India, Sweden, China, and the United States, sparking pre-orders in over two-dozen countries.

With global traction and roughly 100,000 views of our videos, we experienced what is known in the startup world as 'going viral'.

Involuntarily rejecting crowd-investors

As a young company, we used the money from pre-orders to feverishly grow, but we required further funding to build a new supply chain and hire new employees. Given the buzz from Kickstarter, we had multiple offers from investors around the world. However, many were smaller investors (in the $1,000–$15,000 range). Absent sufficient regulation, legal precedent, and vetting tools, we experienced the deep irony of having to turn them away.

Albeit ultimately fruitful, the company's continued search for angel funding has taken valuable time away from vital product and business development.

The difference between equity-based and donation based funding

Donation-based funding remains the holy grail of early stage ventures, due to its ability to help bootstrap a business without dilution. Crowd donation is based on goodwill; equity based funding is based on a mutual higher expected value.

While donation-based is ideal, real-world constraints necessitate a more continuous stream of funding, especially in environments with disjointed demand and a difficult path to profitability. Equity-based funding is simply a much more reliable model because there is a higher tangible monetary benefit for both the venture and the investor.

Different levels of funding are required for different stages

One of the greatest challenges entrepreneurs face with funding is dilution. If they are forced to sell shares when their company is worth less, they give up more shares. If I need to raise $200,000, but my company is worth only $40,000, I would be forced to give up half of my company that I can't get back. This not only impacts founders, but also all future stakeholders.

When companies have to pursue angel funding in a less robust market, as we did with our interest in consumer products, they are subject to often-difficult negotiations with potential investors. There is now less of the pie to be shared. Crowd investing would allow for a smoothing effect here, balancing the playing field.

The timing of the JOBS Act and the global stage

The startup community is very excited about the JOBS Act. Colleagues of mine are eager to test out models that will allow them to work on their projects. Crowd investing would allow entrepreneurs to take on projects with greater ease.

MassChallenge, a Boston-based startup competition, has been recognized by the White House as a key partner in the Startup

America initiative. Last year, 1,237 companies applied for 125 finalist spots, garnering free office space and a summer program with mentors with several companies receiving a cut of $1,000,000 in prize money. They received applications from 35 countries. MassChallenge, like the marketplace, is judged solely based on traction and market adoption. Competition is now a highly global democracy. America must stay competitive.

Supporting a culture of entrepreneurship and innovation

America holds a nearly unparalleled legacy of entrepreneurship and innovation. My grandfather, Merton Purvis, was one of over 1,200 PhDs at Bell Labs at its peak in the 1960s—widely considered to be one of the most innovative organizations in modern history. Since then, startups have taken its place as America's innovation engine. Support for startups must match the speed of global competition.

Programs like Startup Chile provide funding to startups willing to locate in Chile for 7 months, demonstrating the rest of the world's desire for the latest new high-tech and high-growth jobs. Other nations are at the forefront, while America demurs. Sound regulation for the JOBS Act will change that.

Would crowd investing be used?

In short, yes. Angel investing's limitations are connections and the liquid market. In venture capital, it is the idea of being 'proven.' In crowd-donation, too long before or after a certain stage of development, and the donation community may not accept your story. Moreover, crowd investing provides a unique tool. The entrepreneurs I have met over the past 6 years are extremely resourceful and, if given effective new crowd-funding tools, would make quick use of them.

Conclusion

Crowd investing within the JOBS Act demonstrates America's continued commitment to developing the next generation of small businesses and startups. It will provide a real opportunity to strengthen the economy from the ground up. It remains vital to consider all elements of this, including items that are still caught up in legislation, especially the Startup Visa.

New businesses are difficult ventures to undertake, and anything that safely and effectively puts the advantage in the hands of the innovator is greatly desired and beneficial to the economy. Crowd investing through the JOBS Act will be a unique and exciting way to promote new businesses.

As I've noted, I have used a variety of tools in creating new ventures, both for product design and business development. My hope is that my colleagues and I can continue to create new ventures in a way that leads and inspires the world. I eagerly await the day that I can fully utilize crowd funding and crowd investing to help create successful new ventures.

I thank you for this opportunity to explain relevant concerns of the startup community surrounding the JOBS Act and crowd investing.

