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THE JOBS ACT AT A YEAR AND A HALF: ASSESSING PROGRESS AND UNMET OPPORTUNITIES

HEARING

BEFORE THE

SUBCOMMITTEE ON SECURITIES, INSURANCE, AND INVESTMENT

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

ON

EXAMINING THE IMPLEMENTATION OF THE JOBS ACT AND THE OPPORTUNITIES THAT THE ONGOING RULEMAKING MAY CREATE

OCTOBER 30, 2013

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C O N T E N T S

WEDNESDAY, OCTOBER 30, 2013

WITNESSES

THE JOBS ACT AT A YEAR AND A HALF: ASSESSING PROGRESS AND UNMET OPPORTUNITIES

WEDNESDAY, OCTOBER 30, 2013

U.S. SENATE,
SUBCOMMITTEE ON SECURITIES, INSURANCE, AND INVESTMENT,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Subcommittee met at 10 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Jon Tester, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF CHAIRMAN JON TESTER

Chairman TESTER. I will call to order this hearing of the Securities, Insurance, and Investment Subcommittee, a hearing titled "The JOBS Act at a Year and a Half: Assessing Progress and Unmet Opportunities". I am glad we are having this hearing this morning. I look forward to hearing from our witnesses about the challenges and opportunities associated with implementing the JOBS Act.

Since arriving in the Senate, I have held several small business opportunity workshops across the State of Montana, and without fail, during every one of those workshops, capital was always at the forefront of issues that I would hear from entrepreneurs. Capital allows business to grow, take calculated risks, and create more jobs.

In 2011 the Economic Policy Subcommittee, which I chaired, held a hearing to examine the challenges and opportunities that are facing innovative small businesses, many of which present the greatest opportunity for job creation in this country. What came out of that hearing was a plea from businesses for better access to capital, particularly for firms based across this country, small startup firms.

In response to that hearing, Senator Toomey and I introduced a piece of legislation that has become known as "Regulation A Plus," which ultimately was included in the JOBS Act. The opportunity for growth within businesses across America is enormous, and we need to do all we can to empower them with the tools they need to bring innovative products and ideas to the marketplace.

Entrepreneurs are incredibly important to our economy, particularly in a frontier State like Montana, because they embody the spirit of self-reliance that keeps rural America strong and the economy competitive. Without access to capital, the next-generation idea may not become a reality, and that is why I worked so hard last year to get the JOBS Act to the President's desk, because I believe the JOBS Act will provide new opportunities for startups to raise capital and will democratize access to capital for smaller firms.

The idea behind the bill is to provide firms with more access, more choice when it comes to raising capital in a manner most appropriate for different firms at different stages of their development, whether that means going public or remaining private, because what is right for one firm may not be right for another. And from my perspective, it was very important to ensure that this bill works for all entrepreneurs, regardless of where they live.

During the financial crisis, we saw traditional forms of business lending freeze, dried up, and businesses across this country were forced to become more creative when it came to raising capital. I believe the JOBS Act has and will continue to provide access as it continues to be implemented. The opportunities will continue to grow.

I do have some concerns about the pace of implementation of the JOBS Act. After nearly a year and a half, there is rulemaking that has still yet to be proposed. I understand that we have some new folks in place who were not at the SEC when this legislation was signed into law, but when we have so many businesses desperately in need of access to capital, every week counts. And within that context, the pace of progress that we have seen from my perspective is not acceptable.

I am optimistic that we can get this done sooner rather than later, and through my conversations with Chairman White, I am confident that this is on the SEC's front burner. The JOBS Act is truly bipartisan, and I think all of us up here today want to see this done in the right way, as it was intended to work for entrepreneurs and small businesses that need it.

In a place that often gets stuck in politics, I was extremely pleased that we were able to pass a strong, bipartisan piece of legislation that ensures that businesses have access to capital that they desperately need, but now is the time to ensure that this vision becomes a reality.

We have some great witnesses with us here today, and I look forward to hearing from all of them. We will drill down on this important topic.

With that, I welcome Senator Reed, but turn it over to my Ranking Member, Senator Johanns.

STATEMENT OF SENATOR MIKE JOHANNS

Senator JOHANNS. Thank you, Mr. Chairman, for calling this hearing today, and I also look forward to hearing from the witnesses.

The JOBS Act, which is the topic today, is a law that truly had bipartisan support. As the Chairman indicates, it did take a lot of work to get there, but think about these numbers. It was supported by roughly 90 percent of the House. These days that is remarkable. It was supported by 73 percent of the U.S. Senate, and it was endorsed by the President of the United States.

You do not see those numbers very often associated with a significant piece of legislation, so it is very important to all of us that it is carried out as directed and as intended.

The purpose of the JOBS Act, or at least one of the purposes, is pretty straightforward. It makes it easier for small companies to access capital markets and grow. This includes small companies from across the country that want to hire, expand, move their businesses to another level.

For instance, a representative from Natural Grocers will testify today, a company that utilized the JOBS Act to expand. The company actually just opened a new store in Omaha, Nebraska, just this summer. That makes three stores overall in Nebraska—two in Omaha, one in Lincoln. We hope there are more coming.

New stores mean more jobs in Nebraska for Nebraskans. This is the type of economic growth that was intended by the JOBS Act.

While I am encouraged that implementation of the JOBS Act has helped many companies and implementation continues to move along, I would be less than candid if I did not say I am not terribly pleased with the pace of the rulemaking. We are 1½ years removed from the enactment of the law, and many rules are yet to be finalized. For instance, as the Chairman noted, Regulation A Plus in Title IV of the bill remains to be implemented. This provision increases the cap on how much money companies can raise in an IPO without having to register with the SEC.

The old cap was $5 million, which was outdated. It had been in place for over two decades, and it just simply was not helpful. It would be lifted to $50 million if the SEC would act. This relief allows smaller companies to focus more on building the company in the early stages as opposed to jumping through all sorts of hoops and being weighed down with mountains of paperwork from the get-go.

Like most of the JOBS Act, this section garnered a lot of bipartisan support. Unfortunately, it has been over 18 months since the Act's passage, and the SEC has not established the rules that will enable businesses to access the benefits and, therefore, create the jobs.

But I am hopeful that the SEC can move quickly in finalizing Regulation A Plus, and I am pleased that we have finally seen progress on Title II and Title III, the general solicitation and overcrowding provisions.

I remember Mary Jo White testifying before the Banking Committee in March on the importance of finalizing the JOBS Act. She said in reference to the act, and I am quoting: "Completing these legislative mandates expeditiously must be an immediate imperative for the SEC." I agree.

I look forward to hearing from the witnesses today to find out where progress has occurred, where work remains to be done in regard to the JOBS Act, and how we get it to the finish line. There are many job creators who eagerly await full implementation, and we are all keenly interested in moving this forward.

With that, again, I welcome the witnesses, and I thank the Chairman for bringing this hearing together. Thank you.

Chairman TESTER. Yes, thank you, Senator Johanns.

We were going to have a vote at 10:30, so what I hope to happen is we will have your testimony, Mr. Higgins, and then the questions, and then we will probably go vote and come back for the second panel.

So with that, I want to welcome our first witness, Keith Higgins, joining us from the SEC. I want to thank you for your willingness to testify before us today.

Mr. Higgins is Director of the Division of Corporation Finance at the Securities and Exchange Commission. Prior to his current role, Mr. Higgins was a lawyer with Ropes and Gray LLP where he was a partner in its Boston office for 30 years. At Ropes and Gray he advised public companies about security offerings, mergers and acquisitions, compliance, and corporate governance.

Welcome, Mr. Higgins. You have 5 minutes for your oral remarks, but remember your full written remarks will be a part of the record. You may proceed.

STATEMENT OF KEITH HIGGINS, DIRECTOR, DIVISION OF CORPORATION FINANCE, SECURITIES AND EXCHANGE COMMISSION

Mr. HIGGINS. Thank you, Senator. Chairman Tester, Ranking Member Johanns, Senator Reed, and Members of the Subcommittee, as the Senator said, my name is Keith Higgins, and I am the Director of the Division of Corporation Finance at the Securities and Exchange Commission. I appreciate the opportunity to testify today on behalf of the Commission to discuss our implementation of the JOBS Act, which, as the Senator noted, the Chairman has said is one of the Commission's top priorities.

The JOBS Act made significant changes to the Federal securities laws. Some of the provisions were effective immediately upon enactment, while others required Commission rulemaking.

Immediately upon enactment, the SEC staff took steps to inform the industry about the operations of the act. Among other things, we provided guidance about the IPO on-ramp provisions, and we provided guidance about changes to the requirements for registration and deregistration of securities under Exchange Act Section 12(g).

At the same time, teams from across the agency, including economists from our Division of Economic and Risk Analysis, began working on rulemaking recommendations for the Commission's consideration, including the assessment of the potential economic impact of these rules. To increase the opportunity for public comment, we put a page on our Web site so that interested parties could provide comments in advance of the rulemaking. The Commission and staff met with industry participants and others to come in to talk about the JOBS Act and the impending rulemaking. And the rulemaking teams have used this input in putting together proposals for the Commission's consideration.

In July of this year, as the Chairman noted, the Commission implemented Title II by amending Rule 506 to permit issuers to use general solicitation to offer securities, provided that all investors in the offering were accredited investors and that the issuer took reasonable steps to verify that accredited investor status. The Commission also amended Rule 144A to permit general solicitation in offerings to qualified institutional buyers.

In addition to amending these rules, on the very same day the Commission adopted rule amendments implementing provisions of the Dodd-Frank Act to disqualify felons and other bad actors from participating in Rule 506 offerings. We also proposed additional rule and form amendments related to offerings that are conducted under Rule 506.

Earlier this month, the Commission took yet another step and proposed rules to implement the crowdfunding exemption in Title III of the act. Under the proposed rules, an issuer could use this exemption to raise up to $1 million in any 12-month period. Investors would be permitted during a 12-month period to invest a maximum amount based on their annual income or net worth. Issuers would be required to conduct these crowdfunding transactions through either a broker-dealer or a new type of intermediary called a "funding portal," and the proposed rules would set up a registration and regulatory framework for these funding portals. Eligible issuers would be required to file specified disclosures with the Commission and to provide those disclosures both to the intermediary and to investors. We look forward to receiving and considering the public comment on these proposals.

Title IV of the JOBS Act, as noted, also required the Commission rulemaking to create a new exemption similar to Regulation A, Regulation A Plus, for certain offerings up to $50 million in any 12-month period. The staff has met with market participants, industry groups, State securities regulators, and other interested parties, and we are working hard to finalize recommendations on that rule.

The JOBS Act required the Commission to conduct several studies and to prepare reports to Congress. In July of last year, the staff submitted a report on decimalization and its impact on the number of initial public offerings. The staff currently is working with the exchanges to develop and, if possible, to present to the Commission a plan that would implement a pilot program to allow smaller companies to use wider tick sizes.

In October of 2012, the staff submitted a report that examined the Commission's authority to enforce the anti-evasion provisions of 12g5-1, which deals with the record holders under 12g.

And, finally, the staff is finalizing a report on Regulation S-K looking at determining how we can modernize that rule and make it less burdensome and costly for emerging growth companies and really for all issuers, and we expect to make that study public very soon.

Finally, the JOBS Act mandated that the Commission provide online information and conduct an outreach program for small and medium-size businesses and for women-, veteran-, and minority-owned businesses about changes that were brought about by the statute, and we are working on an implementation plan to tailor to these constituencies.

The Commission and the staff continue to work diligently to implement the JOBS Act rulemaking as well as those remaining under the Dodd-Frank Act, and we look forward to completing the remaining provisions as soon as practicable.

Thank you again for inviting me to testify, and I would be happy to answer any questions you may have.

Chairman TESTER. Well, thank you, Mr. Higgins. Right down to the second.

Mr. HIGGINS. I know.

Chairman TESTER. That is pretty darn good.

[Laughter.]

Chairman TESTER. I think we have got about 21 minutes. I think we will put 7 minutes on the clock, and if we do not run over, everybody will get a chance to ask a fair number of questions.

Once again, I want to thank you for being here today, Keith. In my opening statement, I indicated that I was not happy with the pace of implementation of the JOBS Act. I think the Ranking Member talked about the same thing.

But I am also aware of the fact that most of the movement that we have seen, not including staff work behind the scenes, has occurred since you arrived at the SEC back in July, so I am going to view you as my lucky charm key to getting this bill fully implemented.

In terms of finalizing all of the existing rules and having them fully operational for use by entrepreneurs, when can we expect to have the JOBS Act fully off the ground?

Mr. HIGGINS. Senator, as Chair White, who sets the agenda for the Commission, has said to you personally and has testified, completion of the JOBS Act rulemakings and the Dodd-Frank rulemakings are the Commission's top priority. And if it is a priority for her, I can assure you it is a priority for me.

It is really impossible for me to say with any certainty when all the rules will be completed, but what I can say with absolute certainty is we understand the importance of them, we recognize the mandates, and we are working diligently to get them done. So we will get proposals done that we—we will put them out for comment, and we hope to get them done just as diligently as possible. But I cannot promise a particular date.

Chairman TESTER. Not to push you, but I am going to a little bit.

Mr. HIGGINS. Sure.

Chairman TESTER. By the end of the first quarter next year?

Mr. HIGGINS. Again, I think it is really impossible. There are a lot of factors that go into it: the extent of the public comment—I mean, we had a lot of control over the proposals, and I can tell you we will get the proposals out in relatively short order. We have got a couple remaining.

Chairman TESTER. OK.

Mr. HIGGINS. Look, I would love to get it next year.

Chairman TESTER. Right. If you give me a date certain, I would hold you to it.

Mr. HIGGINS. Right. I have heard, right.

Chairman TESTER. Yes, exactly. Well, let us just talk about the rulemaking for just a second. It seems to me the A Plus rulemaking would be a little more straightforward than the other provisions of the JOBS bill. Correct me if I am wrong on that. Do you envision a lengthy comment period with the rulemaking after they are proposed?

Mr. HIGGINS. I would not expect a lengthy comment period. I think typically comment periods are 60 days. I think with crowdfunding we wound up with 90 days because with crowdfunding we are really proposing, in addition to the exemption, a whole new regulatory structure for crowdfunding portals, and I think it really deserves a little bit more time. But a 60-day comment period I think would be a reasonable thing, but we have not really determined that yet, Senator.

Chairman TESTER. OK. My biggest interest with respect to the JOBS Act implementation, A Plus is unfinished. The legislation very clearly contemplates and, in fact, envisions the SEC developing as a part of this rule a definition of "qualified purchasers," a class of sophisticated investors to be defined by the SEC that would qualify for an exemption from State security laws. While some have questioned whether an issuer would utilize this QP exemption over Regulation D, for example, there are clear benefits in terms of transparency, disclosure, and liquidity.

Is the staff considering how to structure this definition?

Mr. HIGGINS. We are, Senator. The issue of qualified purchaser and really the relationship to State registration and qualification laws, the preemption, is an important factor in our rulemaking. We have heard in prior comments or the comment letters that have come in, many commenters have suggested that the cost and burdens of State registration and qualification have been a principal reason that the existing Regulation A has not worked, that we only had 20-some-odd offerings in the last year, and I think, you know, fewer than 100 over the last 7 years.

Chairman TESTER. OK.

Mr. HIGGINS. On the other hand, there are other commenters who have said that State registration qualification is an important investor protection aspect that we should not lose sight of, and so we are trying to look at both sides of the coin and balance those views.

Chairman TESTER. Are there certain metrics or benchmarks that you are utilizing?

Mr. HIGGINS. Well, nothing—what we do not want to do is to get ahead, I do not believe, of—we are working on the "accredited investor" definition as we are required to work on by the middle of next year under the Dodd-Frank Act. And we are concerned about not wanting to front-run that and create some sort of new class of investor, so we are looking at ways in which we can design a system where, between a combination of our review of a registration, a qualification, or offering materials under Regulation A as well as some characteristics of the purchaser could work to create a qualified purchaser under Regulation A.

Chairman TESTER. OK. In your testimony you discussed the many steps that the SEC is taking to inform the industry about the JOBS Act. You know from your past life how critically important it is to reach out to entrepreneurs so that they fully understand the impact and implications of how they can access capital. How can we better educate entrepreneurs about opportunities for access to capital in the JOBS Act?

Mr. HIGGINS. Interesting. We, meaning the SEC, the public generally, I mean, we put guidance out on our, you know, outreach.

I think that once we get our rules done—and we are committed to getting them done as promptly as we can—the industry and market participants will be aware of them and that they will be used, and we are willing to work with any groups to try to make our rules more workable and usable.

Chairman TESTER. I appreciate that. I will tell you that I think as we get the rules out—and I am sure you will soon—I think it is going to be critically important to be able to do the kind of outreach we need, and maybe some folks on the next panel can talk about how we can do that, too, to make sure that some of their folks that they represent or that they know can better utilize some of the benefits out there.

With that, I will turn it over to Senator Johanns.

Senator JOHANNS. Thank you, Mr. Chairman.

Mr. Higgins, again, thanks for being here, and thanks for your work on something that obviously we care about in a very bipartisan way. We want to see this work.

Let me, if I might, focus a question on investors. As you know, in addition to trying to help small companies compete with larger companies, the JOBS Act also seeks to help smaller investors compete with larger investors. Let me, if I might, explain that a little bit.

The SEC defines "accredited investors" as individuals with a net worth of at least $1 million, not including the value of their residence, or with an income of at least $200,000 each year for the last 2 years.

I am wondering about the possibility of more flexibility in this idea, the pros and cons of that. Is income or net worth really the best indication of a quality investor? Of course, you do not want someone throwing away their life savings, putting everything at risk as if they are playing in a poker match. But you also want to make sure that you have a place for those outside the top 1 percent, if you will. Talk us through that. Where does the JOBS Act work here? What are the pros and cons? What should we be thinking about here?

Mr. HIGGINS. Well, Senator, we have begun, the staff has begun work on a review of the accredited investor standard as it applies to natural persons, and the income and net worth test that you talked about relate to the natural persons test. By the middle of next year, we are required to come up with a report about that. That was mandated under the Dodd-Frank Act, and we have begun to work on it.

The GAO put out a study fairly recently on accredited investors to talk about other things that might be added. It seems to me the Holy Grail is how do you define the sophistication necessary to be able to understand investment risks, and I do not know whether anybody has really quite yet found what the answer is to that question. The GAO suggested investor education might be—you know, we would put something like a Series 7 exam. You know, something like that might be a little difficult to administer. Participation by an investor adviser or a broker-dealer in the investment. There is talk about investment limitations, something a la the crowdfunding, where you are only allowed to put a certain percentage of net worth or annual income into—so all of those are on the table for natural persons, and our work has begun in trying to figure out the best way to attack the accredited investor. But you are absolutely right. It is an issue, and I do not think anybody is particularly happy with the current $1 million net worth and that $200,000——

Senator JOHANNS. So your thinking is that the report that is called for will be out by——

Mr. HIGGINS. By the middle of July.

Senator JOHANNS. The middle of July of next year.

Mr. HIGGINS. Next year.

Senator JOHANNS. And what are you anticipating? Will that report indicate some strategies for Congress to look at? Or is it just too early to tell where the direction of that report might go?

Mr. HIGGINS. Well, I think it is too early to tell, but I believe that the Commission has the necessary rulemaking authority to address the issue.