Testimony of

James J. Angel, Ph.D., CFA

Georgetown University McDonough School of Business

and

The Wharton School of the University of Pennsylvania

on

JOBS Act Implementation

House Committee on Small Business

April 11, 2013

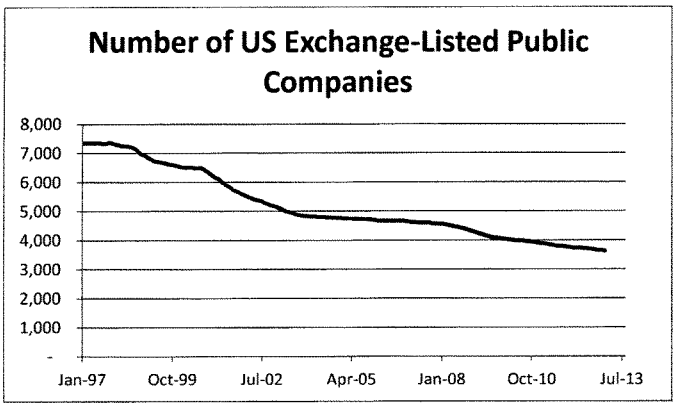
Key points:

- The JOBS Act was passed in response to the twin crises of the Great Recession and the crisis in capital formation in the United States. There are now have approximately half as many U.S. exchange-listed companies as there were 15 years ago.
- Most of the JOBS Act could and should have been done by the SEC under its own volition. Congress should study why the SEC did not act and seek ways of improving the SEC's effectiveness in understanding of the big economic picture and adopting economically sound regulations.
- The SEC has missed numerous Congressional rulemaking deadlines while devoting substantial resources to non-Congressionally mandated rulemaking activities.
- The SEC should adopt temporary interim rules for crowdfunding and analyze the results while it prepares permanent rules, rather than engage in endless contemplation.
- The SEC should permit issuing companies to select their own tick size. Issuers have the incentive to get it right because it is their stock that is affected.
- Many of the features of the JOBS Act make it easier for companies to avoid becoming public companies. The regulatory focus should be on fixing the public markets rather than making it easier to avoid them.
- The SEC needs more resources in order to do its job properly. The SEC's cumulative budget since its founding is less than investors lost from one Bernie Madoff.
- Given the past misallocation of resources, Congress needs to monitor the SEC carefully to make sure that it hires people with the appropriate financial and technical qualifications instead of more inexperienced lawyers.

Introduction: The need for the JOBS Act

My name is James J. Angel and I am an associate professor of finance at the McDonough School of Business of Georgetown University. This year I am a visiting associate professor at the Wharton School of the University of Pennsylvania.[1] I study the operation and regulation of financial markets and have been following the JOBS Act since its inception.

The JOBS Act was enacted in reaction to the twin crises affecting our country – the crisis in capital formation signaled by the continuing decline in the number of exchange-listed US public companies, and the massive unemployment stemming from the Great Recession. The number of U.S. public companies listed on our exchanges has been shrinking steadily for the last 15 years. We have gone from 7,337 U.S. companies traded on our exchanges in January 1997 to only 3,626 at the end of December 2012, a loss of over 50%.[2] We are not creating enough new public companies through initial public offerings (IPOs) to replace those that are lost to attrition.



In short, our public capital markets are no longer nurturing the smaller dynamic companies that represent our economic future. This decline in the U.S. public equity markets represents a crisis in capital

[1] I also serve on the boards of the Direct Edge stock exchanges (EDGX and EDGA). My views are strictly my own and do not necessarily reflect the views of Georgetown University, the University of Pennsylvania, Direct Edge, or anyone else.

[2] These numbers are for U.S. public companies listed on NYSE, NASDAQ, and AMEX, not including foreign ADRs or Exchange Traded Funds (ETFs). Data are from the Center for Research in Securities Prices (CRSP).

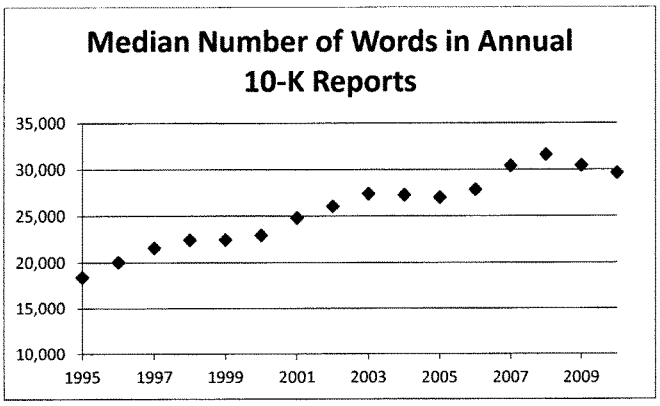
formation. We have made it so difficult and burdensome to be a U.S. public company that fewer companies are going public. By closing off the public markets, we restrict the opportunities for growing companies to raise needed capital for growth and for venture investors to harvest their investments. This means less capital investment, less growth, and fewer jobs.