Now, Congress has said in Dodd-Frank that we cannot move the $1 million net worth test until July of 2014. We were prohibited from changing that, so that needs to stay in place. But I think the Commission's rulemaking authority ought to be sufficient to address the issues. But, again, it is a little early to tell where we will come out.

Senator JOHANNS. Looking at the totality of the JOBS Act, is it possible to give us a summary of what is left in terms of implementation? You would not necessarily have to do it today from memory, but a scorecard would be helpful to us.

Mr. HIGGINS. Right. Well, we can certainly provide you and the staff with a detailed scorecard. In general terms, Title I was largely self-implementing with the on-ramp provisions.

Title II, we have adopted the rules for general solicitation, and those are done. We had some companion rulemaking that was related to that, which is still ongoing and which we are taking comment on.

Title III, the crowdfunding provisions were just proposed. There is a 90-day comment period after which we will look at the comments and begin to get done.

Title IV, Regulation A Plus, again, top priority. I guess I would say the Chair had indicated that her front-burner items for the fall were pay ratio, crowdfunding, and Regulation A Plus, and two of those three are already out, so we are working hard on the third.

Title V and Title VI relating to the registration provisions, there is a little bit of rulemaking to do to clarify some of the provisions, to provide the safe harbor for employees. We expect those to be out soon, but we do not yet have a proposal out on that.

And then Title VII is the outreach.

Senator JOHANNS. Let me ask one more question, and this may be a bit of a stretch but—because we are pushing you on getting JOBS Act rules and regulations in place, but I am thinking about a JOBS Act II. This had so much bipartisan support. I would like to challenge you, as you are seeing this implementing and as you are working with those who are taking advantage of the JOBS Act, to keep us in the loop on what might be next, what is working, what is not working. I think this is one of those rare cases where you have a bill that Congress would be willing to take another look at at some point, probably after I am gone, and see if there are other steps that maybe we overlooked in JOBS Act I. So I will just use the balance of my time to urge you to do that and keep this Subcommittee and the Banking Committee in mind as those are things that pop up and you think about.

Mr. HIGGINS. Thank you, Senator. We will do that.

Senator JOHANNS. Great.

Chairman TESTER. Senator Reed.

Senator REED. Thank you, Mr. Chairman, and thank you, Mr. Higgins, for your testimony.

The JOBS Act requires the SEC to adopt rules that, in the legislation language, "require the issuer to take reasonable steps to verify that purchasers of the securities are accredited investors, using such methods as determined by the Commission." Can you let us know briefly what are some of those methods that they can use to verify?

Mr. HIGGINS. Yes, Senator. Our rules came out with—the principal method is a principles-based method of verification, which depends on the facts and circumstances of the particular offering. It does not prescribe a one-size-fits-all method of reasonable verification. It says you look at the nature of the offering, the nature of the purchaser, the information that you already know about the purchaser, the size of the investment limitations in the offering, to determine what steps would be reasonable.

We wanted to be as flexible as possible in allowing companies to comply, but that was a little—it is a little uncertain what reasonable steps are, and commenters said to us, gee, we would like some certainty, we would like to have a safe harbor where we know for certain.

If we are not sure that our steps were reasonable, if we do certain things, it will be absolutely clear that we took reasonable steps. So we created in the final rules four safe harbors. One safe harbor deals with the annual income test and allows you to establish it via tax returns.

The net worth test you can do it—and, again, this is for natural persons. You can do it through bank statements or other kinds of financial records along with a consumer report about the debt side of that equation.

Third, we provided registered CPAs, attorneys, registered broker-dealers, investment advisers could provide certification that a person as an accredited investor, and that would work.

And then, finally, to address companies that had accredited investors before the JOBS Act was adopted, we said if you were an accredited investor before these new rules took effect you could self-certify and continue to be able to invest.

And so that is the way we tried to balance a principles-based approach with an approach that gave issuers certainty should they choose to do it.

Senator REED. Do you have the capacity to check or do you plan to check, either spot-checking or sort of significant checking, that this is being followed by the issuers?

Mr. HIGGINS. We do indeed, Senator, in some instances. A couple of things. One, the proposal that we put out the same—that the Commission proposed the same days as the general solicitation ban being lifted requires in the Form D that we would require to be filed an issuer to explain the verification procedures that it undertook to satisfy itself of accredited investors. So that is one way we can do it.

Another way is that we have built in—we have a comprehensive work plan to look at how these general solicitation rules are going to work, and one of the things we have done is our Office of Compliance Inspections and Examinations has added to their examination report for broker-dealers and investment advisers questions about what they are doing to ensure in offerings with which they are involved that the accredited investor—that the reasonable verification procedures are in place.

So those are a couple of the things that we are doing to monitor the marketplace to make sure that issuers are taking the right steps.

Senator REED. But you do not have within your plan even sort of spot-checking going into an issuer and looking at the records and looking at what they have said they have done; they have actually done?

Mr. HIGGINS. I am not sure that I—I would have to check with the enforcement and the OCIE folks about what they intend to do. Obviously the inspection function will be—they will be asking for records from the broker-dealers and the investment advisers. I would have to check to see what we are planning on the issuers.

Senator REED. But the issuers, you know, are a critical part of this——

Mr. HIGGINS. Absolutely.

Senator REED. ——since you can conduct one of these offerings without broker-dealers.

Mr. HIGGINS. That is correct, Senator.

Senator REED. And that would probably be an area you would have to pay attention to.

Going back to the issue that Senator Johanns raised about the accredited investor definition, I know you are going to—next year, next July, under Dodd-Frank Act you will have a formal sort of statement about your position. But just remind me, when was the $1 million standard and the $200,000 standard adopted?

Mr. HIGGINS. It has been around for a pretty long time.

Senator REED. I think we were children then, yes.

[Laughter.]

Mr. HIGGINS. So a while ago.

Senator REED. But the standard really started with a significant amount of capital, either, you know, wealth or income, which today now is much, much less in terms of real dollars than it was back then. And, you know, the notion of lowering that, it seems to me to raise some interesting questions. I think it originally was proposed to not only sort of be a proxy for sophistication, but also to be a measure of how much you could actually absorb the entire loss of the investment, and that is another factor.

Are you considering those factors as you go forward? Or I guess the question would be: Is the tendency to raise that level from the 1980s, let us say, to 2013?

Mr. HIGGINS. The notion of raising is certainly something that is raised by commenters who have commented on the rules that it should be inflated to reflect current values. We have heard those.

There are other folks who say that, you know, having too high a standard impedes capital formation. So there is another—you know, there are other people who come in and say, gee, you do not want to raise it any higher because that will impede our ability to go after—so I think we need to look at a range of different ways to come at it. I am not sure that the existing pure net worth and income is the right way to go.

Senator REED. What we are working off is a basis of the—you know, there was a general rule of no public solicitation. So as soon as you saw popping up on the screen someone offering a security that was not registered, you sort of—you know, you were sort of queued up as to this could be—and the burden of proof really was on the other folks, not you.

Mr. HIGGINS. Right.

Senator REED. Now you can do general solicitation, but that has to be to accredited investors, and yet we are looking at a standard which is several decades old—and as I would suggest, it does not just suggest or reflect sophistication, but it also reflects the ability to absorb the loss, and I think that has to be considered.

The final point I would make a comment in response is that if you are considering testing people to be accredited investors, is that a serious proposal?

Mr. HIGGINS. It has been offered as, you know, some sort of investor education or testing, but I think it would be a little difficult to implement, Senator.

Senator REED. I think you are right. Thank you.

Chairman TESTER. Well, thank you, Senator Reed and Ranking Member Johanns, and most importantly, thank you, Mr. Higgins, for being here. I think—it was not too bad, was it? All right. The key is that I think there is a tremendous effort that needs to be done to get these rules out, and I think there is a lot of attention that this Committee will be paying. We have got to do them right, and we have got to be thoughtful. But I think that time is important, especially as we are trying to get the economy moving forward again in a way that best addresses the needs of this country. So we will be watching. You may be coming back in again. Hopefully it will be with good news, and we look forward to that. We very much appreciate your work, Mr. Higgins, and look forward to seeing you again.

They have called a vote, so we will recess until we get back, which will be in pretty short order. I apologize to the next panel, but we will get back here pretty darn quickly.

[Recess.]

Chairman TESTER. We will call the Committee back to order. Senator Johanns is en route, but being a good Senator, he has already read all your testimony, and so I think we will get going with our second panel of witnesses.

The first one is Mr. Alan Lewis, who currently serves as the director of special projects for Natural Grocers by Vitamin Cottage, Incorporated. Mr. Lewis also directs Government affairs and food and agricultural policy for Natural Grocers. Mr. Lewis is also active in several trade organizations and sits on the Boulder County, Colorado, Food and Agriculture Policy Council. I will tell you from a personal standpoint, welcome, Alan. I appreciate you making the trek out here, and I appreciate what you do.

Mr. LEWIS. Thank you.

Chairman TESTER. Mr. Robert Kaplan, Jr., is our second panelist. He is a founder and managing partner at Kaplan Voekler Cunningham and Frank, PLC. Mr. Kaplan's practice is concentrated in the area of securities, business representation, and real estate investment. His experience representing businesses is wide-ranging, including business formation, mergers and acquisitions, general corporate and commercial law, securities compliance, private offerings, tax and strategic partnerships, joint ventures. You have got a full plate. Welcome, Mr. Kaplan.

Mr. KAPLAN. Thank you, Senator.

Chairman TESTER. The third witness is Mr. Rick Fleming, who serves as deputy general counsel for the North American Securities Administrators Association, where he is active in developing model State rules, drafting and reviewing comment letters and amicus briefs, and providing assistance to State securities regulators. Prior to joining NASAA, Mr. Fleming was general counsel for the Office of the Kansas Securities Commissioner. Welcome, we appreciate your work.

And last, but certainly not least, is Mr. Sherwood Neiss, who serves as principal of Crowdfund Capital Advisors and worked to develop the crowdfunding framework in the JOBS Act. Mr. Neiss travels the world presenting to entrepreneurs, professional investors, and institutions, educating them on how to harness emerging crowdfunding investment opportunities and how to build crowdfunding ecosystems to support innovation, strengthen business, and create thousands of jobs. And we appreciate the work that you do, Mr. Neiss, and we thank all the witnesses for being here today.

As with the previous witness, there will be 5 minutes put on the clock for oral statements. Your written testimony in total will be a part of the record.

We will start with you, Mr. Lewis. Please proceed.

STATEMENT OF ALAN LEWIS, DIRECTOR OF SPECIAL PROJECTS, NATURAL GROCERS BY VITAMIN COTTAGE, INC.

Mr. LEWIS. Good morning, Chairman Tester, Ranking Member Johanns, and other Members of the Subcommittee. Thank you for the opportunity to testify about the impact of the JOBS Act on Natural Grocers and our ability to raise capital to support job creation and contribute to the economic growth of the Nation.

My name is Alan Lewis, and as director of special projects at Natural Grocers and an active member of our IPO team, I participated in drafting the Registration Statement on Form S-1 and in making decisions about using certain beneficial provisions found in the JOBS Act. I also continue to provide investor relations support to the analyst and investor communities on behalf of Natural Grocers. Very briefly, I would like to share the introduction to our company and our path to completing our IPO.

Natural Grocers is in many ways the quintessential American business success story. Starting from humble mom-and-pop beginnings in the 1950s, we have grown to operate over 70 grocery stores in 13 States while staying true to our original founding mission, which is helping people stay healthy through better food and nutrition. Of our roughly 2,000 employees, most are well-paying, full-time jobs and are eligible for affordable health care benefits.

In 1998 Natural Grocers was acquired from its founders by their four children. Over the following 10 years they grew the business through long hours and hard work, primarily depending on internal cash-flow and bank loans for capital. Subsequently, they carefully hired additional professional staff and began putting in place the sophisticated accounting, technology, and operational infrastructure needed to support a robust expansion strategy.

Beginning in 2009, in the midst of the recent economic downturn, our leadership team began laying the groundwork to raise outside capital through an initial public offering. At about the same time, Congress began addressing the need for economic stimulus by proposing a number of bills designed to prompt public and private investment to generate new jobs. A number of these initiatives were eventually passed into law in the form of the JOBS Act, which was signed into law just when Natural Grocers was preparing to submit its Registration Statement on Form S-1 to the SEC in anticipation of an IPO during the summer of 2012.

Because we clearly qualified as an "emerging growth company," many of the key provisions of the JOBS Act were anticipated by our legal, accounting, and investment banking advisers. So as a group, we paused to consider which opportunities we would take advantage of, keeping in mind we would likely be among the first companies to launch an IPO under this new regulatory regime, and that investors might be skeptical of some of the new relaxed rules.

Here are just two highlights from the JOBS Act provisions covered in our written testimony:

First, confidential submission of our S-1 greatly reduced the complexity, stress, and risk of undertaking a public offering within such an unsure market environment.

And, second, the reduced requirement for audited financial reports lowered the expense and time needed to prepare for our S-1 but did not seem to impact the acceptance of our offering.

We decided not to opt out of maintaining compliance with new or revised accounting standards, but we elected to fully disclose our executive pay.

Chairman Tester, you have asked us to describe our experience filing confidentially and using some of the reduced compliance provisions under the JOBS Act. In the additional written testimony submitted to each of you, we have discussed in some detail our experience with these and other decisions. I will be happy to answer your questions, of course, within the constraints placed on our corporate communications by Regulation FD and our upcoming fiscal year end earnings announcement.

And speaking of regulations, I would like to yield myself 20 seconds to remind everyone that all statements made in this testimony other than statements of historical fact are forward-looking statements. All forward-looking statements are based on current expectations and assumptions that are subject to risk and uncertainties. Actual results could differ materially from those described in the forward-looking statements because of factors such as industry, business strategy, goals and expectations concerning our market position, the economy, future operations, margins, profitability, capital expenditures, liquidity and capital resources, other financial and operating information, and other risks detailed in the Form 10-K filed by Natural Grocers for the year ended September 30, 2012. The information we present is accurate as of the date of this testimony, and we undertake no obligation to update forward-looking statements.

In the final analysis, our IPO was a success on many levels. Our IPO priced at the high end of our range and the stock price held a healthy but reasonable premium on the first day of trading and thereafter. As one financial commentator stated in an article titled "The Greedy Sit Out an IPO", "[Natural Grocers] has begun its publicly traded life in an environment of fair and balanced trading [. . .] How refreshing."

So, in conclusion, we believe that the JOBS Act is a successful piece of legislation. Key provisions of the JOBS Act enabled Natural Grocers to successfully navigate the financial markets and do exactly what the JOBS Act intended: grow our company and add jobs to the American economy.

Thank you again for all your support of American small business and job growth and for allowing me to be here today to present our experience with the JOBS Act. I am happy to answer any questions you might have.

Chairman TESTER. And we will have questions after the panelists are all done. Thank you for your testimony, Mr. Lewis.

Mr. Kaplan, you may proceed.

STATEMENT OF ROBERT R. KAPLAN, JR., MANAGING PARTNER, PRACTICES, KAPLAN VOEKLER CUNNINGHAM AND FRANK, PLC

Mr. KAPLAN. Thank you, Chairman Tester, and thank you, Ranking Member Johanns, for allowing me the opportunity to come before you today to discuss the implementation of the JOBS Act and in particular the importance of Title IV, commonly referred to as "Regulation A Plus."

Again, my name is Rob Kaplan, and I am managing partner for practices and founder of the law firm of Kaplan Voekler Cunningham and Frank, headquartered in Richmond, Virginia. We are a boutique firm with one of our areas of emphasis being on securities and capital formation. Our practice includes public and private securities, and we represent clients in various capacities of all sizes, from multi-billion-dollar enterprises to fledgling startups. But the bulk of our practice resides amongst what I referred to in my comments as "Main Street businesses," companies in the lower mid-market or smaller, typically with revenue in the $5 million to $150 million range.

My written testimony and your questions will provide greater detail, but in short, our view is that, to date, little movement has occurred to implement those aspects of the JOBS Act that we believe address most ably the needs of Main Street businesses where so many of America's jobs have historically been created.

Main Street suffers presently from a lack of viable options for capital raising. Regulation A Plus presents the most potentially impactful piece of the JOBS Act in aiding Main Street businesses and providing a rational balance between regulatory oversight and access to publicly formed capital. And in turn, Regulation A Plus should provide greater investment options to the American public than what can be found now.

The forms and procedures currently existing under Regulation A can readily be applied to Regulation A Plus, thus obviating the need for further delay in implementing Regulation A Plus. SEC's rulemaking in this context should be balanced so as not to make Regulation A Plus overly burdensome but foster issuer transparency and the efficient dissemination of information to support a market for these securities.

At the same time SEC should adopt a workable definition of "qualified purchaser" which affords investor protection but eliminates unnecessary and obstructive layers of regulatory procedure.

Recently we have seen movement on the implementation of the JOBS Act beyond the IPO on-ramp provisions of Title I, and specifically I am referring to the adoption of Rule 506(c) and the release several days ago of the proposed rules related to crowdfunding. But we believe that Regulation A Plus can be leveraged by a greater diversity of companies who are responsible for much of the job growth in this country.

Senators, Main Street businesses are not going to be, for the most part, in our view, likely candidates for crowdfunding or these 506 options. Crowdfunding addresses a capital need by companies that are much smaller and in an earlier stage of growth than the companies we typically represent. And in the 506 context, we have seen a steady decrease in the amount of accredited investors that may be the potential audience for investment. We have also seen those investors shying away from restricted securities, and we have seen the regulatory environment, which I am not necessarily commenting to the wisdom or efficacy of that, but the practical reality is that some of the new rules that are coming into place that I discuss in my written testimony are really producing a chilling effect with brokerages and investment banks that may assist issuers in forming company capital in the private context.

So what we see is the market being predominated by institutional investors, and those investors have return demands which often do not fit with the types of companies that could really benefit from Regulation A Plus.

The reason we see Regulation A Plus as so important here is that, unlike a lot of other aspects of the JOBS Act, what it truly does, in concert with the intent of the Act, is create a balance between regulation and capital formation. It literally offers an exchange of access to a greater segment of the investing public in exchange for submission to a regulatory regime which ensures a standard of disclosure which allows for transparency, and that transparency can allow for a modest but workable market in these securities, which also provide risk mitigation for the investors. And, finally, because of that standard of disclosure, it can provide access to greater investment options that they can look at with their advisers.

We believe it could be implemented under the current forms and the current rules. We urge this because, quite frankly, we have such a small volume of these deals that we believe the SEC should foster the use of it so they can have the appropriate rules made.

We also believe that a "qualified purchaser" definition is absolutely necessary. As I discuss in my written testimony, some of our experiences we believe, looked at in the context of a broader market, could potentially chill or obstruct the use of what could be a very balanced approach to capital formation.

We have suggested a "qualified purchaser" definition with a net worth of $500,000 or a gross annual income test of $150,000 with a net worth of at least $250,000, and we have also suggested that that definition would perhaps have an investment cap for natural persons where they cannot invest more than 20 percent of their net worth. We think this is a reasoned balance between the legitimate investor protection concerns of NASAA and Congress in enacting the act. But I think it is important to allow this method of capital formation to move forward and for a viable market to be developed.

Thank you, and I am, of course, available to answer any questions you may have.

Chairman TESTER. Thank you for your testimony, Mr. Kaplan.

Mr. Fleming, you may proceed.

STATEMENT OF RICK FLEMING, DEPUTY GENERAL COUNSEL, NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

Mr. FLEMING. Thank you. Good morning, Chairman Tester, Ranking Member Johanns, Senator Reed, and other members of the Subcommittee. My name is Rick Fleming, and I am an attorney for NASAA, the association of State securities regulators. I would like to note that the president of our association, Ohio Securities Commissioner Andrea Seidt, regrets that she is unable to testify today, but we are certainly appreciative of your willingness to allow me to testify in her place.

Prior to joining the NASAA staff 2 years ago, I was the general counsel for the Office of the Kansas Securities Commissioner, and in that role, I spent 15 years protecting Main Street investors by prosecuting scam artists and by bringing disciplinary actions against licensed individuals who engaged in dishonest or unethical business practices.

But I also during that time worked with many Main Street businesses and their counsel to help them understand the various options for raising capital under State and Federal law. And like my colleagues in other States, I had absolutely no interest in throwing up needless barriers to economic development in the State of Kansas.

So drawing upon our experience with small business issuers who want to create jobs, the States are committed to exploring new and innovative ways of fostering small business capital formation. But our experience with investors tells us that we also need to create an environment in which those investors feel sufficiently protected. The trick is to balance the legitimate interests of investors with the legitimate goals of entrepreneurs and to adopt policies that are fair to both.

Under President Seidt's leadership, NASAA is embarking this year upon a campaign for what she calls "smarter regulation," meaning regulation that takes advantage of technology to make the offering process more efficient for small businesses without sacrificing important protections for investors. And a first step in this direction involves Regulation A Plus.

Given the risky nature of investments in startups generally and the fact that the States have traditionally been the primary regulator of small business offerings, NASAA believes that State oversight of these offerings is essential. However, we also recognize the need to change some of our longstanding policies to make Regulation A offerings as successful as possible. And toward that end, a NASAA project group has consulted with a task force of the American Bar Association to develop an initial proposal that peels back some of our normal guidelines to accommodate this new type of offering. And as part of that proposal, we have designed a multistate review process in which one or two States will take a lead role in reviewing a registration application and work with the company that is issuing the securities to resolve any deficiencies in that application.

In addition, we are developing a multistate electronic filing platform that will allow a one-stop filing process with all the States, and we intend to build out that system to accommodate Regulation A Plus filings.

This past August, a draft proposal to establish this new multistate review program was submitted to our NASAA members, the State regulators, for what we call an "internal comment period." And, in addition, the proposal was discussed during our last face-to-face meeting, which was actually earlier this month. And I am pleased to report that the comments that we have received from our members have been favorable and that the proposal will be issued for public comment later today.

As NASAA moves through this process, we will, of course, continue to coordinate and communicate with the SEC in an effort to keep both the Federal and the State requirements in sync.

With respect to Title II of the JOBS Act, NASAA remains deeply concerned that the lifting of the ban on general solicitation will attract even more con artists to the Rule 506 marketplace, and that those persons will ultimately poison the well so that investors are reluctant to invest in even the most legitimate private companies. So to avoid this type of unintended consequence, NASAA asked the SEC to enhance investor protections in Rule 506 by adopting a number of further changes to that rule while it was in the process of lifting the ban on general solicitation. We are pleased to see that the SEC proposed many of our suggested changes, and we continue to urge their swift adoption.

In particular, we consider it vital for the Commission to require the filing of Form D before a company begins to advertise for investors. We have also asked the Commission to establish meaningful consequences for issuers who fail to file the form because, absent the filing of a Form D, the States will have no information about offerings that are being advertised to investors in our own back yards.

As you know, last Wednesday the SEC released its proposed rules on the crowdfunding portion of the act. The SEC is required to consult with the States about those rules, and we are currently doing a thorough analysis of that proposal.

Thank you again, Mr. Chairman and members of the Committee. I would be pleased to answer any questions.

Chairman TESTER. Well, thank you for being here. Thank you for your flexibility to be here, Mr. Fleming, and thank you for your testimony.

Mr. Neiss, you may proceed.

STATEMENT OF SHERWOOD NEISS, PRINCIPAL, CROWDFUND CAPITAL ADVISORS LLC

Mr. NEISS. Chairman Tester, Ranking Member Johanns, and Senator Reed, thank you for holding this hearing. My name is Sherwood Neiss. I am a pharmaceutical at Crowdfund Capital Advisors. CCA works with Governments, multilateral organizations, investors, and entrepreneurs on creating crowdfunding ecosystems. I am also an entrepreneur and one of the cocreators of the Startup Exemption, the framework used by Congress to create Title III, crowdfunding.

If there is one thing I want to stress in my speech, it is that while the proposed rules are fair, we need a few more changes to create an efficient crowdfunding ecosystem. This law will allow entrepreneurs to use their social networks and regulated Web sites to raise capital for their endeavors from people who believe in them. This law allows supporters to pledge their support in the form of equity investments or loans to promising businesses. This law addresses the funding void faced by startups and small businesses and, if implemented according to the intent of the law, may result in much needed economic growth, innovation, and jobs.

Last week the SEC voted unanimously in favor of the proposed rules related to Title III. I would like to commend the SEC and their staff for their incredibly hard work and detailed analysis of regulation crowdfunding. This legislation effectively solves earlier problems with easing regulations around capital formation by deterring the "pumping" of securities by disallowing compensation tied to the success of an offering unless that individual is a registered broker. And the legislation deters the "dumping" of securities by requiring them to be held for 1 year. It deters potential scam artists from entering the market by have background checks performed, disclosures mandated, and transactions taking place on regulated intermediaries. This entire process happens online, creates a digital footprint that can easily be referenced if anything goes wrong.

Now to the proposed rules. First, I will discuss some positive elements and then go into areas that are less appealing. There are five positive components issuers should pay attention to.

First, while issuers must hit 100 percent of their funding target or no money is exchanged, they can exceed their offering amount as long as they disclose what they will do with that extra money.

Second, unlike Title II, investors are allowed to self-certify their income or net worth, which will reduce the compliance burden on issuers.

Third, issuers can verify product interest with a crowdfund campaign and not worry about triggering the feared 2,000-investor filing cap. These are all good.

Fourth, issuers can do a parallel offering, effectively allowing them to test market demand while attracting more sophisticated capital.

And, fifth, the SEC added the flexibility of dynamic pricing which gives both issuers and investors more flexibility. These are all great things.

Next are three parts of the rulemaking that could make this offering less appealing to prospective issuers.

First, the biggest hurdle is compliance. There is a lot of reporting in the system. While such reporting will promote transparency and deter fraud, it may also deter the honest but overwhelmed issuer from deciding to crowdfund.

Second, while the legislation mandates it, we were hopeful that the SEC would understand the impracticality of audited financials for small businesses seeking to raise in excess of $500,000. Audited financials are beneficial for large complex corporations, but crowdfunding corporations are smaller and more transparent by nature.

Two years of audited financials, which are required in the legislation, could easily represent 10 percent of a $500,000 raise. This might deter some issuers. We would hope the audit requirement would be adjusted.

And, third, I believe the crowdfunding industry might be better served if it were overseen by industry participants itself who are solely concerned about developing an efficient, credible, transparent crowdfunding marketplace.

There are two things problematic in the rules.

First, the proposed rules do not allow funding portals much flexibility when determining who can list on their sites. Not giving them the flexibility to deny a business they believe is not ready for crowdfunding or will not be successful may increase failures. Portals should be given more leeway in making decisions prior to listing companies.

Second, the proposed rules leave liability with the funding portals for material misstatements by issuers when the portals play a limited role in crowdfunding. It is the role of the crowd to do the diligence on the issuer and question disclosures on the common pages of the campaign, not the funding portals. Funding portals should be allowed to explicitly state on their Web sites that it is the job of the issuers to review the disclosures for nonfactual statements and that the portal is just providing the matching service. This was the intent of the legislation. Without these changes, I believe it will be very hard for portals to flourish.

In sum, the potential for equity and debt crowdfunding is there, but will be constrained by the proposed regulations—as they now stand—to implement Title III of the JOBS Act. With a few changes, I do believe a robust and efficient crowdfund investing market may develop in the United States.

I look forward to your comments.

Chairman TESTER. Thank you, Mr. Neiss. Thank you for your testimony, as I thank all of you for your testimony.

I think we will put 7 minutes on the clock again and proceed—I think we have got plenty of time—because there is a vote again at noon, but I think we will be done before that pretty easily.

Mr. Lewis, Natural Grocers has a great business model and remains, even after the public offering, a family run business. You need to be congratulated on that. And I would also note that you recently opened up a store in Kalispell, Montana. Thank you for that. And when Natural Grocers did go public in July of 2012, it was kind of guinea pig for the JOBS Act, filing as an emerging growth company.

So could you talk a little bit more specifically about which provisions were most important to you?

Mr. LEWIS. Yes, very simply, that confidential filing provision is just very helpful. Specifically, we have to remember that it was a very difficult environment, an unsure environment. We had some difficulties with the Facebook IPO just the month before we were starting our road show. And, to have the S-1 submitted confidentially, and then to work through the SEC staff comment process—without disclosing all of the secrets and other trade information in the S-1 to our competitors—was especially helpful in case the market did not recover or respond initially to our expectations.

Chairman TESTER. You opted out of some of the provisions in the JOBS Act. Could you talk briefly about that and, specifically why?

Mr. LEWIS. For example, we have extensive disclosures in our Form S-1 regarding executive pay. For us, it was an obvious decision—something we are proud of—to disclose how our executives are paid, based on their roles and individual responsibilities. That was something we wanted to include.

In regard to the financials, in the reduced requirement for 2 years of audited financials, we had 3 years of audited financials prepared plus the 9 months or three quarters of interim financials that would eventually be audited at the end of the fiscal year. In 2007 and 2008, there were issues with changing audit firms and a change of year-end and the cost and complication of complying with those just seemed too high in relation to the benefit it would have given to the potential investors, those after 2 years.

Chairman TESTER. OK. What has been your experience after you have decided to go public? Has it fulfilled the projections you had hoped for? Or has it failed the projections you had hoped for?

Mr. LEWIS. In terms of our business, we have set the expectations in the market, and we have met them successfully quarter after quarter. And, of course, that all depended on having the proceeds from the IPO and using them as we did. So I would say it was very successful.

Chairman TESTER. Good. Thank you.

Mr. Kaplan, I agree completely with the statement that you made in your testimony that Regulation A Plus was probably the least understood provision in the JOBS Act. We have heard from a number of folks about the potential of this provision to provide a new avenue for access. You talked about it in your testimony. I think the potential benefits of this could be very positive.

Can you discuss the benefits of raising capital through Regulation A Plus versus other methods for raising capital as well as for the capital markets more broadly?

Mr. KAPLAN. Sure, Senator. Traditionally the dichotomy in capital raising in this country has been between public registration and private placement of securities, most commonly under Regulation D.

The interesting thing about Regulation A and, in concert, Regulation A Plus, is, rather than being a transactional exemption, you are exempting the securities themselves. So now we move away from the accredited investor requirements. We can engage in general solicitation. We also have a security that is freely tradeable, but this is done within the construct of regulatory oversight that can give the market confidence in the securities that are being sold.

What we have seen—and I alluded to this in my opening remarks—in the Regulation D marketplace is that that audience is shrinking, and we believe it is going to shrink significantly more in light of some moves that will be made regulatorily by the Commission based on suggestions by the GAO and others. We do not speak to the wisdom of that. Again, that is the practical reality. But what Regulation A Plus will allow is the ability to go to a broader audience, and we personally believe, because of that standardized disclosure and the size of the deals and companies we are dealing with, there has been any number of brokerages and investment banks around this country that have been iced out, for lack of a better term, of the public IPO marketplace.

You know, there are somewhere just south of 5,000 broker-dealers in the United States, and so if you are dealing with these Main Street businesses, as I have coined the phrase, you have the ability potentially to have placements done on a regional level. Being done on a regional level means an enhanced layer of transparency for the investor and the brokerage houses that work with these issuers. They are going to be the subject of articles in the local business section of the local paper every day. They are going to be on the news.

And so, you know, I think what is really interesting about Title IV and really where the utility is going to be seen is the fact that you are creating this intermediate level of securities which allows for a greater diversity of professional vendors, brokerages, analysts, news reporters, everybody to come to the marketplace and create a greater variety of securities for individuals.

Chairman TESTER. And not to put words in your mouth because I think you have indicated with the words you have already spoken that you feel like there is solid demand for the Regulation A Plus once the rules get through the process.

Mr. KAPLAN. Senator, I conservatively take about 15 calls a week from potential issuers out there asking when Regulation A Plus is going to be promulgated. There is a small handful of brokerages that are trying to work with Regulation A right now to move up the learning curve. But, yes, I believe the demand will be there.

Do I believe that the dollar level of these securities in the near future will be that of the Regulation D marketplace? No. That is predominated by institutional investors that put out lots of money.

But I do believe that it will be a very viable and working marketplace very quickly.

Chairman TESTER. Super. Very quickly, because I am out of time, what is the benefit of the qualified purchaser exemption? Do you see a benefit, and what is it?

Mr. KAPLAN. I do. I see the qualified purchaser exemption, the primary benefit being is that right now we are dealing with a situation where we have Federal Government oversight and we have layered upon that the potential State oversight of 50 States. I applaud some of the moves that NASAA has made, but the reality is we are dealing with 50 different State administrators. They apply their rules differently. We have seen, you know, lack of activity by administrators. We have seen overreaching by administrators. And so, if issuers of the size that I am talking about who really create the majority of jobs in this country are going to have the confidence to pay a lawyer a retainer and the costs associated with doing this deal and do audited financials and subject themselves to this, there has got to be some definition that gives them confidence they can go efficiently raise this capital.

I totally acknowledge the State administrators' and NASAA's concern and Congress' concern about investor protections, but I do think we need to strike a balance here to get this market stimulated.

Chairman TESTER. Thank you for that. We will probably get to Mr. Fleming in the next round.

Senator Johanns.

Senator JOHANNS. Thank you, Mr. Chairman. In fact, Mr. Chairman, I am going to jump right into that.

You know, one of the advantages of sitting up here is you get to watch the body language of all the witnesses, and sometimes you learn something from that. When Mr. Fleming was offering his testimony, Mr. Kaplan, Mr. Lewis, you were kind of sitting there wondering—and maybe I could say the same about Mr. Neiss. You can see that we like the idea of the JOBS Act. I even asked about is there a JOBS Act II. It has broad bipartisan support, it has Presidential support, and these days in Washington that is a bit of an unusual creature. And we see it as offering the same opportunities, Mr. Kaplan, that you are talking about: a pathway for that smaller operation to access capital, to grow and create jobs in our States and in our communities.

But at the same time, we can imagine, I think, some of the things that Mr. Fleming is concerned about. You come from the State of Kansas. Much like the State of Nebraska——

Mr. FLEMING. Right.

Senator JOHANNS. ——we kind of pride ourselves in not being overly regulatory. We try to hit the light touch and do it right. What I am trying to figure out here, Mr. Kaplan, to follow up on a statement you made, what is the right balance here? You have got a lot of people out there who are probably interested in investing. That is especially true in an atmosphere where that CD pays 1.5 percent or 1 percent, and they are trying to take that retirement money maybe and make it into a bigger thing.

So I am going to start with you, Mr. Fleming. Is there something we are missing here? How significant a red flag are you raising?

And how do we fix that? And then I am going to ask all of you to react to what Mr. Fleming is saying. I will put you on the spot, Mr. Fleming.

Mr. FLEMING. I do not think I am really raising a red flag on Regulation A Plus. We really see that as kind of a step forward in that it really allows the States to be the primary regulators of really small business offerings. And we think that—you know, we understand the concern with duplicative regulation, but we think for small business offerings it really should be the States that are kind of the lead of that. And so Regulation A creates an exemption under Federal law and kind of leaves it to the States to be the primary regulators, which we think is good thing, a good model, that if we can be successful in Regulation A, maybe we can expand into other areas.

But, you know, obviously to be successful we realize that you have to have rules that are consistent from State to State. You also have to have rules that, you know, make sense in the context of a very small business offering and those types of things. You have to have a one-stop filing system. So we are trying to develop those things so that Regulation A Plus can be as successful as possible.

Senator JOHANNS. When do you think you will have that in place? Do you think you are on the same track as Regulation A Plus?

Mr. FLEMING. With the SEC?

Senator JOHANNS. Yes, time-wise.

Mr. FLEMING. We are probably a little ahead of them right now.

Senator JOHANNS. OK.

Mr. FLEMING. We are getting ready to go out for public comment with our proposal this afternoon, actually, and we will have a 30-day comment period. There may be—you know, based on the comments that we receive, we may have to go back and tweak some things. It is possible we could have an additional comment period after that. But, you know, I suspect if things follow their normal course, this type of rule proposal would be considered at the next face-to-face meeting of our members, which is scheduled for next April.

Senator JOHANNS. Next April.

Mr. Neiss, let me start with you. What is your reaction to what Mr. Fleming is saying?

Mr. NEISS. I personally think that the regulators play an important role. However, if you look at the issuer and the size of the issuer and what they are trying to do, there is just no way they can be compliant with filing with each of the 50 States. The bureaucracy and the costs would be too overwhelming for a small issuer to go out there.

I think the answer is not looking at regulators as the people that are policing the market, even though they play that important role, but looking at technology as a solution to how we can efficiently build markets.

So that is the beauty about crowdfunding, is we are forcing people to use the Internet and technology to put their listing up there, and the information is stored online, so they can do their job, any State regulator can do their job of policing what is going on in the market without an individual person having to register in all 50

States. I think technology is something that we get in front of, not behind, and if we can enable it in this capacity, we can probably get more businesses going.

Senator JOHANNS. Mr. Kaplan.

Mr. KAPLAN. Yes, Senator. Well, first off, I have to say, with all due respect, I disagree with the statement that the Federal Government defers to the State in regulating Regulation A securities. These securities actually go through a very thorough process of being vetted for disclosure and adequacy of that disclosure at the Federal level. The exemption is an exemption from registration. It does not exempt them from regulation at the Federal level.

Second, you know, many of the State securities regulators defer to the review of the Federal Government in the review of Regulation A securities. But the biggest point of concern I have, given our experience, is with all the things that NASAA is doing, respectfully, NASAA does not police the actual examiner who is working with the potential issuer, and that is where we are seeing the breakdown here in many instances.

In other instances, we have perfectly good experiences with regulators. The people in California have been great, for example. But in other instances, we have had absolutely, for lack of a better term, frustrating experiences that have, you know, unnecessarily—unnecessary delays in registrations. One we filed in December of last year we still have not heard from them. We have had investigations that have been instituted by the investigations departments of examiners against our issuers who are just complying with the law.

And so, you know, the motivation for our qualified purchaser definition is, look, this is going through a very sophisticated process at the Federal level. We are layering more onto that in Regulation A Plus. We certainly understand that there has got to be a line. But at the same time, we have been given this qualified purchaser opportunity. Let us find a reasoned definition where now that we have disclosure that is vetted by the regulators, that is based upon a discipline that is analogous to registration, that is in plain language, you know, let us find a level of investor that can understand that; and perhaps with the caps on investment you still maintain, as Senator Reed pointed out this morning, that containing the risk that any given investor could have in that investment. And those securities can move beyond the State registration process. If they want to go to a broader audience, submit to the process.