There are multiple drivers to this trend, and much debate over the causes. A non-exhaustive list includes:

Compliance costs

One of the main drivers of this trend has been the increasing compliance costs that we have placed on U.S. public companies but not on private companies. Regulations continue to require ever more extensive disclosures of public companies but not private ones. For example, recent regulations require companies to provide expensively audited reports on the use of "conflict minerals" from the Democratic Republic of the Congo in their supply chains, even if they purchase no such minerals from the Congo. [3] However, private companies that do business in the dark in the Congo have no such disclosure requirements.

Even before the conflict minerals requirements, the creeping nature of required disclosures has resulted in longer and longer required annual reports on Form 10-K. From 1995 to 2010 the median number of words in a 10-K filing has increased from 18,450 to 29,653, a 61% increase. [4]

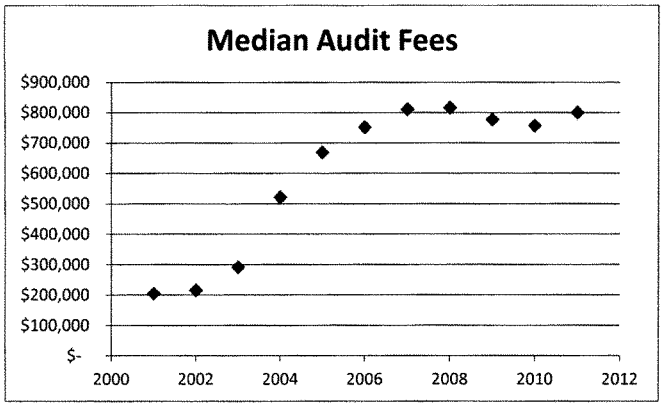


Costs rise commensurately with this increase in disclosures. The following chart demonstrates that the median audit and audit-related fee paid by a U.S. exchange listed company quadrupled from $205,620 in

[3] See the 356 page final rule at http://www.sec.gov/rules/final/2012/34-67716.pdf

[4] This is based on the word count data found on Li Feng's web site, http://webuser.bus.umich.edu/feng/.

2001 to $800,608.[5] A large part of this is the result of Sarbanes-Oxley requirements, which are applied to public but not private companies.



The bottom line is that we have made it so expensive to be a public company that smaller companies can no longer cost-effectively access the public equity markets. Growing companies have no other choice but to go to the private equity market.

Litigation risks

Although all companies in this country are targets for abusive lawsuits, public companies have an extra "sue me" sign painted on their backs. Any bit of bad news affecting a company can lead to a series of "shareholder" lawsuits. This leads to a double penalty for the real shareholders, who suffered from the original bad news as well as the costs of dealing with the litigation. Approximately 6% of exchange-listed firms are sued each year.[6] Over the course of two decades, there are better than even odds that a public company will be the target of such litigation. This added risk is yet another reason for firms not to go public. As one CEO of a private firm explained to me "If I go public, I get sued."

[5] Data on audit fees obtained from Audit Analytics.

[6] According to the Stanford Securities Class Action Clearing House, there were 152 lawsuits filed in 2012 and comparable amounts in previous years. Dividing the 152 lawsuits by the 3,626 public companies at the end of 2012 gives a hazard rate of 6.37%. http://securities.stanford.edu/ The Clearing House also concluded that previous attempts by Congress to reign in such litigation such as Private Securities Litigation Reform Act of 1995 had little effect. Their web site states "The absolute number of issuers sued does not appear to have changed dramatically since passage of the Act, once the effects of the IPO Allocation Litigation are excluded."

Market structure changes

The United States used to have a very different structure for trading small cap stocks. The old NASDAQ dealer market operated a very different market mechanism from the auction market used on the NYSE and the AMEX. A series of technological, economic, and regulatory changes have led to a U.S. market structure that is the essentially the same for all exchange-listed companies. Many of these changes were well-intentioned and have resulted in a market structure for large-cap companies that works extremely well. However, it is by no means clear that the best market structure for large-cap companies is the same as for small-cap companies.

We should encourage innovation and experimentation in the market structure for smaller companies. We should allow the exchanges to adopt different mechanisms for different types of stocks. However, the SEC staff has been extremely reluctant to let exchanges try anything really different. The result is a "one market fits all" approach that does not fit our small companies well.