Senator JOHANNS. Mr. Lewis, I am out of time, but I have one thought here, if the Chairman will indulge me, or one additional question. With what NASAA is talking about doing and with Regulation A Plus making its way through the process, admittedly slower than we would probably like, is there a brewing storm out there. Is there a conflict waiting to happen between NASAA and what we are trying to do with the JOBS Act? I just get this feeling that NASAA is kind of out there doing what it thinks is best, and there is conflict on the horizon. Am I missing something here?

Mr. FLEMING. I do not see any particular conflict with the JOBS Act. I think obviously the intention of the JOBS Act was to make investment opportunities available to more people. We get that. Essentially the investment limit was raised from $5 million to $50 million.

I think a lot of the criticisms that Mr. Kaplan has are with existing Regulation A, as opposed to what has been proposed, and Regulation A Plus, and with the system that we are trying to create. I think a lot of his concerns will be ameliorated when we get this new system up and running.

Senator JOHANNS. OK. Thank you, Mr. Chairman.

Chairman TESTER. Thank you, Senator Johanns.

Senator Reed.

Senator REED. Thank you, Mr. Chairman.

Mr. Fleming, in your testimony you make, I think, several very important suggestions, particularly with respect to the Rule D, Regulation D, Rule 506 type offerings, where you are suggesting that there be a prior filing of the Form D. Can you elaborate on why that would be critical?

Mr. FLEMING. Sure. You know, before the JOBS Act, when we would get a call from an investor about an offering where they are being solicited, you know—and we encourage people to call our offices to check out investments that may be, you know, not on a market or something like that. When we would get those calls, the first thing we do is determine whether it has been registered, and if not, whether it would qualify for an exemption.

Well, prior to the JOBS Act, we could easily determine that it was not—it would not qualify for an exemption because they were making a general solicitation. We did not need a Form D to tell us that.

Now when an investor calls, we will walk through that same process. Is it registered? No. Is it exempt from registration? That is where we get the hangup. We do not know—if an advertisement can be made to the public but the filing does not have to be made until later, there is no real way that we can tell at a glance, you know, is this an issuer that is trying to comply with Regulation D? And we can kind of separate the wheat from the chaff that way.

The other reason it is important is that it does have some information on it that is helpful to investors. For example, it requires the disclosure of control persons of the issuer. So an investor that calls us and asks about an offering, we can take that Form D, and we can look at the control persons; we can, you know, look at whether we have had any prior regulatory problems with them, that type of thing. That is helpful to an investor when they are doing their due diligence.

Senator REED. So there is a potential, you know, if we do not do something like this, have the Form D filed prior to the offering, that you just will not know what is going on. Someone will call you up and say, "I was solicited over the Internet," and you have no idea who the issuer is, really, who the controlling parties are, et cetera, and you will be stymied in terms of giving advice to potential investors and also enforcing the law. Is that correct?

Mr. FLEMING. That is exactly right, although I would point out that the rule proposal has come out with a 15-day advanced filing requirement before the use of a—so you would have to file your Form D 15 days before you advertised. We do not really need a 15-

day advanced filing. For our purposes, it would be sufficient just any time prior to the advertising.

Senator REED. Very good. The other thing, obviously, as you emphasize in your testimony, is that with the lifting of the ban on general solicitation under Rule 506, there is an enhanced possibility of fraud, and you have reflected that in terms of the initial discussion we have had. But could you elaborate on other aspects of fraud that could take place?

Mr. FLEMING. In Rule 506?

Senator REED. The 506, the Regulation D process, with now the lift on general solicitation.

Mr. FLEMING. Yes, we do see—you know, we have always seen a lot of fraud—well, to us, a lot of fraud in this area, and we expect with the lifting of the ban on general solicitation that is just going to increase. Regulation D offerings are always on our top ten list of potential investor traps, and they are normally number one in terms of State enforcement actions, at least for the last few years. We would anticipate that with the lifting of the ban on general solicitation and broadening the pool of potential investors in this marketplace, fraud is going to increase not decrease.

Senator REED. Let me ask you another question, too, the jurisdictional one. If the offering is made out of State, in some cases—and I do not know if this is feasible these days, but with the Internet you have to think even globally of, you know, sites popping up offering, maybe deliberately and fraudulently offering securities under the new procedures that you can buy, is that a problem that you are anticipating in terms of, you know, you might have Kansans who have been victimized, but you cannot even—you cannot even reach, you know, the issuer or the sponsor or the controlling entities?

Mr. FLEMING. Yes, that is definitely a problem. I do not know that the JOBS Act necessarily changes that.

Senator REED. No, I think that is just one of the problems today of an Internet-based global economy.

Mr. FLEMING. Sure.

Senator REED. And, Mr. Lewis, again, thanks for your leadership. Actually, I think if—I have been in Kalispell, Montana.

Chairman TESTER. Yes.

Senator REED. And he has not been in Rhode Island, so I am ahead of him on this.

[Laughter.]

Chairman TESTER. I am due.

Senator REED. He is due. But this whole issue of fraud, which I spoke to Mr. Fleming about, I think looking at—and we looked back at your 10-K for 2012. As an emerging growth company, you have highlighted the possibility that the market might react to the status not because of what you have done—in fact, I compliment you for the disclosures you have given and the accounting rules that you have—the rigorous path you have taken. But there is a fear, I suspect, in this of a spillover effect if we do not police this market very well, that even legitimate, bona fide principal issuers like yourself might suffer. Is that a concern?

Mr. LEWIS. I think that is a fair concern of yours, yes.

Senator REED. Well, I think, you know, we—this is a potentially very powerful tool, but if we do not put in reasonable controls on issuers and give the regulators the ability to check effectively, it could not be as powerful or as useful, and I think that is a point that we should make.

The other issue that I think is important to emphasize is that we are in a situation where we want to encourage capital formation, but we also want to make sure that we protect investors and we protect individuals. You do, too. I mean, that is the essence of what you have done with your company.

So I think we have a lot to do, and it comes back to that sort of often used term of balance between investor protections, State regulation, Federal regulation, and capital formation. So we are going to continue and we have to continue to monitor this, too, because if it takes off in the right direction, we want to applaud it. If it starts going the wrong direction, we want to be able to step effectively in and put in the brakes.

Thank you, Mr. Chairman.

Chairman TESTER. Thank you, Senator Reed.

I have got a couple more, and I am going to start with you, Mr. Neiss. We talked a lot about what Senator Reed was talking about as it relates to your perspective. You discussed some of your concerns that relate to the proposed crowdfunding rules, suggesting that without some modifications the bar would be set so high that some could be priced out of crowdfunding as a viable option. I would like you to elaborate more specifically on your suggestions for how to balance crowdfunding so it remains a reliable option yet offers protection for investors.

Mr. NEISS. OK. There are two areas that I would talk about: one would be the audit requirement, and the other would be the cost of capital related to raising money on the portals because of the responsibilities the portals have.

So when you are going out and raising capital, there are three tiers in crowdfunding. If you are raising under $100,000, it can just be self-certification by essentially an executive in the company. Between $100,000 and $500,000, you have to have a CPA review. And over $500,000, it is where you have to have the audited financials.

The audited financials I think are the challenging part, particularly for startups, because they might have a zero balance sheet, and how do you audit that?

Those type of requirements are onerous, and the cost of capital will come out of the money that is raised. So I do not think—if 10 percent of a $500,000 offering goes to an audit outside of what they have to pay for getting the forms together and hiring an attorney perhaps to help them do this, it could cost them up to 20 percent to do an offering. That does not really make sense.

The second part of it comes down to the funding portals themselves. The burden of having to go through the compliance and registration with FINRA for them, when it was meant to be really a broker-dealer-light solution, a very light touch on them, the cost of that compliance, too, is just going to come out of how much investors have to pay and issuers have to pay the portals themselves for the use of that service.

Now, people are talking about that could be between 7 and 14 percent of the offering. Again, if you look at those costs, the more compliance that portals have to have and the more burden that is placed on them, they are just going to take it out of how much money is raised.

The whole point of crowdfunding, if you look at what happens in donation and perk space, it is a very much hands-off approach. The crowd comes in and says, listen, let me look at everything that you have. Let me look at your disclosures, let us talk about it amongst ourselves and see if this is something that we want to get behind. That is the crowd wisdom, and that is the diligence that goes into it. They absorb a lot of the costs related to doing these offerings, and that is the benefit of crowdfunding.

If you force the portals to do all the regulation that is going into it—and that is what is in the proposed rules—I just fear that this is going to end up costing the individuals, the issuers and the investors, more of their capital that they really want going into businesses.

Chairman TESTER. OK. So what you are saying is the balance really falls upon the investor. Is that fair to say?

Mr. NEISS. Yes, I mean, the investors are—when we look at a constellation of trust that is built around this entire ecosystem, it is not the entrepreneur that is in the middle. It is the investor that is in the middle, because it is the investor's money that they are deploying into these businesses. Anything that we are doing that increases the burden on entrepreneurs or portals really affects the investor because it is their capital that is paying for all of this.

Chairman TESTER. I got you.

On the previous panel we talked about outreach for education, and I kind of indicated that we would talk about that a little bit with this panel, so this question is to anybody who wants to talk about it. Ensuring good information gets out to entrepreneurs and investors about the JOBS Act I think is very important. From your perspective how do we better educate entrepreneurs and investors about the JOBS Act so that they are empowered to make informed decisions? And anybody can start.

Mr. NEISS. Well, I will just tell you, in Title III it is mandated education. So investors have to essentially take an investor education series to understand the risks involved in investing in startups and small businesses, that there is no guarantee of return, that if they see their money, it might not be what they put into it. So there is a list of questions that they essentially have to certify that they understand. I think that is a really important part of Title III, and I think it is really beneficial for investors that are going into it that they understand that there is no guaranteed return on anything when you invest in the private capital markets.

We are as an industry incredibly focused on education. We understand that it is investors and it is entrepreneurs. Entrepreneurs need to understand the responsibilities that they have when taking investors' monies. But investors need to understand the risks associated with this as well.

You know, I think it would be great if other parts of the JOBS Act had this in there.

Chairman TESTER. OK. Anybody else want to talk about——

Mr. FLEMING. I think NASAA is—we are pretty much in agreement with Mr. Neiss's group as far as the importance of investor education. We have put out an investor alert to walk investors through these types of things that they need to consider before making an investment decision in a crowdfunded offering.

In addition to that, though, we have issued what we call an "Issuer Alert" that is directed to the small business and helping them evaluate whether crowdfunding is the right option for them. You know, do they want to have a whole bunch of people out there that think they own the business and might have some say in how it is run? That type of thing.

Chairman TESTER. How do the alerts get out? How broad of a net is this?

Mr. FLEMING. We put them on our Web site. We issue a press release. We encourage the States to push them out to the press. That type of thing.

Chairman TESTER. All right. Thanks.

Mr. KAPLAN. Senator, at the risk of sounding trite, my answer is get the rules out there. Get the rules for all of the options under the JOBS Act, because the most efficient way to get education out there is to have the private market, the brokerage community, the banking community, the legal community, all of these understanding the options and being able to provide a comparative analysis, and you will get that education quickly because that is how they make their money.

Chairman TESTER. OK. Mr. Lewis, would you like to respond? It is up to you.

Mr. LEWIS. Yes, thank you, Senator. In my world, if I need to find out about something, I have more than enough ability to find out about it, and once I start looking for it, they magically know I am wanting it and sending it to me endlessly. So I do not think it is as hard as it was 20 years ago to get this information out. But I would definitely recommend getting all the rules out because that is exactly what will happen. They will be promulgated in every which way.

Senator JOHANNS. I am good.

Chairman TESTER. Senator Johanns is good. Well, I just want to thank all the witnesses here today. I want to thank Senator Johanns for being here. I very much appreciate his line of questioning. I especially want to thank you guys for what you had to say and being up front and frank about it. I appreciate that. That is what hearings should be about. It is about getting good information so that as policy makers we can make decisions that are effective and basically good.

I think the hearing underscored it best. I think you said it at the very end, Mr. Kaplan. You have got to get the rules out. Once you get the rules out, I think we can have a positive impact on economic growth in this country through the JOBS bill, and I look forward to continued progress on this issue.

Just a little housekeeping for the record. This record will remain open for 7 days for additional comments and any questions that can be submitted for the record at that point in time.

So, with that, once again I want to thank you all for your time and for your testimony and for your frank answers. We are adjourned.

[Whereupon, at 11:50 a.m., the hearing was adjourned.]

[Prepared statements and responses to written questions supplied for the record follow:]

PREPARED STATEMENT OF KEITH HIGGINS

DIRECTOR, DIVISION OF CORPORATION FINANCE, SECURITIES AND EXCHANGE COMMISSION

OCTOBER 30, 2013

Chairman Tester, Ranking Member Johanns, and Members of the Subcommittee, I 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 my 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 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 5 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 Web site that explained how emerging growth companies could submit draft registration statements for confidential nonpublic 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 Web site 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 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, teams consisting of staff from across the Commission, including economists from the Division of Eco-

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

[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.*

nomic and Risk Analysis (DERA), have been working on rulemaking recommendations, including the assessment of their potential economic impact, for the Commission's consideration. The Commission has adopted rule amendments that lifted the restriction on general solicitation in offerings conducted pursuant to Rule 506 and Rule 144A, thereby implementing Title II. It also has proposed rules to implement a new exemption to permit crowdfunding in connection with the implementation of Title III.

To aid the rulemaking process and increase the opportunity for public comment, the Commission established a page on its Web site 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 Web page was established in April 2012, a wide range of interested parties have provided feedback and insights relating to the Commission's implementation of the JOBS Act, and these comments are publicly available on the Commission's Web site.[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 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 nonconvertible debt in the previous 3 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 days before the date the issuer conducts a road show. To date, the Commission has received more than 300 confidentially submitted draft registration statements for nonpublic review as permitted under Title I. Of those, more than 170 have completed their initial public offering.

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 nonissuer would be required to comply.

Title I also made important changes with respect to communications around securities offerings and the provision of research and securities analyst communications. The law provided a Securities Act exemption for emerging growth companies and

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

[4] *See, id.* As of October 15, 2013, the Commission has received 230 comment letters relating to the provisions in Title I, 84 comment letters relating to the provisions in Title II, 216 unique comment letters and 126 form letters relating to the provisions in Title III, 25 comment letters relating to the provisions in Title IV, 27 comment letters relating to the provisions in Titles V and VI and 6 comment letters relating to Title VII.

[5] The comment file for each title provides information about JOBS Act-related meetings in which members of the Commission and the staff participated. *See, http://www.sec.gov/spotlight/jobsactcomments.shtml.*

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 provided 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 prohibited 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 brokers, 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 nonpublic 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] 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 and provides guidance when needed.

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 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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[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.*

[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.

In addition, the SEC's recently implemented Market Information and Data Analytics System (MIDAS)[13] provides depth of order book detail beyond the publicly posted best bid and ask prices, which, in the context of a tick size pilot, would enable SEC staff to better investigate the impact of increasing tick sizes on the liquidity provision across the entire limit order book. Posting the results of these investigations online also could allow the public to examine book liquidity measures over the period of a pilot program.

Currently, the staff is working with the exchanges as they develop and, if possible, present to the Commission for its consideration a plan to implement a pilot program that would allow smaller companies to use wider tick sizes.

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 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. The Commission's staff is finalizing this report and expects to make it public very soon.

Title II

Title II of the JOBS Act required 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. Title II stated that "[s]uch rules shall require the issuer 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 stated 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 offerings under the Federal securities laws as a result of general solicitation or advertising.

In addition, Title II required the Commission to revise Securities Act Rule 144A[16] to provide that securities sold under that rule may be offered to persons other than

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

[13] For further information about MIDAS, *see, http://www.sec.gov/marketstructure/.*

[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 nonexclusive 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 Rule 506 prior to the amendments, an issuer could 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 safe harbor was 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." The amendment to Rule 506 adopted by the Commission eliminated this prohibition on general solicitation and general advertising for offerings in which issuers take reasonable steps to verify that purchasers are accredited investors.

[16] 17 CFR 230.144A. Rule 144A is a nonexclusive safe harbor exemption from the registration requirements of the Securities Act for resales of certain "restricted securities" to qualified institutional buyers, or QIBs. Prior to the amendments adopted by the Commission, Rule 144A did not include an express prohibition against general solicitation, but did provide that offers of securities under Rule 144A must be limited to QIBs, which had 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 aggre-

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qualified institutional 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.

On July 10, 2013, the Commission implemented Title II by adopting amendments to Rule 506 and Rule 144A.[17] These amendments became effective on September 23, 2013, and issuers have begun making offerings under the new rules.[18]

Specifically, the Commission adopted new paragraph (c) to Rule 506, which permits issuers to use general solicitation and general advertising to offer securities under Rule 506, provided that all purchasers of the securities are accredited investors and the issuer takes reasonable steps to verify that the purchasers of the securities are accredited investors. The Adopting Release explained 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 nature of the offering, and the amount and type of information that the issuer has about the purchaser.

In addition to this principles-based facts and circumstances method of verifying accredited investor status, the Adopting Release included a nonexclusive list of methods for verifying the accredited investor status of natural persons that issuers may rely upon to establish whether they have satisfied the verification requirement. The Adopting Release also preserved the existing portions of Rule 506 as a separate exemption so that issuers that wish to conduct Rule 506 offerings without the use of general solicitation and general advertising would not be subject to the new verification requirement.

With respect to Rule 144A, the Adopting Release amended the rule to provide that securities sold may be offered to persons other than qualified institutional buyers, including by means of general 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.

In addition to adopting these amendments to Rule 506 and Rule 144A, the Commission took two other actions on July 10, 2013. First, the Commission adopted rule amendments that disqualify felons and other "bad actors" from participating in Rule 506 offerings, as required by the Dodd-Frank Act.[19] Second, the Commission proposed additional rule and form amendments related to offerings conducted in reliance upon Rule 506 that "are intended to enhance the Commission's ability to evaluate the development of market practices in Rule 506 offerings and to address concerns that may arise in connection with permitting issuers to engage in general solicitation and general advertising under new paragraph (c) of Rule 506."[20] To pro-

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gate, owns and invests on a discretionary basis at least $10 million in securities of issuers that are not affiliated with the broker-dealer. The amendment to Rule 144A adopted by the Commission permits issuers to offer securities to persons other than QIBs provided that securities are sold only to persons the seller and any person acting on behalf of the seller reasonably believe are QIBs.

[17] Securities Act Release No. 33-9415 (Adopting Release), 78 Fed. Reg. 44771 (July 24, 2013), available at *http://www.sec.gov/rules/final/2013/33-9415.pdf.* Commissioner Luis A. Aguilar dissented from the Commission's action. Statements from the July 10, 2013, Open Meeting regarding the Adopting Release are available on the SEC's Web site at the following links: Chair White statement: *http://www.sec.gov/News/Speech/Detail/Speech/1370539689380;* Commissioner Aguilar's dissenting statement: *http://www.sec.gov/News/Speech/Detail/Speech/1370539684712;* Commissioner Gallagher statement: *http://www.sec.gov/News/Speech/Detail/Speech/1370539665007;* Commissioner Paredes statement: *http://www.sec.gov/News/Speech/Detail/Speech/1370539701591;* and Commissioner Walter statement: *http://www.sec.gov/News/Speech/Detail/Speech/1370539699218.*

[18] Based on the information reported in the initial Form D filings reviewed by DERA, as of October 18, 2013, there have been 170 new offerings made in reliance on the new Rule 506 exemption that became effective on September 23, 2013, with approximately $911 million in total amount sold in these offerings. In addition, 44 offerings that commenced in 2013, but before the effective date of the new Rule 506 exemption, were subsequently converted to offerings relying on the new exemption. Since the new rules became effective, the average offering size for Rule 506(c) offerings was $6.1 million, as compared to $22.8 million for Rule 506(b) offerings; the median offering size for Rule 506(c) offerings was $1.3 million, as compared to $1.8 million for Rule 506(b) offerings.

[19] Securities Act Release No. 33-9414, 78 Fed. Reg. 44729 (July 24, 2013), available at *http://www.sec.gov/rules/final/2013/33-9414.pdf.*

[20] Securities Act Release No. 33-9416, 78 Fed. Reg. 44806 (July 24, 2013), available at *http://www.sec.gov/rules/proposed/2013/33-9416.pdf.* Commissioners Daniel M. Gallagher and Troy A. Parades dissented from the Commission's action. Statements from the July 10, 2013, Open Meeting regarding the proposing release are available on the SEC's Web site at the following links: Chair White statement: *http://www.sec.gov/News/Speech/Detail/Speech/1370539689380;* Commissioner Aguilar statement: *http://www.sec.gov/News/Speech/Detail/*

vide the public with additional time to consider the matters addressed by, and comments submitted on, the proposal, the Commission recently re-opened the comment period until November 4, 2013. To date, the Commission has received more than 440 unique comment letters and 45 form letters on the proposed amendments.

Finally, Title II amended 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 Web site 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]

Title III

Title III of the JOBS Act provided a new exemption from Section 5 of the Securities Act for offers and sales of securities through crowdfunding, 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 conditions, Title III limited 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 required 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 an exemption from broker registration.

Title III included other requirements for issuers and intermediaries, including disclosure obligations and restrictions on advertising the terms of the offering. The Commission also was 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.

On October 23, 2013, the Commission proposed rules that would implement Title III. Under the proposed rules, an issuer could raise a maximum aggregate amount of $1 million pursuant to the exemption in any 12-month period. Investors would be permitted, during a 12-month period, to invest up to:

- $2,000 or 5 percent of their annual income or net worth, whichever is greater, if both their annual income and net worth are less than $100,000; or
- 10 percent of their annual income or net worth, whichever is greater, if either their annual income or net worth is equal to or more than $100,000. During the 12-month period, these investors would not be able to purchase more than $100,000 of securities through crowdfunding.

The proposed rules would exclude certain issuers from relying on the exemption, including non-U.S. issuers, Exchange Act reporting companies, investment companies, issuers that have not complied with annual reporting requirements under the proposed rules, and issuers that have no specific business plan or that have indicated their business plan is to engage in a merger or acquisition with an unidentified company or companies.

The proposed rules would set up a registration and regulatory framework for funding portals that limits their securities activities to acting as intermediaries in crowdfunding securities transactions and prohibits them from engaging in certain activities, such as offering investment advice or handling investor funds. Funding portals would be required to register with the Commission by filing a new form and

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Speech/1370539698546; Commissioner Gallagher's dissenting statement: *http://www.sec.gov/News/Speech/Detail/Speech/1370539665007;* Commissioner Paredes' dissenting statement: *http://www.sec.gov/News/Speech/Detail/Speech/1370539701591;* and Commissioner Walter statement: *http://www.sec.gov/News/Speech/Detail/Speech/1370539699218.*

[21] 17 CFR 230.500 through 230.508.

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

to become a member of FINRA or any other registered national securities association.[23] The proposed rules also would require the funding portals to, among other things:

- provide investors with educational material that informs them about the risks associated with crowdfunding securities;
- obtain information about investor income, net worth, and other crowdfunding investments, for purposes of determining investment limitations;
- make available on its platform the information provided by the issuer;
- take steps to ensure the proper transfers of investor funds and securities; and
- comply with anti-money laundering and privacy requirements.

The proposed rules also would require eligible issuers to file specified disclosures with the Commission and provide the disclosures to both the intermediary and investors, including disclosures concerning the issuer's officers and directors, as well as owners of 20 percent or more of the issuer's securities; the issuer's business; the intended use of proceeds; the terms of the offering; and the financial condition of the company.

Consistent with Title III, issuers also would be required to provide financial statements. Financial statements would be required to be prepared in accordance with U.S. GAAP and cover the shorter of the two most recently completed fiscal years or the period since the issuer's inception. For offerings of $100,000 or less, financial statements would be certified by the principal executive officer and issuers would be required to provide income tax returns for the most recently completed fiscal year. For offerings of more than $100,000, but not more than $500,000, the financial statements would need to be reviewed by an independent accountant. For offerings of more than $500,000, the financial statements would need to be audited by an independent auditor.

Issuers also would be required to file annual reports with the Commission. The disclosure would be similar to that required when the issuer is offering securities, but would not include offering-specific information.

The proposed rules also contain measures intended to reduce conflicts of interest and the risk of fraud. Among other things, the proposed rules prohibit an intermediary from having any financial interest in an issuer using its services, and require background and regulatory checks on an issuer and each officer and director, and certain security holders. The proposed rules also contain a safe harbor for certain insignificant deviations from the requirements; impose resale restrictions on securities purchased in crowdfunding transactions; disqualify certain bad actors from relying on the new exemption; and exempt securities issued in reliance on the new exemption from the record holder count for purposes of Exchange Act Section 12(g).

The comment period for the proposed rules will be open for 90 days after publication in the Federal Register. We look forward to receiving and considering public comment on all aspects of this proposal.

Title IV

Title IV of the JOBS Act required Commission rulemaking to create a new exemption from Securities Act registration, similar to existing Regulation A,[24] which would allow certain "small issue" offerings of up to $50 million in a 12-month period.[25] Title IV specified 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 required the Commission to review the offering limit under the new exemption not later than 2 years after enactment of the JOBS Act and every 2 years thereafter. Staff have met with market participants, industry groups, State securities regulators and other interested parties about the implementation of Title IV.[26] Staff in the Division of Corporation Finance and DERA are finalizing rule recommendations under Title IV for the Commission's consideration.

[23] Today, FINRA is the only registered national securities association.
[24] 17 CFR 230.251 through 230.263.
[25] *See, http://www.sec.gov/comments/jobs-title-iv/jobs-title-iv.shtml* for comments on Title IV.
[26] *See, http://www.sec.gov/comments/jobs-title-iv/jobs-title-iv.shtml.*

Titles V and VI

Titles V and VI of the JOBS Act amended 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 amended Section 12(g) to raise the threshold for registration from 500 holders of record to 2,000 holders of record, of which no more than 500 holders of record can be investors who are not accredited investors. Title V also excluded from the calculation of the number of holders of record shares held by persons who received the shares pursuant to employee compensation plans, and required Commission rulemaking to provide a safe harbor for the determination of whether such a holder is to be excluded.

Title VI applied only to banks and bank holding companies. It amended Section 12(g) to raise the registration threshold from 500 holders of record to 2,000 holders of record, and also changed the threshold for exiting the reporting system from 300 holders of record to 1,200 holders of record. Title VI required 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 Web site addressing anticipated questions related to the JOBS Act changes to the requirements for Section 12(g) registration and deregistration. To date, approximately 90 bank holding companies have deregistered.[29] The staff is preparing recommendations for rule proposals for the Commission's consideration to address the new requirements of Titles V and VI.

Title V also required 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, DERA 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).

Title VII

Effective upon enactment, Title VII required 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 has expanded 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. This content will continue to be updated as the Commission proposes and adopts further JOBS Act rules.

Conclusion

While there is still much to be accomplished, the Commission and the staff have made significant progress on, and continue to work diligently in, implementing the JOBS Act mandates. It is a high priority to do so. The staff has either completed or is in the process of completing the studies mandated by the JOBS Act. The Commission and staff also have either completed or are moving forward expeditiously

[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. §78l(g) and 17 CFR 240.12g-1.

[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.*

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

on the various rulemakings required by the JOBS Act. We look forward to completing the remaining provisions as soon as practicable.

Thank you again for inviting me to testify today, and I am happy to answer any questions you may have.

PREPARED STATEMENT OF ALAN LEWIS

DIRECTOR OF SPECIAL PROJECTS, NATURAL GROCERS BY VITAMIN COTTAGE, INC.

OCTOBER 30, 2013

Chairman Tester, Ranking Member Johanns, Members of the Subcommittee, thank you for the opportunity to testify about the impact of the Jumpstart our Business Startups Act (the "JOBS Act") on Natural Grocers by Vitamin Cottage, Inc. (Natural Grocers) and its ability to raise capital to support job creation and contribute to the economic growth of the Nation. As Director of Special Projects at Natural Grocers and an active member of our IPO team, I participated in drafting the Registration Statement on Form S-1 and in making decisions about using certain beneficial provisions found in the Jobs Act. I am also an active member of NIRI, the National Investor Relations Institute, and I provide ongoing investor relations support within Natural Grocers. I welcome this opportunity to answer your questions and provide you with additional information on how the JOBS Act affected our company's growth prospects during and after our Initial Public Offering in July 2012.

Natural Grocers is in many ways the quintessential American business success story. Starting from humble mom-and-pop beginnings in the 1950s, we have grown to operate over 70 grocery stores employing over 2,000 people in 13 States while staying true to our original founding mission: helping people stay healthy through better food and nutrition. To support this mission, we scrupulously review every product before we agree to sell it. Our standards for natural groceries do not allow artificial ingredients such as colors, flavors, preservatives, or sweeteners or dangerous ingredients like hydrogenated fats. We are also committed to sustainable agriculture using minimal chemical inputs, so we only sell USDA certified organic produce in our stores.

Beyond providing only clean healthy food, however, we are committed to help consumers become better informed about how nutrition directly impacts their health and wellness. To this end we staff our stores with full time credentialed nutritionists and offer classes, advice, and reference materials on various health topics. We present complex scientific information using accessible language to give people a basic understanding of the principles of good nutrition so they feel empowered to make proactive decisions. It is probably not an overstatement to say that Natural Grocers endeavors to support the American healthcare system by improving our customers' diets so they can better avoid expensive chronic diseases as well as achieve better outcomes from medical treatment.

In 1998, Natural Grocers was acquired from its founders by their four children. Over the following 10 years they grew the business through long hours and hard work, depending on internal cash flow and bank loans for capital. Subsequently, they carefully hired additional professional staff and began putting in place the sophisticated accounting, technology and operational infrastructure needed to support a robust expansion strategy.

Beginning in 2009, in the midst of the recent economic downturn, our leadership team began laying the groundwork to raise outside capital through an initial public offering. The grocery business is highly fragmented and competitive, and success in the industry partially depends on maintaining economies of scale, controlling administrative costs, and securing volume purchasing discounts. Our decision to seek additional capital was partly based on the need to increase our ability to capture these competitive advantages by expanding our store base.

Concurrent to our own internal strategic planning process, in 2009 (and before) Congress began addressing the need for economic stimulus by proposing a number of bills designed to prompt public and private investment to generate new jobs. A number of these initiatives were eventually passed into law in the form of the JOBS Act, which was signed into law just when Natural Grocers was preparing to submit its Registration Statement on Form S-1 to the SEC in anticipation of an IPO during the summer of 2012.

Many of the key provisions of the JOBS Act were anticipated and welcomed by our legal, accounting, and investment banking advisors. We clearly qualified as an "emerging growth company." As a group, we paused to consider which opportunities we would take advantage of, keeping in mind we would likely be among the first companies to launch an IPO under this new regulatory regime, and that investors might be skeptical of some of the new relaxed rules. We decided to take advantage of the confidential filing provision and, temporarily, some of the reduced financial reporting requirements. We decided not to "opt out" of maintaining compliance with new or revised accounting standards. We will discuss our experience with each of these decisions below. We did not contemplate utilizing any methods to "Test the Waters" for the offering because the provision was simply too new.

The IPO Market Environment in 2012

Before we start, let me remind you that all statements made in this testimony other than statements of historical fact are forward-looking statements. All forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could differ materially from those described in the forward-looking statements because of factors such as industry, business strategy, goals and expectations concerning our market position, the economy, future operations, margins, profitability, capital expenditures, liquidity and capital resources, other financial and operating information, and other risks detailed in the Form 10-K filed by Natural Grocers for the year-ended September 30, 2012. The information we present is accurate as of the date of this testimony. Natural Grocers undertakes no obligation to update forward-looking statements.

Chairman Tester has asked me to describe our experience filing confidentially and using some of the reduced compliance provisions under the JOBS Act. My testimony today will explain why we chose to do so and how these measures helped us in our efforts to raise capital.

To begin, it is worth remembering that the summer of 2012 saw the first substantial thawing of the financial markets after four very difficult years. IPOs were few and far between and not always successful. Some registration statements had been filed publicly on EDGAR but later postponed indefinitely. Facebook's difficult IPO in May 2012—just before our road show was to begin—weighed heavily on the markets. Still, interest rates on cash continued to be at or near zero, so investors were looking for quality companies to buy into.

Confidential Filing

Within this unsure market environment, the ability to file our Form S-1 confidentially and proceed with the SEC staff's comment process before ever making our filing public was extraordinarily helpful. We continued to survey the strength of the market while simultaneously preparing our registration statement for public EDGAR filing. Because we were able to file confidentially, our trade practice and financial statement disclosures contained within the S-1 were not telegraphed to our competitors unnecessarily or unnecessarily early. Had the Form S-1 not been treated confidentially, Natural Grocers could have decreased its competitive advantage due to a lengthy delay in our IPO because of a soft market. Confidential filing allowed us to better orchestrate the timing of the road show and IPO successfully, despite unpredictable and skittish financial markets.

For our company, confidential submission greatly reduced the complexity, stress and risk of undertaking a public offering.

Two Years Minimum Required Audited Financial Statements

The second opportunity provided us by the JOBS Act was to reduce the number of years of audited financial statements from 5 years to 2. After much deliberation, our team decided to disclose audited financial statements for fiscal years 2009, 2010, and 2011, plus interim unaudited financial statements for the first 9 months of fiscal year 2012. (Our IPO took place during the last quarter of our fiscal year 2012, which ended on September 30th, so audited year-to-date financials were not yet available.) After consulting with our investment bankers, we felt that the 2007 and 2008 financial statements did not add significant context, color or detail to our company growth story. Nor did they help communicate the viability of our future growth strategy. Furthermore, there were complexities around presenting the 2007 and 2008 financial statements due to a change in fiscal year and a change in audit firm. Audited 2007 and 2008 financial statements could have been included in our S-1, but only with significant delays and additional costs.

We had some concern that analysts and investors might be wary of the reduced reporting requirement, There were a number of inquiries by analysts and investors about the potential significance of the missing 2007 and 2008 fiscal year reporting. However, the absence of those historical financial statements did not seem to impact the ultimate success of our offering.

The following sections describe certain other optional, reduced, or delayed disclosure and accounting requirements offered by the Job Act that Natural Grocers did not implement during its IPO.

Exemption From Certain Sarbanes-Oxley Requirements

The Sarbanes-Oxley Act of 2002 addressed numerous additional regulations in corporate auditing, internal controls and accountability. SOX Section 103 created new requirements for audits and auditors, and SOX Section 404 set new standards for assessment of internal controls. Both sections were considered controversial among some because of the high cost of compliance, and, in turn, the greater burden those costs place on smaller companies relative to their revenue. The JOBS Act granted an exemption to qualified emerging growth companies from potential future requirements to rotate audit firms and for audit firms to provide supplemental information about how the audit was conducted, among other requirements. The JOBS Act also exempted emerging growth companies from compliance with internal control, evaluation, and reporting requirements in Section 404 of Sarbanes-Oxley. Natural Grocers determined it would continue to maintain compliance with Sections 103 and 404 of Sarbanes-Oxley.

Opting Out of New or Revised Accounting Standards

Section 107 of the Jobs Act allows emerging growth companies to make a one-time decision to comply with all new or revised accounting standards or to temporarily opt out of keeping up with new and revised rules. The intent of this provision appears to be to reduce the cost and burden associated with complex accounting rule changes. We acknowledge that ongoing compliance with the myriad rule changes can be costly. It may also present a significant distraction to company management of an emerging growth company that is focused on key growth drivers rather than finicky accounting rules. Natural Grocers opted to not elect into this provision upon its initial filing.

Dodd-Frank Executive Pay Disclosures

The JOBS Act also amended the Investor Protection and Securities Reform Act of 2010, commonly referred to as Dodd-Frank, by exempting emerging growth companies from the executive compensation disclosures required under Section 953 of Dodd-Frank. Natural Grocers did not take advantage of this exemption because we did not see any advantage to doing so. On the contrary, we believe our executives are paid fairly relative to our industry benchmarks and their individual roles and responsibilities. An extensive disclosure regarding compensation for our executives begins on page 93 of the prospectus contained in our Registration Statement on Form S-1.

A Successful IPO for Natural Grocers and Its Investors

Our IPO was a success on many levels. Our IPO priced at the high end of our range and the stock price held a healthy but reasonable premium on the first day of trading and thereafter. As one financial commentator stated in an article titled "The Greedy Sit Out an IPO", "[Natural Grocers] has begun its publicly traded life in an environment of fair and balanced trading [. . .] How refreshing."[1]

The company used the proceeds from its IPO to pay off its outstanding term loan and pay down its credit facility while retaining some cash reserves to fund additional new store growth. During our last quarterly earnings announcement on August 7, 2013, we noted the Company had a total 70 Natural Grocers stores operating in 13 States, two additional stores planned for the fourth quarter of fiscal 2013, and 15 new stores planned for fiscal 2014. Our revenue and unit growth, supported by capital provided by public shareholders, has created hundreds of new, well paid, full-time jobs—all which qualify for our 401k plan and affordable health care benefits.

There were other benefits to being a publicly traded company. As a company traded on the New York Stock Exchange, our stature in the national financial press was elevated the moment we rang The Opening Bell™ above the floor of the Exchange. We now appear in news coverage on an equal footing with many of our larger peer competitors. Our company news is more widely circulated and referenced as a benchmark for the natural foods industry. Our higher profile has allowed us to take part in significant public policy debates at a level where our views and perspectives are better heard and acknowledged. We believe this national recognition of Natural Grocers' approach to product standards and dedication to consumer education and community outreach has provided welcome public awareness of, and affinity for, our brand as we enter new markets.

[1] *http://www.smallcapnetwork.com/The-Greedy-Sit-Out-an-IPO-How-Refreshing-NYSE-NGVC/s/via/14/article/view/p/mid/1/id/917/*

Success of the JOBS Act of 2012

In conclusion, we believe that the JOBS Act is a successful piece of legislation. Key provisions of the JOBS Act enabled Natural Grocers to successfully navigate the financial markets and do exactly what the JOBS Act intended: grow our company and add jobs to the American economy.

Thank you, again, for your support of American business and job growth, and for allowing me to be here today to present the perspective of Natural Grocers on the JOBS Act. I am happy to answer any questions that you might have.