The JOBS Act also provided a very important nudge to the SEC to re-examine the issue of the tick size. Section 106 required the SEC staff to study the issue and explicitly authorized the SEC to set different tick sizes for emerging growth companies.[7] The "tick" is the minimum price increment at which stocks trade.[8] For example, our markets will allow an investor to place an order to buy Microsoft at $25.00 or $25.01, but not $25.0001. When our markets switched from trading in fractions to decimals, the tick size fell from 12.5 cents to 1 cent for most stocks. This was enshrined in SEC Rule 612.[9]

This sounds like a narrow technical issue, and it is, but it is one that is very important to the trading of stocks.[10] The optimal tick is not zero, and it is different for different firms, even with the same price level.[11] For example, the Bank of America (BAC) is a $12 bank stock that trades an average of about 150 million shares per day. New Jersey Bancorp (BKJ) is a $12 bank stock that trades an average of less

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[7] This authorization to set tick sizes appears to be redundant, as the SEC already sets tick sizes in Rule 612. To the best of my knowledge no one has ever challenged the SEC's authority to set such rules.

[8] I testified on this issue before the House Commerce Committee's Subcommittee on Finance and Hazardous Materials on April 16, 1997. The subject was HR 1053, The Common Cents Stock Pricing Act of 1997.

[9] Rule 612 -- Minimum Pricing Increment, reads

> a. *No national securities exchange, national securities association, alternative trading system, vendor, or broker or dealer shall display, rank, or accept from any person a bid or offer, an order, or an indication of interest in any NMS stock priced in an increment smaller than $0.01 if that bid or offer, order, or indication of interest is priced equal to or greater than $1.00 per share.*

[10] For more details, see my comment letter to the SEC on tick size, http://www.sec.gov/comments/jobs-title-i/tick-size-study/tick-size-study-1.pdf.

[11] For a mathematical model of the optimal tick size, see Angel, James J., 1997, Tick Size, Share Prices, and Stock Splits, *Journal of Finance* 52: 655–681.

than 2,000 shares per day. Yet they both have the same tick size of $.01, thanks to the "one-tick-fits-all" approach of SEC Rule 612. Bank of America would probably be better off with a tick size of one half penny, while the trading in New Jersey Bancorp would benefit from a wider tick size.

The SEC staff actually met the deadline for studying the issue.[12] Their study was basically a review of previous literature on tick size changes, and a call for more study. The SEC also held a roundtable on the issue, and is apparently planning a pilot program to examine the impact of different tick sizes.[13] As an academic I love pilot studies, because they give me lots of data to play with.

However, the real public policy question is "Who decides the tick size?" The SEC? The exchanges? The issuers? Given that the optimal tick size is different for different companies, I am of the opinion that the issuers themselves should pick their tick sizes. If the issuers pick the wrong tick size, the liquidity (and thus the share price) of their firms will suffer, so they have the best incentive to get it right. If the tick size is too big, a higher than optimal bid-ask spread will drive up investor's transactions costs and lead to a lower stock price. If the tick size is too small, the stock will suffer from illiquidity and the share price will also suffer. The issuers themselves should have the flexibility to experiment with different tick sizes in order to discover the right tick size.

Collapse of dotcom bubble

Clearly, the dotcom bubble had an impact on our capital markets. However, there were only approximately 500 dotcoms that went public, so the decline in the number of U.S. companies listed on our exchanges is not an artifact of the bubble.

Overall market conditions

Clearly the mediocre performance of the equity markets in recent years has led to a challenging environment. However, there was a recovery in the middle of the last decade before the onset of the Great Recession, and stock prices have since recovered and reached new highs. Although the entire world has experienced similar overall economic conditions, the other countries have not experienced the same precipitous decline in the size of their public equity markets.

The rise of private equity

Some argue that there is less need to go public because of the growth of the private equity industry. However, much of the growth of the private equity has been driven by the closure of the public equity market to smaller issuers. In short, smaller firms have no place else to go, and private equity firms have stepped in to fill the gap – for a price. The closure of the public equity option gives growing companies fewer potential sources of capital.

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[12] http://www.sec.gov/news/studies/2012/decimalization-072012.pdf

[13] http://www.sec.gov/news/press/2013/2013-16.htm

The shutting down of the public equity markets for smaller firms has created lucrative opportunities for the private equity firms that are not available to ordinary investors and the mutual funds we invest in.

The JOBS Act and SEC authority

The JOBS Act makes numerous changes to U.S. regulatory policy. It relaxes disclosure requirements for smaller companies, reduces restrictions on marketing activities in securities offerings, provides a regulatory framework for crowdfunding, and calls for various studies.

Almost all of these provisions are things that the SEC could and should have done on its own. The SEC has abundant legislative authority to set rules and to exempt smaller companies from various rules.[14] The question that Congress should be asking is "Why hasn't the SEC exercised its powers to do this on its own?" What is wrong with the structure, culture, and operation of the SEC that led to this, and what should be done about it?