Background Information

About Natural Grocers

Natural Grocers by Vitamin Cottage (NYSE:NGVC), founded in Colorado by Margaret and Philip Isely in 1955, was built on the premise that consumers should have access to affordable, high-quality foods and dietary supplements, along with nutrition knowledge to help them support their own health. The family-run store has since grown into a successful national chain with locations across Colorado, Texas, Utah, Wyoming, Oklahoma, Missouri, New Mexico, Montana, Kansas, Idaho, Nebraska, Arizona, and Oregon—employing over 2,000 people. The company went public in July 2012; however, Isely family members continue to manage the company, building on the foundation of their parents' business. Natural Grocers' popularity and success can be traced back to its founding principles: providing customers with high quality products at every day affordable prices.

Our Competitive Strengths

We believe we are well-positioned to capitalize on favorable natural and organic grocery and dietary supplement industry dynamics as a result of the following competitive strengths:

Strict focus on high-quality natural and organic grocery products and dietary supplements. We offer high-quality products and brands, including an extensive selection of widely recognized natural and organic food, dietary supplements, body care products, pet care products and books. We offer our customers an average of approximately 19,500 SKUs of natural and organic products per store, including an average of approximately 7,000 SKUs of dietary supplements. We believe this product offering enables our customers to utilize our stores for all of their grocery and dietary supplement purchases. In our grocery departments, we only sell USDA certified organic produce and do not approve for sale products that are known to contain artificial colors, flavors, preservatives, sweeteners, or partially hydrogenated or hydrogenated oils. Consistent with this strategy, our merchandise selection does not include conventional products or merchandise that does not meet our strict quality guidelines. Our store managers enhance our robust product offering by customizing their stores' selections to address the preferences of local customers. All products undergo a stringent review process to ensure the products we sell meet our strict quality guidelines, which helps us generate long-term relationships with our customers based on transparency and trust.

Engaging customer service experience based on education and empowerment. We strive to consistently offer exceptional customer service in a shopper-friendly environment, which we believe creates a differentiated shopping experience and generates repeat visits from our loyal customer base. Our customer service model is focused on providing free nutrition education to our customers. This focus provides an engaging retail experience while also empowering our customers to make informed decisions about their health. We offer our science-based nutrition education through our trained associates, Health Hotline® newsletter and sales flyer, one-on-one nutrition health coaching and nutrition classes. Our commitment to nutrition education and customer empowerment is emphasized throughout our entire organization, from executive management to store associates. Every store also maintains a Nutritional Health Coach SM position. The Nutritional Health Coach is responsible for training our store associates and educating our customers in accordance with applicable local, State, and Federal regulations. Each Nutritional Health Coach must have earned a degree or certificate in nutrition, human sciences or a related field from an accredited school, complete continuing education in nutrition, and be thoroughly committed to fulfilling our mission. Substantially all of our Nutritional Health Coaches are full-time employees. We believe our Nutritional Health Coach position is unique within our industry and represents a key element of our customer service model.

Scalable operations and replicable, cost-effective store model. We believe our scalable operating structure, attractive new store model, flexible real estate strategy and disciplined approach to new store development allow us to maximize store performance and quickly grow our store base. Our store model is successful in highly competitive markets and has supported significant growth outside of our original Colorado geography. We believe our supply chain and infrastructure are scalable and will accommodate significant growth based on the ability of our primary distribution relationships to effectively service our planned store locations. Our investments in overhead and information technology infrastructure, including purchasing, receiving, inventory, point of sale, warehousing, distribution, accounting, reporting, and financial systems support this growth. In addition, we have established effective site selection guidelines, as well as scalable procedures, to enable us to open a new store within approximately 9 months from the time of site selection. Our limited offering of prepared foods also reduces real estate costs, labor costs, and perishable inventory shrink and allows us to quickly leverage our new store opening costs.

Experienced and committed team with proven track record. Our executive management team has an average of 35 years of experience in the natural grocery industry, while our entire management team has an average of over 27 years of relevant experience. Since the second generation of the Isely family assumed control of the business in 1998, we have grown our store count from 11 to 59 stores as of September 30, 2012, while remaining dedicated to our founding principles. Over their tenure, members of our executive management team have been instrumental in establishing a successful, scalable operating model, generating consistently strong financial results, and developing an effective site selection and store opening process. The depth of our management experience extends beyond our home office. As of September 30, 2012, 42 percent of our store managers at comparable stores (stores open for 13 months or longer) have tenures of over 4 years with us, and our store and department managers at these stores have average tenures of 3 to 4 years with us. In addition, we have a track record of promoting store management personnel from within. We believe our management's experience at all levels will allow us to continue to grow our store base while improving operations and driving efficiencies.

Our Growth Strategies

We are pursuing several strategies to continue our profitable growth, including:

Expand our store base. We intend to continue expanding our store base through new store openings in existing markets, as well as penetrating new markets, by leveraging our core competencies of site selection and efficient store openings. Based upon our operating experience and research conducted for us by customer analytics firm The Buxton Company, we believe the entire U.S. market can support at least 1,100 Natural Grocers stores, including approximately 200 additional Natural Grocers stores in the 13 States in which we currently operate or have signed leases.

Increase sales from existing customers. We have achieved positive comparable store sales growth for over 40 consecutive quarters. In order to increase our average ticket and the number of customer transactions, we plan to continue offering an engaging customer experience through science-based nutrition education and a differentiated merchandising strategy of delivering affordable, high-quality natural and organic grocery products and dietary supplements. We also plan to utilize targeted marketing efforts to our existing customers, which we anticipate will drive customer transactions and convert occasional, single-category customers into core, multicategory customers.

Grow our customer base. We plan to continue building our brand awareness, which we anticipate will grow our customer base. We believe offering nutrition education has historically been one of our most effective marketing efforts to reach new customers and increase the demand for natural and organic groceries and dietary supplements in our markets. We intend to enhance potential customers' nutrition knowledge through targeted marketing efforts, including the distribution of our Health Hotline newsletter and sales flyer, the Internet and social media, as well as an expansion of our educational outreach efforts in schools, businesses and communities, offering lectures, classes, printed and online educational resources and publications, health fairs, and community wellness events. In addition to offering nutrition education, we intend to attract new customers with our everyday affordable pricing and to build community awareness through our support of local vendors and charities.

Improve operating margins. We expect to continue to improve our operating margins as we benefit from investments we have made in fixed overhead and information technology, including the implementation of an SAP enterprise resource planning system in fiscal year 2010. We anticipate these investments will support our long-term growth strategy with only a modest amount of additional capital. We expect to achieve economies of scale through sourcing and distribution as we add more stores, and we intend to optimize performance, maintain appropriate store labor levels, and effectively manage product selection and pricing to achieve additional margin expansion.

Forward-Looking Statements

Except for the historical information contained herein, statements in this document are "forward-looking statements" and are based on current expectations and assumptions that are subject to risks and uncertainties. All statements that are not statements of historical facts are forward-looking statements. Actual results could differ materially from those described in the forward-looking statements because of factors such as our industry, business strategy, goals and expectations concerning our market position, the economy, future operations, margins, profitability, capital expenditures, liquidity and capital resources, other financial and operating information and other risks detailed in the Company's Form 10-K for the year-ended September 30, 2012, as amended by Form 10-K/A (Form 10-K) and our subsequent quarterly reports on Form 10-Q. The information contained herein speaks only as of its date and the Company undertakes no obligation to update forward-looking statements.

For further information regarding risks and uncertainties associated with our business, please refer to the "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors" sections of our SEC filings, including, but not limited to, our Form 10-K and our subsequent quarterly reports on Form 10-Q, copies of which may be obtained by contacting investor relations or by visiting our Web site at *http://Investors.NaturalGrocers.com.*

PREPARED STATEMENT OF ROBERT R. KAPLAN, JR.

MANAGING PARTNER, PRACTICES, KAPLAN VOEKLER CUNNINGHAM AND FRANK, PLC

OCTOBER 30, 2013

Mr. Chairman and honorable Members, thank you for your kind invitation to speak before you today. I am Managing Partner for Practices at the law Firm of Kaplan Voekler Cunningham and Frank, PLC, headquartered in Richmond, Virginia. I am also the Firm's founder. As such, I am at heart an entrepreneur, and uniquely positioned to relate to the concerns, challenges and issues I hear communicated by members of the private business community related to current state of their access to the capital markets.

We are a boutique firm with one of our focuses being on securities and capital formation. Most of our attorneys, including myself, come originally from some of the largest law firms in the Nation. Our practice includes public and private securities, and we represent clients in various capacities of all sizes from multi-billion-dollar enterprises to fledgling start-ups, but the bulk of our practice resides amongst companies in the lower mid-market or smaller (clients with $5MM to $150MM of revenue), "Main Street" businesses.

According to the Department of Labor, Bureau of Statistics, 65 percent of all net new jobs in the U.S. created between 1993 and 2009 were created by businesses such as my firm represents.[1] It is VITAL that action be taken now to implement fully the JOBs Act.

The current situation can be reduced to the following:

1. To date, little movement has occurred to implement those aspects of JOBS Act that address the needs of the lower middle market and smaller "Main Street" businesses.
2. That lack of progress has resulted in a relative stagnation in the ability of smaller businesses in this country to raise capital and has placed further uncertainty into the broader economy.
3. "Main Street" suffers presently from a lack of viable options for capital raising.
4. Title IV of the Act, euphemistically referred to as "Regulation A+", presents the most potentially impactful legislation to aid "Main Street" and provides a rational balance between regulatory oversight and access to publicly formed capital.
5. The forms and procedures currently existing under Regulation A can be readily applied to A+, thus obviating the need for further delay in implementing Regulation A+.

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[1] U.S. Dept. of Labor, Bureau of Labor Statistics, "Business Employment Dynamics"; Advocacy-funded research by Zoltan Acs, William Parsons, and Spencer Tracy, 2008 *(archive.sba.gov/advo/research/rs328tot.pdf)*.

6. The Securities and Exchange Commission ("SEC" or the "Commission") should adopt a workable definition of "qualified purchaser" which affords investor protection but eliminates unnecessary and obstructive layers of regulatory procedure.
7. SEC's rulemaking in this context should be balanced so as not to make Regulation A+ overly burdensome but foster issuer transparency and efficient dissemination of information to support a market for these securities.
8. Regulation A+, in turn, should provide greater investment options to the American public than what can be found now—with retail investors largely relegated to mutual or hedge funds or investment in private securities under Regulation D, which carry risks associated with being restricted and relatively nontransparent.

For lower mid-market and smaller businesses, options to capital are limited at best. Public registration is not a viable option in light of the enormous costs associated with an initial public registration and the ongoing regulatory burdens associated with reporting requirements, Sarbanes-Oxley and Dodd-Frank. These cost and regulatory factors have played a considerable role in narrowing the opportunity of utilizing public registration to companies well beyond the size of the mid-market and at deal sizes far past the needs of most "Main Street" firms.[2] That has, in turn, limited drastically opportunities for smaller investment banking, brokerage, legal, and accounting firms to participate in public securities offerings, which creates an insulated market where expense associated with public offerings will remain inflated.

Alternatively, the viable audience for private securities of lower mid-market and smaller businesses is severely constrained presently. Changes to the accredited investor definition found in Rule 501 of Regulation D, have further narrowed the number of potential accredited investors available to invest in such offerings. Some estimates have put the reduction of the accredited investor audience as a result by at least twenty percent (20 percent).[3] Currently, the Commission is considering increasing the $1,000,000 requirement currently found under the net worth test for accredited investor status for individuals. GAO recently suggested that this number could be revised upwards to $2,300,000 to account for inflation since establishment of the test.[4] This is estimated to reduce the accredited investor pool by another 60 percent.[5]

Since 2008, the accredited investor market has dramatically reduced in size and activity. Many accredited investors have eschewed illiquid, restricted securities after being unable to exit failing investments during the recession. That same phenomenon resulted in an influx of FINRA arbitration related to failed investments. Many broker-dealers and investment banks who would potentially work with lower mid-market and smaller businesses have ceased handling private placements beyond institutional investments as a result. Others are precluded entirely from placing private securities due to the unwillingness of Errors and Omissions insurance carriers to insure them for such activities.

Rules promulgated by the Commission related to general solicitation under Rule 506(c), pursuant to Title II of the Act, and new "bad boy" prohibitions from use of Regulations D promulgated pursuant to Dodd-Frank have further "chilled" any potential market beyond institutional investment in professionally distributed private placements. Instituting Title II's requirement that reasonable steps be taken to ensure accredited status of all investors, Rule 506(c) creates an uncertain "facts and circumstances" test as to the reasonableness of the method undertaken to assure accreditation, subject to limited SEC prescribed safe harbors. We believe, and have seen borne out in our market experience, that the uncertain nature of a "facts and circumstances" test will push issuers and their distributors towards the prescribed safe harbors which predominantly involve intrusive requests for the financial and tax records of potential investors. These information gathering requirements in-

[2] Median deal size for initial public offerings (IPO) in 2012 was $124MM. *See,* "2012 IPO Market Annual Review", Renaissance Capital, January 2, 2013. Median deal size for IPO's through 3rd quarter of 2013 is $101MM. *See*, "United States: 03 2013 IPO Report", Wilmer Hale, October 24, 2013. We consistently see issuer's legal fees in these transactions disclosed at greater than $1,000,000, and accounting between $500,000 and $1,000,000. According to a 2012 report of PwC, an issuer can expect on average to spend $1MM in legal and $600K in auditors for an offering of $50MM or less. *See*, "Considering an IPO?: The Costs of Going and Being Public May Surprise You", PwC, September 2012.

[3] "Alternative Criteria for Qualifying as an Accredited Investor Should Be Considered", GAO 9-10 (July 2013), *http://www.gao.gov/assets/660/655963.pdf.*

[4] Id.

[5] Id.

crease the regulatory burdens on issuers and their distributors, frustrate potential investors and, consequentially, reduce the appeal of publicly solicited Regulation D offerings. Further, the Commission has proposed rules regarding pre-filing the Form D and general solicitation materials for an offering relying on Rule 506(c) and instituting draconian punishment of failures in administrative notice filings for all Rule 506 offerings. While these proposals have been met with significant negative commentary and our (and our clients) hope is that they will ultimately not be adopted, they have nonetheless created an environment of uncertainty surrounding public solicitation and the professionally distributed Regulation D market as a whole.

Added to these regulatory obstacles are the new "bad actor" rules instituted as required by Dodd-Frank. While we certainly agree with the intent of the "bad actor" rules, no one wants people previously convicted of securities fraud selling unregistered securities, it also cannot be argued that these rules add risk and uncertainty to the usage of Rule 506, especially in the context of an offering distributed through retail broker-dealers to multiple individual accredited investors. By visiting the sins of a single participant in an issuer's distribution network, or even potentially a single investor, upon the offering as a whole, the application of the "bad actor" rules can result in the loss of the Rule 506 exemption and severe consequences for the sale of unregistered securities by the issuer, its management and its distribution network. As a result, issuers and their distributors are forced to institute expensive and uncertain compliance procedures, or narrow the scope of their capital raising to limit risk. This leads to a greater emphasis on institutional or very high net worth capital. Institutional investment generally comes with demands for large returns on invested capital to offset risk associated with longer holds in restricted securities and exacerbated by a the volume of competition seeking the same dollars. As a result, innumerable companies which might present solid investments, but cannot credibly show double-digit returns or exponential growth on a short term basis are ignored.

Regulation A+ can give much broader variety of issuers and businesses the ability to offer their securities to a much broader segment of the population. Regulation A+ can provide the opportunity for many issuers who, for example, have solid fundamentals and can reliably produce dividends, but perhaps not the ability to achieve the prodigious return rates sought by institutional capital, to reach a much broader segment of the population with performance goals that are realistic and achievable.

At the same time, however—and I should emphasize that this really goes to the cruxt of the opportunity under Title IV that has been overlooked for so long—Regulation A+ combines that opportunity for the issuer with a requirement that the issuer submit to a "right-sized" disclosure and reporting regime that is designed to insure standards for complete and illustrative disclosure and a current picture of the status of that issuer. Thus, the issuer is provided access to a broader investing audience with a more diverse set of investment priorities in exchange for compliance with the same conceptual regulatory discipline as registration, but streamlined to account for the relative size of the issuer and offering. This has a number of salutary effects for the investing public, as well as the issuers:

1. *Transparency*—standardized disclosure and reporting can insure that investors and shareholders enjoy efficient dissemination of material information concerning offerings and issuer performance.
2. *Liquidity*—Regulation A+ securities are freely tradeable, which presents a major advantage of restricted securities where no market exists for most of these securities. As such, investors who can no longer tolerate risk associated with their investments or otherwise find themselves in a situation where they need to exit the investment can. With standardized disclosure and reporting, pricing can be arrived at with confidence. To be clear, for the foreseeable future, we believe the vast amount of any trading activity in these securities will be episodic at best, given the size of most issuers and deals, with the bulk occurring as trades by appointment. But the critical piece will be that investors, brokers and investment advisors will have information at hand to use to discern amongst investments and to establish a price as required, and have confidence in the same. This presents an enormous leap forward from the restricted nature of most Regulation D securities with no information disseminated publicly and, thus, no market.
3. *Investment Options*—The average investor is relegated to public fund products (hedge, mutual, money market). Regulation A+ can give an investor the opportunity to invest in enterprises (such as those we typically represent) with confidence based on the information they can access and review with their broker or investment advisors. Because of the size of the issuers that we believe will utilize Regulation A+ consistently, we believe most deals will be distributed re-

gionally, and the investor will see options presented in their own "backyard" by local and regional investment banks and brokerages, providing a further element of transparency as a result of local "word of mouth," but also those investment banks and brokerages being able to maintain contact with management and monitor status with relative ease.

We urge the Commission to implement Regulation A+ as soon as possible. The delay associated to date with its implementation has been somewhat baffling to us, as Form 1-A provides a readily useable framework for disclosure under Regulation A+. As to ongoing reporting, we believe a straightforward regime of simple disclosure associated with the annual audited financial statements to be filed with SEC, supplemental provision of unaudited, GAAP-compliant quarterly financials and requirements to report material events (analogous to a stripped down 8-k) make sense. Beyond this, until there is sufficient volume of deals created to understand the scope and activities of this marketplace have the real potential to become overly burdensome and counter the intent of Title IV.

The largest issues in our mind is updating some of the mechanics of the offering process and the interplay between the feds and the States. That said, we do not believe those issues would be cause for the implementation of Regulation A+ to have been delayed as it has.

Offering Mechanics

Electronic filing through EDGAR is mandated by Title IV and will be a logical and effective means to ensure dissemination of material information concerning Reg A+ issuers. That said, revisions to current Regulation A, if the same general framework is to be used in the context of Reg A+, need to be made to account for public access to all reporting through EDGAR. Currently, Rule 251(d)(2) requires physical delivery of the offering circular to the prospective investor, the need for which is obviated by having all disclosure related to an issuer generally available with the click of a button through EDGAR. In short, a Reg A+ analog to Rule 172 will be critical to furthering the JOBS Act's congressional intent.

Furthermore, it is our expectation that the vast majority of Reg A+ deals will be done on a continuous, best efforts basis. This will result in necessary updates to offering circulars. Currently Rule 253(e) requires any updated or revised Offering Circular to be filed with an amended Offering Statement and requalified with the Commission. This requalification requirement places an unnecessary burden on issuers engaged in such offerings, and one not seen in the context of a public registration where only information tripping the requirements of Item 512 of Reg S-K requires a post-effective registration statement amendment and other updates to the prospectus may be filed under Rule 424. For instance, in a recent offering filed by our firm the issuer simply desired to add another jurisdiction and update some ancillary business information—disclosures which would, arguably, require requalification with significant offering disruption but with little or no investor protective impact. Again, an analog for Reg A+ needs to be adopted.

Blue Sky and the Definition of "Qualified Purchaser"

In enacting Title IV, Congress did express plainly its concern that 50 different regulatory schemes presently imposed on Regulation A would have a negative impact on the ability of small and midsize businesses to raise capital in the future under Regulation A+ or otherwise.[6] It has been our firm's experience with current Regulation A to be EXACTLY THE CASE.

First, just conceptually speaking, the notion of up to 50 different regulatory regimes being applied to an offering which has just gone through a thorough process of review by the Commission seems excessive and fraught with opportunities for delay or missteps.

Our experiences with State regulators in conducting these offerings have been diverse to say the least, ranging from the cooperative and efficient to the downright abusive, or even nonexistent. Of course, if the goal is to create an efficient system for "Main Street" firms to form necessary capital, then the involvement of the States in the offering process must be assessed by their weakest performances.

For example, we have had multiple occasions where States have just simply failed to respond to filings. In one instance, a filing was made with the Commonwealth of Massachusetts in December of last year, and, to date, we have yet to hear any response. In another, an initial filing was made with the State of Ohio in June of this year—we have still heard nothing.

[6] *See,* Section 402 of the JOBS Act requiring a study of the impact of State blue sky laws on offerings made under Regulation A.

And in probably the most egregious example to date, we filed this summer a registration in the Commonwealth of Virginia. As part of the filing, we submitted a copy of the Form 1-A we filed with the SEC, as required by Virginia law. Form 1-A requires the registrant to list all affiliates of the registrant as well as any securities offerings of affiliates in the past 12 months. It is important to note that any securities transactions conducted by these affiliates were conducted amongst all accredited investors outside of the Commonwealth under Rule 506 of Regulation D, and, thus, specifically under applicable regulations, are exempt from any filing requirement in Virginia. [7] There has been no allegation or any intimation of suspected wrongdoing in any offering by any of these entities. Nevertheless, the result of attempting to comply with Virginia's registration requirements in the context of a Regulation A offering has been for the Virginia State Corporation Commission to institute an investigation into a number of entities affiliated with the registrant through its parent and "any other affiliates [undefined]," making vague and extremely broad requests for information related to the entities, while at the same time, making no visible effort to proceed with the registration of the securities of the registrant. I have attached a redacted copy of the letter notifying of the investigation and making the informational requests (Exhibit A-redacted). This process will likely cost my client tens of thousands of dollars to comply with the Commonwealth's demands all because of my client's attempt to comply with the law and also use an offering method which subjects it to greater transparency for the good of the investing public.

With the possibilities of such delays or the danger of arbitrary investigations which can be costly to an issuer, the State blue sky process stands right now as an enormous obstacle to the reliability of Regulation A+ as a credible channel for forming capital. Ironic, given that this fact could have the potential for issuers to remain focused on Regulation D, which is a largely unsupervised offering process presently at the State and Federal level.

Nevertheless, I understand legislative reticence to completely preempt the States for a method of offering that has been largely underutilized in recent memory. Congress, therefore, struck a reasonable balance for the interim—by creating an additional class of "covered security," under NSMIA for Regulation A+ in situations where the securities are either listed on a National Exchange or sold exclusively to "qualified purchasers." In the latter instance, Congress specifically delegated to the Commission the authority to define "qualified purchasers" recognizing the Commission's expertise in balancing oversight and efficiency in capital formation. [8] To date, the Commission has not done so, nor have they provided the public any guidance as to their thinking on this.

We believe the "qualified purchaser" exemption, if defined appropriately, will be a reasonable and workable option to any number of small and midsize issuers over other options that might not provide the regulatory oversight of disclosure, transparency, and the potential liquidity for investors that Regulation A and A+ can provide. [9] At the same time, such definition would not only provide a balanced approach to State investor protection issues, but also allow the Commission to observe a "critical mass" of activity within the Regulation A and A+ so that the Commission can have the ability to determine what further regulation (or changes to present regulations) might be necessary to accomplish Congress' intent without excessive risk to the investing public.

I believe that a definition can easily be tailored that can address State concerns related to investor protection, while having the intended effect of providing a meaningfully broader audience for businesses to go to for capital. Specifically, we have proposed to the Commission a definition of "qualified purchaser" which combines a net worth/income test with a cap on the amount of investment by an investor in any one issuance. A qualified purchaser would be defined as a purchaser having, excluding (in the instance of natural persons) the value of a purchaser's primary residence, either:

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[7] *See*, 21 VAC5-45-20.

[8] 15 U.S.C. §77r(b)(4)(D).

[9] The GAO completed its required study in July 2012 entitled "SECURITIES REGULATION Factors That May Affect Trends in Regulation A Offerings", (the "GAO Study") and found that in fiscal 2010 and 2011 there were 8 qualified Regulation A offerings versus over 15,500 Regulation D offerings for $5 million or under, the vast majority of which were under Rule 506 with very limited oversight of disclosure. The GAO identified State securities law compliance as a factor in pushing issuers towards Regulation D and indicated that the GAO's research and conversations with securities attorneys and a small business advocate identified State securities registration requirements as time consuming and costly for small businesses. *See,* p. 17 of the GAO Study.

- a net worth of at least $500,000; or
- a gross annual income of at least $150,000 and a net worth of at least $250,000.

Further, the amount of investment by a natural person(s) who would be a qualified purchaser may not exceed 20 percent of the net worth of such natural person(s).

We would note that this definition is well in excess of NASAA's standard guidelines for minimum investor suitability and is designed to permit small issuers to reach a broader investor audience while addressing investor protection concerns—demanding a requisite amount of sophistication from the investor to review and digest disclosure drafted to requirements of the Commission designed to be accessible to investors in the public marketplace and that has been reviewed and qualified previously by the Commission, at the same time, it limits the exposure that an individual could have to a potential loss in any given instance. [10]

Without a measured exemption here, we believe the current approach by the States, coupled with the current realities of our economy, could combine to subvert Congress' intent here to provide a meaningful apparatus for capital formation and job creation that is subject to the light of public disclosure.

To date, the regulation of capital formation under our securities laws has been premised on the stark dichotomy between private offerings, typically made available to a very narrow audience of investors, and public registration with its attendant costs and regulatory burdens. The genesis of the JOBS Act was the notion of finding reasoned approaches for businesses to form capital, balanced against the need to protect the investing public. Title IV presents the most impactful of the approaches presented in this legislation, supported by an existing mechanism to make these securities available to the marketplace. The Commission needs to act NOW. Thank you.

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[10] Certain commentators have proposed the use of the "accredited investor" definition found in Rule 502 of Regulation D, if a net worth test for a qualified purchaser is to be adopted. We disagree adamantly with this suggestion. Given the need for audits, mandated forms of disclosure, and periodic reporting under Reg A+, adopting such a definition would only have the result of causing issuers to default to Rule 506(c) of Regulation D, rather than adopting Reg A+, which provides for greater transparency and regulatory oversight, for the formation of capital.

EXHIBIT A

COMMONWEALTH OF VIRGINIA

RONALD W. THOMAS
DIRECTOR

THOMAS M. GOULDIN
DEPUTY DIRECTOR

MAILING ADDRESS:
P.O. BOX 1197
RICHMOND, VA 23218-1197

WWW.SCC.VIRGINIA.GOV/SRF

STATE CORPORATION COMMISSION
DIVISION OF SECURITIES AND RETAIL FRANCHISING

October 4, 2013

CERTIFIED MAIL

Mr.

Re: LLC; LLC; LLC; LLC; DST; LLC; LLC; LLC; LLC; LLC; LLC; LLC; LLC; LLC; LLC; LLC; and other associated entities

Mr.

The Division of Securities and Retail Franchising is responsible for enforcing the provisions of the Virginia Securities Act. The Act requires people and entities that offer and sell securities to register with the Division or have an applicable exemption.

We are investigating whether or not you or the companies you are associated with offered or sold securities without registering with the Division or having an applicable exemption. In addition, the offers and sales of securities you, your companies, or its affiliates have made may be in violation of § 13.1-507 of the Act.

I am asking you provide the following items pursuant to § 13.1-518 A of the Act. In addition, I am requesting you serially number the pages of all documents and provide an itemized list of materials submitted.

1. Provide a detailed explanation why the following entities with principal addresses in Virginia, and which you appear to be associated with, are not filed with the Virginia Clerk's Office.
   a. , LLC
   b. , LLC
   c. , LLC
   d. , LLC
   e. , LLC
   f. LLC

g. , LLC

For each of the entities listed above, please provide the address where the books and records are maintained, the entities' incorporation or formation documents, and the name and address of each officer, director or managing member. Further, please state if any of the above referenced entities sold any type of investment and, if so, the details of the investment.

2. Provide a detailed explanation why the following entities with principal address in Virginia, and which you appear to be associated with, did not make any filings with the Division regarding their Securities and Exchange Commission filings:

   a. , DST
   b. LLC
   c. , LLC
   d. LLC
   e. LLC
   f. , LLC
   g. , LLC
   h. LLC

   Please note, even if the above referenced entities did not offer investment opportunities to Virginia residents, §13.1-507 only contemplates the offer and sale, stating, "It shall be unlawful for any person to offer or sell any security..." Therefore if the business is located and transacting business in the Commonwealth, it is the Division's opinion that is sufficient to meet the requirements of §13.1-507.

   For each of the entities listed above, please provide the address where the books and records are maintained, the entities' incorporation or formation documents, and the name and address of each officer, director or managing member. Further, include what exemption, if any, from registration each entity is claiming in Virginia.

3. A legible copy of all prospectuses, offering circulars, exhibits or other disclosure material in their entirety that have been presented or made available to prospective investors by all companies you are an officer, director, or managing member.

4. A legible copy of all signed notes, contracts, or other agreements, in their entirety, executed by investors of all companies you are an officer, director, or managing member.

5. The names, home addresses, e-mail addresses, and home phone numbers of all people or entities who were sold an investment opportunity by or through the companies you are an officer, director, or managing member. For each investor please provide:
    a. The date the investment was made;
    b. The amount invested, exchanged, or contributed by each person or entity;
    c. How many currently outstanding preferred and/or common shares each person or entity owns;
    d. If the stockholder is an entity, provide the names, home street addresses, e-mail addresses, and home phone numbers of the owners, officers, members and/or partners;
    e. The current state of the investment; and
    f. The full name and address of the selling agent involved.

6. A list of all loans made by any companies you are an officer, director, or managing member of to any current or former members (or any immediate family members) of the Board of Directors, officers, or management or any business associated with any current or former member of the Board of Directors, officers, or management (or any immediate family members). For each loan, include:
    a. The name of the person or entity the loan is being made to;
    b. The amount of the loan;
    c. The terms and condition of the loan;
    d. The date of the transaction and a list of payments on the loan;
    e. The current balance of the loan; and
    f. All corresponding loan documentation.

7. The names, e-mail addresses, home street addresses, home phone numbers, titles and dates of tenure of each and every officer, Director or managing member of every entity you are an officer, Director, or managing member.

8. All correspondence, faxes, and e-mails received from or sent to investors.

9. State what process you and the entities you are associated with undertook and implemented to determine whether a potential investor was "accredited" as defined by the Act.

10. State how , LLC determined the suitability standards described on Page 1 of the Offering.

11. Explain how on Page "iv" of the , LLC offering document LLC is listed as an affiliate but on Page 5 the same entity is listed as a predecessor.

If you are unable or do not intend to produce the records by Friday, November 1, 2013, you must provide me with a written explanation listing each item and detailing the reason each item cannot be produced by the deadline. We may refer this matter to our Office of General Counsel for formal action if you fail to comply or provide a written explanation by the deadline. I look forward to hearing from you. You may contact me at (804) 225-4419 or Marc.Bantel@scc.virginia.gov if you have any questions.

Sincerely,

Marc C. Bantel
Senior Investigator

PREPARED STATEMENT OF RICK FLEMING

DEPUTY GENERAL COUNSEL, NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

OCTOBER 30, 2013

Introduction

Good morning Chairman Tester, Ranking Member Johanns, and Members of the Subcommittee. I am Rick Fleming, Deputy General Counsel for the North American Securities Administrators Association, Inc. (NASAA),[1] the association of State and provincial securities regulators. One of my roles at NASAA is to coordinate the activities of the NASAA Corporation Finance Section Committee. Prior to joining NASAA in 2011, I served as General Counsel for the Office of the Kansas Securities Commissioner. In that role, I frequently represented the State in disciplinary and enforcement cases, including criminal prosecutions and related appeals.

I am honored to testify before this Subcommittee about the Jumpstart Our Business Startups Act, or JOBS Act, a year and a half after its enactment.

Securities regulation is a complementary regime of both State and Federal securities laws. NASAA has had a long history of working closely with the Securities and Exchange Commission (SEC) to affect greater uniformity in Federal–State securities matters, including meeting annually as required by section 19(d) of the Securities Act of 1933. The States also work closely together to uncover and prosecute securities law violators.

State securities regulators have protected Main Street investors for the past 100 years, longer than any other securities regulator. They are responsible for enforcing State securities laws by pursuing cases of suspected investment fraud, conducting investigations of unlawful conduct, licensing firms and investment professionals, registering certain securities offerings, examining broker-dealers and investment advisers, and providing investor education programs and materials to your constituents.

States are also the undisputed leaders in criminal prosecutions of securities violators. In 2012 alone, State securities regulators conducted nearly 6,000 investigations, leading to nearly 2,500 enforcement actions, including 339 criminal actions. Moreover, in 2012, 4,300 licenses of brokers and investment advisers were withdrawn, denied, revoked, suspended, or conditioned due to State action, up 27 percent from the previous year.

State securities regulators continue to focus on protecting retail investors, especially those who lack the expertise, experience, and resources to protect their own interests. In addition to serving as the "cops on the beat" and the first line of defense against fraud for "mom and pop" investors, State securities regulators serve as the primary regulators of most small size offerings. As such, State securities regulators regularly work with and assist small and local businesses seeking investment capital.

NASAA shares Congress' desire to improve the United States economy by, in part, spurring private investment in small business. However, we believe this goal is best achieved through restoring investor confidence, and it is our hope that the JOBS Act will be implemented with a balanced approach that reflects smarter regulation.

My testimony today will provide an overview of the current status of NASAA's work in designing a new multistate review process for offerings conducted under Title IV of the JOBS Act, including a one-stop, filing process for "Regulation A+". I will also present NASAA's views on Title II of the JOBS Act, which lifted the longstanding ban on general solicitation, and summarize the most important of our recommendations to the SEC in association with the rulemakings under this title. Finally, my testimony will consider Title III's crowdfunding provisions and NASAA's views of the SEC's proposed rules. Although preempted from regulating crowdfunding offerings, the States have been committed to working with the SEC and the Financial Industry Regulatory Authority (FINRA) to develop a responsible regulatory framework for implementation of the Act.

My testimony will conclude with a discussion of sensible efforts to improve the ability of small businesses to obtain capital, along with a brief discussion of further deregulatory legislation in the House that is referred to as "JOBS Act 2.0". NASAA's view is that the JOBS Act imposed changes to the securities laws that were neither

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

simple nor straightforward, and which required the SEC to grapple with very complex issues in its rulemaking. We would encourage Congress to observe and evaluate the full impact of the JOBS Act before proposing further legislation purportedly designed to spur economic growth.

Title IV: Regulation A+

When a company wants to raise capital by selling securities, the company must first register those securities with the Government unless the securities are sold in a way that qualifies for an exemption from the registration process. Title IV of the JOBS Act requires the SEC to adopt a rule to provide an exemption for certain offerings up to $50 million.

Because of its similarity to the current exemption under Regulation A, which is capped at only $5 million, this new exemption is commonly referred to as Regulation A+. These offerings will be exempt from SEC registration under the new Section 3(b)(2) of the Securities Act of 1933, but they will be subject to registration at the State level unless the securities are listed on a national securities exchange or sold to a qualified purchaser as defined by the SEC.

Given the inherently risky nature of these offerings, and the primacy of the States' role in policing small size offerings, NASAA believes State oversight is critically important for investor protection and responsible capital formation. However, we also recognize that in some instances this process can be costly and particularly burdensome upon small companies.

When a company applies for registration of securities at the State level, the company must ensure that the terms of the offering and the content of the disclosure document satisfy the legal requirements that apply to that particular type of offering. These legal requirements are found in State law but are usually derived from NASAA Statements of Policy that are approved by a majority of the NASAA members. A typical equity offering would be subject to a general set of rules, including things like limitations on underwriting expenses and a requirement to specify the anticipated use of proceeds.[2] More specialized securities, such as church bonds, oil and gas interests, and real estate investment trusts (REITs), are subject to specific rules for those types of offerings. All States conduct a "disclosure" review to ensure that all material risks are disclosed to investors, and some States conduct a further "merit" review of the offering to prevent offerings that are inherently unfair to investors. If an application for registration does not satisfy all of the legal standards applicable to that type of offering, the State securities regulator will issue a deficiency letter and communicate with the company until the deficiencies are resolved.

On behalf of NASAA President and Ohio Securities Commissioner Andrea Seidt, I want to assure this subcommittee that one of NASAA's priorities is the creation of an efficient filing and review process for multistate securities offerings, including but not limited to, Regulation A+. In fact, in her inaugural speech to NASAA's membership earlier this month, President Seidt outlined her goal for this type of system as follows:

> The corporation finance world needs the equivalent of a CRD/IARD system for multistate offerings. My vision is for there to be a one-stop, automated filing system for every type of corporation finance offering filed in multiple States. A system that has NASAA guidelines, forms, and core State requirements embedded in its design, a system in which all regulatory and industry users can track the filing status of an offering in all States in real time.[3]

For now, NASAA is focused particularly on Regulation A+ and is actively engaged in the design of a new multistate review process for those offerings. As currently contemplated, one State would be designated the lead "disclosure" State and another would be designated the lead "merit" State, and those two States would coordinate the multistate review of the offering to minimize the possibility of duplicative or inconsistent comments from multiple States. Of course, this means that the States would have to agree to a set of uniform standards that would apply to the particular type of offering. We are also working on a multistate electronic filing platform that will allow one-stop filing with automatic distribution to all States, and we intend to build out that system to accommodate Regulation A+ filings.

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[2] For a full list of NASAA Statements of Policy, *see, http://www.nasaa.org/regulatory-activity/statements-of-policy/.*

[3] Andrea L. Seidt, President, North American Securities Administrators Association, Inc., 2013 Presidential Speech, NASAA 96th Annual Conference, Salt Lake City, Utah (Oct. 8, 2013), available at *http://www.nasaa.org/26900/2013-presidential-address-andrea-seidt-ohio-securities-commissioner/.*

In designing the system and developing a uniform set of standards, NASAA has consulted with a task force of the American Bar Association (ABA) to determine whether existing standards could be applied in the context of offerings under Regulation A+. The task force expressed concern about certain existing NASAA guidelines that are difficult for start-ups to satisfy, including the required amount of promoters' equity investment and the limitation on using investor funds to repay loans from officers of the company. In response to these concerns, a NASAA project group has proposed a review process that lowers some of our long-standing guidelines.