For example, Congress had to step in to assert that it was legal for emerging growth companies to "test the waters" to see if investors were interested in a public offering before the company went to the expense of filing a formal registration statement with the SEC. In its FAQ on the JOBS Act, the SEC staff points out that accepting nonbinding indications of interest for any firm is not a violation of Rule 15c2-8(e), and that the rule only applies once a registration statement has been filed with the SEC, past regulatory behavior had left the impression that such testing the waters risked unpleasant sanctions from the SEC.[15]

JOBS Act deadlines

The JOBS Act specified that the SEC should adopt rules to facilitate crowdfunding within 270 days of the enactment of the legislation. A year has gone by, and the Commission has not even published proposed rules. What it has done is put out a chilling message saying that crowdfunding is illegal until the SEC decides to make it legal by adopting the rules.

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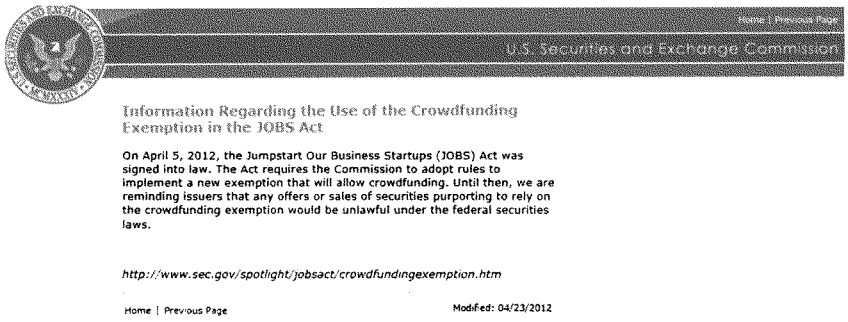
[14] Section 36 of the Securities Exchange Act of 1934 gives the Commission very broad exemptive authority.

[15] http://www.sec.gov/divisions/marketreg/tmjobsact-researchanalystsfaq.htm



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U.S. Securities and Exchange Commission

Information Regarding the Use of the Crowdfunding Exemption in the JOBS Act

On April 5, 2012, the Jumpstart Our Business Startups (JOBS) Act was signed into law. The Act requires the Commission to adopt rules to implement a new exemption that will allow crowdfunding. Until then, we are reminding issuers that any offers or sales of securities purporting to rely on the crowdfunding exemption would be unlawful under the federal securities laws.

http://www.sec.gov/spotlight/jobsact/crowdfundingexemption.htm

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Just a few days ago, on April 9, 2013, more than a year after the passage of the ACT and more than three months after the missed deadline for rules, Crowdcheck held a conference here in DC at which an SEC staffer spoke. At the Q&A part of the presentation, he was asked whether the SEC would have adopted the required regulations by the ***second*** anniversary of the Act, more than 15 months after the deadline. The staffer could not say. **Apparently the regulations are on such a slow track at the Commission that it is questionable whether companies that are starving for capital will be able to access crowdfunding more than 15 months after the Congressional deadline.**

The Commission is also very far behind on many of the rulemakings required under Dodd-Frank. However, the Commission has taken on itself to devote substantial resources to rulemakings in other areas that Congress did not deem important enough to mention in either Dodd-Frank or the JOBS Act. These endeavors include efforts to change the money market fund industry, and its 377 page proposal on Systems Compliance and Integrity.[16]

One reason for the SEC's hesitancy with regard to rule writing has to do with the legal risk that its rules will be overturned due to faulty cost-benefit analysis. The courts have rightly struck down some SEC rules because of faulty cost-benefit analysis. Rather than providing a solid economic justification for its rules, the SEC's cost benefit analyses were a perfunctory afterthought buried near the end of its rule proposals. Although the SEC claims to have learned its lesson and promises to do a better job of economic analysis, it remains to be seen whether a lawyer-run agency like the SEC has really changed.[17] The culture of a large organization like the SEC is very hard to change.

Another possible reason for hesitancy is the fear of making a mistake. With some rules, it is indeed better to take additional time to get them right rather than fast. By spending more time to study and reflect on a rule, it is plausible that a rule will be better for the delay. However, with an economy facing massive unemployment, such a leisurely approach is not appropriate as delay is costing jobs. Congress

[16] http://www.sec.gov/rules/proposed/2013/34-69077.pdf

[17] http://www.sec.gov/news/testimony/2012/ts041712mls.htm

appropriately gave the SEC a 270 day deadline for adopting crowdfunding rules which the agency has inappropriately ignored.

It is clear that the SEC did not take extra time because it was intently studying the issue. It took the extra time because it was **not** studying the issue. For example, on July 26, 2012, a conference was held on crowdfunding at the Georgetown University Law Center in order to discuss crowdfunding and the JOBS Act.[18] This event was within walking distance of the SEC headquarters. A number of noted academics and practitioners were there, and the SEC was invited. Yet nobody from the SEC thought the topic was important enough to show up. (One staffer did show up in the afternoon after I contacted one of the Commissioner's offices and pointed out how embarrassing it was to the Commission that nobody from the Commission was in attendance.) This pattern of ignoring the intellectual contributions happening outside the Commission is one of the reasons that the Commissions economic understanding of markets has suffered.

However, the delay in adopting the required crowdfunding rules stems from more than just the fear that the rules will be overturned. The Commission has shown a pattern of antipathy towards the idea of crowdfunding from the beginning and is in great danger of killing the idea through regulatory delay and overregulation.

The concept behind "crowdfunding" is quite simple: Let small companies raise small amounts of capital with a minimum of expensive regulatory requirements. Limiting the amount that any one investor can invest to a modest amount limits the risk to that investor. The SEC basically ignored a rulemaking petition in 2010 to permit small offerings of up to $100,000 with a maximum of $100 per investor[19]. The SEC received over 100 comments supporting the petition. [20]

To be sure, there are some serious issues with respect to crowdfunding. The first is investor protection from fraud and abuse. Hucksters could raise funds for dubious enterprises and then just disappear. However, such frauds would still be criminal violations. The second concern is that of disclosure, both at the initial offering and afterwards. Will investors have sufficient information to decide whether to invest in such offerings, either in the primary or the secondary markets? The third issue is the quality of trading in the secondary market. Will investors in such tiny offerings have the ability to sell at a fair price when they need to sell? Will the secondary market be rife with manipulation?

These are indeed legitimate concerns. However, fear of every conceivable bad thing that could happen should not stand in the way of proper experimentation to find out what actually will happen. Limiting the maximum investment to a modest amount limits the risk to any one investor.

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[18] The report can be found at http://www.milkeninstitute.org/pdf/crowdfunding120827.pdf. This is an unfortunate pattern for the SEC. It rarely sends staff people even to local industry conferences that examine important topics on the regulatory agenda. This reflects a false view that there is nothing for the SEC to learn from such events.

[19] http://www.sec.gov/rules/petitions/2010/petn4-605.pdf

[20] http://www.sec.gov/comments/4-605/4-605.shtml. I also submitted a supporting comment letter which can be seen at http://www.sec.gov/comments/4-605/4605-33.pdf.

As far as disclosure goes, as long as investors know that they will get less detailed information than they get from larger offerings, and that these are very high risk investments in which they could and often would lose their entire investment, then they should have the freedom to make such a risky investment. The required disclosure to investors should include a short warning indicating that it is a tiny offering and the investor could lose all their money. This can be done with a very simple and inexpensive "black box" warning label:

For example, it could say:

- **This is a risky investment. You may lose your entire investment!**
- There may not be any market for selling these securities when you want to sell.
- Financial information about this investment may not be as reliable as the audited financial statements of large public companies.

Indeed, such a simple warning label may be far more effective than a two hundred page registration statement that lulls an unsophisticated reader into thinking that the offering is a sound investment that has been thoroughly vetted by the experts at the SEC.

However, the SEC ignored this reasonable petition on crowdfunding, so Congress stepped in with Title III of the JOBS Act. Title III basically provides a regulatory framework for crowdfunding deals up to $1 million dollars with investments as large as $10,000 each, provided they are done through regulated crowdfunding portals. Many other restrictions and requirements are also included.

Many of these regulations sound innocuous, but could in the hands of hostile regulators become a heavy millstone that seriously inhibits the use of crowdfunding. For example, Section 4A(b)(4) requires issuer to

> "not less than annually, file with the Commission and provide to investors reports of the results of operations and financial statements of the issuer, as the Commission shall, by rule, determine appropriate, subject to such exceptions and termination dates as the Commission may establish, by rule; and
> "(5) comply with such other requirements as the Commission may, by rule, prescribe, for the protection of investors and in the public interest."

In other words, the SEC could easily require full-blown financial reports just like it requires from IBM. There is a temptation for this agency which has been so unresponsive to the will of Congress to over regulate crowdfunding to death in the name of consumer protection.

The concern about the quality of trading should also not prevent innovation and experimentation to proceed. Crowdfunding will probably be most useful in providing seed capital (so-called "angel

financing") for startup ventures. For example, an entrepreneur with a cool idea needs some money to live on so she or he can quit their day job and devote fulltime to launching the venture. The seed money will be spent developing the business plan and proof of concept. Such ventures will usually need additional rounds of capital in order grow. These additional funding rounds will often dilute the original investors, but may also offer exit opportunities. The exit for most of the crowdfunding investors will not be to sell shares into a tiny and totally illiquid secondary market, but to exit when the firm gets another round of financing or when the firm gets acquired.

Crowdfunding is new, and it is unlikely that the adopted rules will be perfect no matter how much time the SEC spends on the rules. **A more common sense approach in the midst of a recession is for the SEC to quickly adopt interim rules.** This will allow the Commission to learn from experience how the rules work and will lead to more informed final rules. One very well done precedent was the SEC's implementation of Rule 204T during the heat of the financial crisis in September 2008. The rule promptly reduced the endemic settlement failures that were an embarrassment to the U.S. equity market. Later, after observing the success of the rule, it was made permanent.[21]

We should fix our public capital markets rather than make it easier to leave them.

The Act increases the threshold to require firms to register with the SEC from 500 shareholders of record to 2000 shareholders of record. Note that this is shareholders *of record*, and not total beneficial shareholders. Since many if not most shareholders hold their shares in street name through a broker or a custodian bank, the number of shareholders of record is much smaller than the number of people who actually own shares. For example, suppose 500 different people own shares that are held in one particular brokerage firm and that brokerage firm is a participant of Depository Trust and Clearing Corporation, the entity that clears and settles most stock transactions in the United States. Then that brokerage firm would appear as the owner of the shares and count as one shareholder of record.

This provision is a two edge sword. Rather than deal with the problems in our public capital markets, Congress made it easier for firms to avoid the public capital markets.[22] It recognizes how burdensome SEC registration has become, and it frees thousands of firms from the requirement of SEC registration. Such firms still need to be SEC registrants in order to be listed on our exchanges, but their shares can still trade in the over-the-counter markets in the U.S. without registration. However, I think that the solution is not to make it easier to leave the public markets, but to fix the public markets so they are more attractive.

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[21]. Rule 204T and later Rule 204 basically require firms to deliver sold shares on the regular settlement date and provides for mandatory buy-ins. Alas, the Commission had received thousands of complaints in the previous decade about settlement failures, and tinkered around with a complicated Regulation SHO Threshold list approach to the problem. It took a financial meltdown for the Commission to do the obvious and simple thing – require sellers to deliver the stock on the settlement day – with a temporary rule.

[22] Indeed, a quick search of the Compustat database finds less than 1,400 US exchange-listed firms reporting more than 2,000 shareholders in the database.

The SEC needs the resources to do the job right.

Defenders of the SEC can point out that the SEC has continually suffered from insufficient resources to do its job well. The technical experts who truly understand financial markets and technology are not cheap, and the SEC has not had the resources to attract and retain enough of the highly skilled people it needs to do its job well. Don't get me wrong: There are a lot of intelligent, highly skilled, and dedicated people at the SEC. There just aren't enough of them.

There is one statistic that shows how penny-wise and pound foolish the U.S. has been with its funding of the SEC. From its founding in 1934 to the present time, the cumulative budget of the SEC expressed in current dollars has been about $20 billion. That is less than investors lost from one Bernie Madoff or one Enron.

However, the SEC has a long history of misallocating the resources that it has received. Rather than hiring experienced people with the financial and technical experience it needs to regulate today's complex high-tech markets, it has hired lots of attorneys who engage in hairsplitting minutia while missing the big picture. Don't get me wrong. My father and grandfather were attorneys. I actually like lawyers. They are interesting people and it is fun to get into intellectual debates with them. However, if you have a leaky pipe, you need a plumber, not a lawyer. The SEC needs to hire more market plumbers and fewer lawyers.

Summary and conclusions

In the JOBS Act, Congress told the SEC to be serious about promoting capital formation. Decades of well-meaning changes in our capital markets have created a market structure suited to large companies but not smaller companies.

The SEC has been slow to implement important provisions of the JOBS Act. This is partly due to insufficient resources, both monetary and technical, as well as to foot dragging by the Commission.

What can Congress do?

1. Continue to hold hearings like this to let them know that Congress is watching. Grill the Commissioners and staffers on their performance, and why the Commission has devoted huge amounts of staff time to dealing with less urgent matters that were not on the to-do list that Congress gave them.
2. Write letters to the agency. That gets their attention.
3. Give the SEC sufficient resources to do its job well. The SEC is self-funded through user fees, so this is not a costly to the general fund.
4. Grill the SEC regularly on the makeup of its work force. In addition to the number of lawyers and paralegals on staff, ask them regularly how many SEC staffers have other relevant

qualifications in the financial area(CFA, MBA, Ph.D., Series 7 license, etc.) and in the technical areas (degrees in engineering or IT).

5. Pay attention to the culture of the Commission, and in particular its attitude toward timely and sensible action.
6. Move the SEC to New York and Chicago. In those locations it will be able to draw on a labor pool of people who really understand financial markets. In today's economy, there are plenty of unemployed people with serious financial experience. They know where the bones are buried in our financial markets. The problem is those people are in New York and Chicago, not Washington DC. Locating the SEC in the heart of our financial markets will make it much easier for our regulators to do their job well.

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Congress of the United States
House of Representatives
Washington, DC 20515–3227

March 26, 2013

The Honorable Elisse Walter
Acting Chairman
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Dear Chairman Walter:

Last year, the President signed into law the Jumpstart Our Business Startups (JOBS) Act. This bipartisan legislation, specifically designed to help small businesses obtain the capital they need to grow and create more jobs, has been stalled by the rulemaking process within the SEC.

A pillar of this legislation, Title IV – Small Company Capital Formation, is especially important to job creators as it would amend Regulation A by raising the threshold for SEC registration requirements from $5 million to $50 million. While businesses would still be required to file an SEC offering statement and follow state registration requirements, raising this offering threshold would provide significant benefits to businesses trying to raise private capital.

The last time the threshold was raised was in 1980. Now, even with the passage of the JOBS Act almost one year ago, the SEC has been slow in implementing this rule and many others. Private businesses cannot wait any longer. A recent report by the Government Accountability Office (GAO) found:

> "The number of Regulation A offerings filed and qualified (that is, cleared) by the Securities and Exchange Commission (SEC) has declined significantly after peaking in fiscal years 1997 and 1998, respectively. In particular, offerings filed since 1997 decreased from 116 in 1997 to 19 in 2011. Similarly, the number of qualified offerings dropped from 57 in 1998 to 1 in 2011."

This downward trend could be reversed, however, by implementation of Title IV of the JOBS Act. By reforming Regulation A and transforming it to Regulation A+, this exemption could soon become the primary tool for businesses to raise private capital without going public.

Small businesses are the primary drivers of our economy. That is why Congress passed and the President signed into law this legislation that would give these businesses the jumpstart they need to grow our economy. I respectfully ask you to follow the letter of the law and provide a timeline on when you expect to close the comment period and issue a final rule.

As a small businessman and member of the House Committee on Small Business, I know how critical capital formation is to private businesses. The SEC should help, not impair, job creators. I look forward to hearing from you on this important matter.

Sincerely,

CHRIS COLLINS
Member of Congress

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Statement for the Record
Submitted to the Committee on Small Business
United States House of Representatives
Washington, D.C.

Submitted by Kristie Arslan
President & CEO, National Association for the Self-Employed
April 11, 2013

The National Association for the Self-Employed (NASE) respectfully submits this official statement for the record on the April 11, 2013, hearing, "*JOBS Act Implementation Update.*" The NASE represents the 22 million self-employed and micro-business owners (10 employees or fewer), providing educational resources for those looking to start and grow their businesses. Founded in 1981, the association has been the sole voice advocating for America's small businesses in all areas of public policy.

On behalf of the 22 million self-employed, the NASE would like to thank Chairman Schweikert for holding today's hearing on the lack activity by the Securities and Exchange Commission in promulgating proposed and final rules for the provisions included in the JOBS Act. The NASE strongly endorsed the JOBS Act, applauding Congress's bi-partisan action on legislation aimed at supporting and encouraging small-business growth, especially embracing the ability for individuals and small businesses to raise capital through crowdfunding.

The NASE believes that crowdfunding is an exciting avenue for both new entrepreneurs and established small businesses to raise needed capital to launch or grow a small business. At present, nearly 48 percent of the self-employed and micro-businesses are utilizing personal or retirement savings to keep their businesses afloat, accordingly to a 2012 poll of NASE Members. Furthermore, friends and family have been a primary source of funding for many new entrepreneurs. Crowdfunding will bring together this age-old approach to financing with technology and investment practices, allowing small-business owners and aspiring entrepreneurs the opportunity to reach out to their communities, investors and the world to secure necessary funding to start and expand their business.

While we understand that the regulatory process is not designed to be expedient, the NASE struggles to understand how it is that the Securities and Exchange Commission continues to be deaf to the growing calls to release at a minimum a timeline for anticipated action. We ask that the subcommittee uses its oversight responsibility to continue to hold the SEC accountable and ensure that the provisions of the JOBS Act are implemented through the rulemaking process without delay. Crowdfunding plays an important part in helping small-business owners navigate challenging financial times while also opening new avenues of funding opportunities for America's smallest businesses.

Respectfully,

K. Arslan

Kristie Arslan, CEO & President
National Association for the Self-Employed