The proposed multistate review program was submitted to NASAA members for "internal" comment, and the comment period expired on September 30, 2013. In addition, the members of NASAA engaged in a face-to-face discussion of this proposal at our annual meeting in Salt Lake City on October 6, 2013. From the comments and discussion, the NASAA membership appears willing to embrace this new review system.

I am pleased to report that the NASAA Board of Directors met 2 days ago and approved the distribution of the proposal for public comment.

NASAA is also communicating with the SEC in an effort to ensure that the requirements the Commission adopts for the Federal exemption are consistent with the requirements we adopt for the State-level review of these offerings. As we continue to move forward in this process, we intend to keep Chairman Tester and the Subcommittee apprised of our progress.

It remains to be seen whether Regulation A+ will be used with any greater frequency than the existing Regulation A, especially considering the new alternative of crowdfunding and the use of general advertising under Rule 506.[4] For NASAA's part, however, State securities regulators are committed to helping Regulation A+ achieve its fullest potential. NASAA realizes that the increase in the cap from $5 million to $50 million will mean that the offerings are more broadly disbursed and that uniformity and efficiency are critical. NASAA also understands that investor protections must be maintained so that investors have confidence to enter this new marketplace. By working with the ABA and other interested parties, NASAA is attempting to strike the best possible balance so that Regulation A+ will be an attractive option for both the small business that needs capital and the investor who is asked to provide it. If we are successful in striking such a balance, we believe that shrewd investors and securities professionals will soon see that State review of these offerings generally yields safer opportunities than are available in the "Wild West" of Rule 506, and small businesses will find that smart, efficient, twenty-first century regulation can be beneficial for their capital formation efforts.

Title II: General Solicitation

Even though securities sold in compliance with Rule 506 are "covered securities," which results in preemption of State-level registration requirements, the States retain antifraud jurisdiction and, for all practical purposes, are responsible for policing this market. As the regulators closest to small investors throughout the United States, State securities regulators frequently receive complaints from those who are victimized in offerings conducted under Rule 506, and private placements are commonly listed on NASAA's annual list of top investor traps.[5] In 2011 and 2012, NASAA members recorded 340 enforcement actions involving Rule 506 offerings,[6] making Rule 506 offerings the most common product or scheme leading to enforcement actions by State securities regulators during that period. As a result, the States have a very large stake in the SEC's rulemaking in this area.

In addition to protecting Main Street investors through enforcement actions, State regulators educate Main Street businesses about alternatives for raising capital under State and Federal law, including Rule 506. States want to see those businesses succeed in their capital raising efforts so they can thrive and create jobs in

[4] Title IV of the JOBS Act called for a GAO study to determine the reasons that Regulation A is underutilized. The study concluded that a variety of factors have influenced the use of Regulation A, including the time and cost of the SEC review process and the attractiveness of other available exemptions. To be sure, State regulation was identified as one of the factors that led issuers to avoid Regulation A, but it was not the only factor and its importance could be greatly diminished if the States adopt uniform review standards and an efficient multistate review system.

[5] *See,* "Laws Provide Con Artists With Personal Economic Growth Plan: NASAA Identifies Emerging and Persistent Investor Threats" (August 21, 2012), available at *http://www.nasaa.org/14679/laws-provide-con-artists-with-personal-economic-growth-plan/*.

[6] The enforcement statistics published by the SEC do not specifically identify the number of enforcement actions involving private placements. However, under the broader category of actions involving "Securities Offerings," which presumably includes private placement offerings, the Commission reports that it took a total of 213 enforcement actions in 2011 and 2012. *See, http://www.sec.gov/news/newsroom/images/enfstats.pdf.*

our local communities. No NASAA member is interested in creating excessive or inefficient rules, but States have learned that efforts to spur successful capital formation must reflect a balanced regulatory approach that minimizes unnecessary costs and burdens on small businesses while protecting investors from fraud and abuse. Without adequate investor protections to safeguard the integrity of the private placement marketplace, investors may flee from the market, depriving small businesses of an important source of capital.

The recent lifting of the ban on general solicitation in Rule 506 will have an enormous impact on the securities markets in the United States. While some of this impact will be positive, NASAA members can anticipate that a greater number of investors will be defrauded, sold unsuitable investment products, or otherwise victimized in offerings conducted under Rule 506. NASAA believes that it is imperative for the SEC to adopt reasonable rules to protect investors in this market and that improvements to Rule 506 will facilitate the investor trust that is necessary to promote the capital formation goals embodied in the JOBS Act.

NASAA believes that modest changes can be made to Rule 506 and Form D that will enhance the ability of the Commission and NASAA members to protect investors while minimizing the burdens to the small businesses who utilize the rule to raise capital. These changes need to be adopted quickly, before unmonitored general solicitations begin to erode investor confidence in private placements and make it harder for businesses to find investors who are willing to enter this marketplace.

NASAA supported the adoption of the final rules prohibiting bad actors from using Rule 506 and requiring verification of accredited investor status. In general, we also support the proposed rules that would require the filing of Form D prior to advertising and make several improvements to the Form. However, we have suggested modest changes to the proposed rules that we believe will yield important protections for investors at the lowest possible cost to issuers, and we have pointed out places where we believe the proposed rules could be scaled back to save costs without unduly harming investors. It is our hope that our balanced approach will help the Commissioners reach consensus on these issues so that the final rules will be adopted as rapidly as possible.

Advance Filing of Form D

From the perspective of State securities regulators, the most important item in the proposed rules is the requirement to file a Form D prior to the use of general solicitation. As part of NASAA's investor education efforts, State regulators implore investors to "investigate before you invest," and encourage investors to contact the securities regulators in their States if they have questions about an offering. Frequently asked questions include whether the offering is registered or exempt, whether there have been any complaints against the issuer or placement agents, and whether the issuer, control persons, or placement agents have any regulatory history. With the Commission's recent lifting of the ban on general solicitation, States anticipate a substantial increase in the number of investors who will want this type of information as part of their due diligence. However, without a requirement that the Form D be filed prior to the use of general solicitation, there is no way for State securities regulators to respond to these basic questions.

In addition, the lack of a pre-solicitation filing makes it impossible for State enforcement personnel to easily determine whether an offering is being conducted in accordance with the securities laws. Under the current rules, Form D need not be filed until 15 days after the first sale, so an issuer can advertise for investors without filing the form. An investigator who sees an advertised offering will not be able to check the Commission's records to quickly determine whether the issuer is attempting to engage in a compliant Rule 506(c) offering or is merely advertising an unregistered, nonexempt public offering with no intention of complying with any legal requirements. Regulators may have no alternative except to contact issuers—with subpoenas, if necessary—to determine whether their offerings are being conducted in compliance with Rule 506(c). This will increase the number of investigative inquiries directed to legitimate issuers and lengthen the process for stopping illegitimate offerings. Ultimately, investors will be put at greater risk because it will be more difficult for regulators to prevent or stop investor losses.

The proposed rule would require the filing of the Form D at least 15 days before the issuer engages in general solicitation. For NASAA's purposes, it would be sufficient to simply require the filing at any time prior to the use of general advertising. The critical issue is that the Form D should be publicly accessible before an issuer begins to publicly solicit investors.

Consequences for Failure To File

For far too long, the Commission has failed to address a glaring problem in Rule 506 offerings. As reported by the SEC Inspector General in 2009, "there are simply no tangible consequences when a company fails to file a Form D."[7] The proposing release cites only one case in which the Commission has ever brought an action under Rule 507 to enjoin an issuer from future use of Regulation D.

The voluntary nature of Form D has significant repercussions for State regulators. Pursuant to Section 18 of the Securities Act of 1933, States are preempted from requiring registration of securities that are sold in compliance with Rule 506. However, State regulators routinely review Form D filings to ensure that the offerings actually qualify for an exemption under Rule 506 and look for "red flags" that may indicate a fraudulent offering. The absence of a Form D filing complicates State efforts to protect the investing public. In addition, a promoter who has no intention of complying with Rule 506 may attempt to assert it as a defense to a State-level enforcement action by filing a Form D long after the fact.

Apart from bad actors, it is likely that many legitimate issuers never file a Form D because they simply have no incentive to file one. As the proposing release illustrates, this makes it nearly impossible to accurately gauge the size of the private placement market.[8] From what we do know, the market rivals the size of public offerings, but policy makers are left to guess at the implications of loosening the rules for private placements. The information captured in Form D, as enhanced in the proposing release, will provide important data that can be used to determine future economic impacts for businesses and investors. A lack of a true and complete understanding of the private placement market hampers States' ability to foster growth in that market and police bad actors.

For these reasons, it is imperative for the Commission to act quickly to establish meaningful consequences for issuers who fail to file a Form D. Because the filing is such a critical part of the exemption, and because it is such a simple condition to satisfy, NASAA believes that the loss of the exemption is a reasonable consequence for failure to file the form.

Other Changes to Rule 506

NASAA supports the addition of several data points to Form D. For example, we believe the disclosure of certain uses of proceeds will provide clear, material information that is necessary for investors to make informed decisions and will deter abusive practices in which promoters pay themselves with investor funds. We believe that additional information on Form D will be beneficial to investors, and it will capture data that will help policy makers evaluate the use of the exemption. In particular, the proposed closing amendment will provide important data about offerings that were unsuccessful and the types of issuers who have difficulty raising capital. This information can be used to determine whether the changes to Regulation D were effective in achieving the JOBS Act goals of economic growth and job creation or whether investors are reluctant to invest in these offerings.

In NASAA's view, it is not necessary for the Commission to require the long advertising legend as proposed in Rule 509. We agree that the issuer should be required to disclose the information that is contained in the proposed legend, but believe that it would be better for the Commission to require some indication that the issuer has read the material. This could be done by requiring the information to be contained in the subscription agreement or by requiring the investor to click through the information on the issuer's chosen Internet platform. Then, instead of the lengthy legend as proposed, the Commission should require a very brief legend on all Internet-based advertising. A brief legend containing a unique short phrase will readily identify the offering as one being conducted under Rule 506. The Com-

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[7] SEC Inspector General Report No. 459, "Regulation D Exemption Process" (March 31, 2009), at 10, available at *http://www.sec-oig.gov/Reports/AuditsInspections/2009/459.pdf.* When Rule 506 was originally adopted in 1982, it required compliance with Rules 501 through 503, including the timely filing of a Form D, in order to qualify for the exemption. 47 Fed. Reg. 11251, 11267 (Mar. 16, 1982). In 1989, Regulation D was amended to remove the requirement of compliance with Rule 503 as a condition of the Rule 506 exemption. 54 Fed. Reg. 11369, 11373 (Mar. 20, 1989). The Commission's summary of the rule change stated, "While the filing of Form D has been retained, it will no longer be a condition to any exemption under Regulation D. New Rule 507 will disqualify any issuer found to have violated the Form D filing requirement from future use of Regulation D." SEC Release No. 6,825 (Mar. 14, 1989).

[8] A study by the SEC's chief economist in 2011 found that private offerings grew by nearly 50 percent from 2009 to 2010; from about $950 billion to about $1.4 trillion, and that private stock issuances surpassed debt issuances in 2010 and the first quarter of 2011. *See,* Craig Lewis, "Unregistered Offerings and the Regulation D Exemption", November 2, 2011, available at *http://www.sec.gov/info/smallbus/acsec/acsec103111presentation-regd.pdf.*

mission could then monitor online advertising without requiring it to be filed as proposed in Rule 510T.

NASAA has long encouraged the Commission to revisit the monetary thresholds set forth in the "accredited investor" definition in Rule 501 to account for inflation that has occurred since the rule's adoption. According to the U.S. Bureau of Labor Statistics, $200,000 had the same buying power in 1982 as $484,719 has in 2013,[9] but the annual income threshold for accredited investors remains unchanged. Similarly, $1,000,000 had the same buying power in 1982 as $2,423,595.85 today,[10] yet the net worth threshold has only been changed during that time period to remove the value of a potential investor's primary residence from the calculation. NASAA also believes that the Commission should update the definition of accredited investor to ensure that it more accurately reflects investor sophistication. However, given the importance of the other rules that have been proposed in the current release, we urged the Commission to move forward with the other rule proposals and to address the accredited investor definition in a separate rulemaking.

Title III: Crowdfunding

As the voice of State securities regulators, NASAA has a special interest in the rules governing crowdfunding issuers and intermediaries. State securities regulators work closely with small businesses in their capital formation efforts and want those businesses to be successful in raising money through crowdfunding or other methods so they can thrive and produce jobs. However, State securities regulators are keenly aware that capital formation requires confident investors who are adequately protected. Thus, NASAA believes that crowdfunding, to be successful, requires a balanced regulatory approach that minimizes unnecessary costs and burdens on small businesses while protecting their investors from fraud and abuse.

Given the length of the proposed rules that were issued by the SEC last Wednesday, October 23, 2013, NASAA has not yet formulated an official response to the proposing release. From our initial observations, it appears that the SEC has attempted to stay relatively close to the statutory mandates, but we will be taking a closer look at the proposed rules and we expect the SEC to consult further with State regulators as required by Section 302(c) of the JOBS Act.

NASAA's largest concern about Title III of the JOBS Act is that it removed much of the States' authority over equity-based crowdfunding. Congress chose to preempt the States from regulating crowdfunding issuers, thus retaining only the States' antifraud, post-sale enforcement authority. Furthermore, although Section 305 of the JOBS Act preserves the authority of a crowdfunding intermediary's home State to conduct examinations of resident intermediaries, State rules cannot exceed the Federal requirements. In effect, this puts State governments in the position of enforcing Federal laws from which they may not deviate.

NASAA firmly believes due to the localized nature of smaller offerings, the States should be the primary regulator of small business capital formation efforts, including crowdfunding offerings. Based on the small size of the offering, the small size of the issuer, and the relatively small investment amounts, it is clear that the States have a more direct interest in these offerings. The States are in a better position to communicate with both the issuer and the investor to ensure that this exemption is an effective means of small business capital formation. The States will be most familiar with the local economic factors that affect small business and have a strong interest in protecting the particular investors in these types of offerings. Further, requiring the SEC to regulate these small, localized securities offerings is not an effective use of the agency's limited resources.

During the debate surrounding the JOBS Act, NASAA asked Congress to leave the regulation of small investments in small companies to the States because the Federal Government has neither the inclination nor the resources to regulate effectively in this area. Before the JOBS Act was even introduced, three States allowed crowdfunding in intrastate offerings,[11] and during the debate on the Act, NASAA was working on a model exemption that would apply to multistate offerings. The model rule envisioned a one-stop filing mechanism and the application of uniform review standards. However, those efforts were halted when Congress enacted a Federal exemption for crowdfunding that preempted State authority.

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[9] *See, http://www.bls.gov/data/inflation__calculator.htm* as of September 18, 2013.

[10] Id.

[11] Two States—Kansas and Georgia—adopted exemptions before the JOBS Act was even introduced. See the "Invest Kansas Exemption", Kan. Admin. Reg. 81-5-21 (adopted Aug. 12, 2011) and the nearly identical "Invest Georgia Exemption", Ga. Rule 590-4-2-.08 (adopted Dec. 2012). Idaho adopted an exemption by order on January 20, 2012, which imposes similar conditions upon crowdfunding as the Kansas and Georgia regulation.

Ironically, many crowdfunding advocates have grown frustrated with the pace of Federal rulemaking that they are again seeking State-level crowdfunding exemptions. Earlier this year, bills were introduced in six States to allow intrastate offerings that involve equity crowdfunding.[12] We believe this underscores why Congress should let the States innovate and be creative in striking a reasonable balance between investor protection and capital formation for smaller offerings.

New and Unmet Opportunities and JOBS Act 2.0

Successful regulation requires balancing the legitimate interests of investors with the legitimate goals of business owners through tailored regulation, and pursuing policies that are fair to both. One of the fundamental problems that the JOBS Act failed to adequately address was investor retreat from the markets. Investor confidence in the U.S. securities markets remains low, as reflected by a recent Bankrate survey.[13] A Gallup survey in June 2002 found that 67 percent of Americans owned a 401(k) or otherwise invested in individual stocks, bonds, or mutual funds. Earlier this year, that number was down to 54 percent.[14] To have an impact on investor participation, and, by extension, job creation, Congress must focus on giving those 13 percent the confidence to re-enter the marketplace.[15]

One way to increase investor confidence is to carefully craft the rules implementing Titles II, III, and IV of the JOBS Act so they do not have the undesired effect of decreasing investor confidence, thus subverting the overall intent of the Act. Further, if the rules lack clarity, they will lead to litigation between State regulators and issuers, and judges will ultimately be required to provide greater clarity. We also encourage the SEC to finalize its investor protection mandates under the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Although NASAA has not yet come to firm conclusions about new, and unmet opportunities that would decrease investor cynicism and encourage capital formation, we are interested in a few proposals, discussed below, that would be worthy of further study and consideration by this Subcommittee.

First, NASAA believes that Congress should study the impact of high frequency trading and take steps to ameliorate any associated risk of harm to retail investors. According to Charles Schwab, high frequency traders flood the market with orders to evaluate the market, then cancel 90 percent or more of the orders and retain only the advantageous trades.[16] To curb these abuses, some European Governments have proposed transaction taxes on all orders that are placed in the markets, but Mr. Schwab has suggested a narrower approach that would probably be less controversial and more effective—a penalty on excessive cancelations.[17]

Another innovative effort to combat high frequency trading has been undertaken by ParFX and EBS, two international currency trading platforms. They use a randomized pause so that the first order placed in the system queue is not necessarily the first to be executed.[18] According to Larry Tabb, founder of the TABB Group, "In the equities market, it's going to be pretty tough for an exchange to introduce randomization because the regulations have been interpreted to be very time-price

[12] Maine L.D. 1512, Michigan H.B. 4996, New Jersey S. 3008, North Carolina H.B. 680, Washington H.B. 2023, Wisconsin A.B. 350.

[13] When asked to pick the best way to invest money that would not be needed for the next 10 years, investors picked cash, real estate, and even precious metals over the stock market. The findings of the Bankrate survey are available at *http://www.bankrate.com/finance/consumer-index/financial-security-charts-0713.aspx.*

[14] *See, http://www.gallup.com/poll/147206/stock-market-investments-lowest-1999.aspx.*

[15] The legislative history of the Securities Act of 1933 reveals that "smart" regulation can be successful in encouraging investors to reenter the capital markets. As one of the principal drafters of the Act noted, "[t]he great and buoyant faith in capitalism, in the competitive system, is largely deflated, and . . . it is not only a question of whether the system is just, but whether it works." L. Baker, Felix Frankfurter 146 (1969) (taken from a Frankfurter speech delivered at Smith College, Feb. 22, 1933). Smart and robust regulation embodied in the Securities Act of 1933 led to a substantial increase in new corporate offerings of over $2.5 billion in 1935 and over $4.3 billion in 1936 (from a low of $644 million in 1932 and $380 million in 1933). Goldschmidt, Registration Under the Securities Act of 1933, 4 *Law and Contemp. Probs.* 19, 28 (1937); *see also,* Bureau of the Census, "Historical Statistics of the United States: Colonial Times to 1970" 1006 (1975). As history reveals, smart regulation does not always equate to deregulation, and we encourage Congress to study the outcome of the JOBS Act in the coming year.

[16] Charles Schwab and Walt Bettinger, "Why Individual Investors Are Fleeing Stocks", *Wall Street Journal* Editorial, July 10, 2013, available at *http://online.wsj.com/news/articles/SB10001424127887323582904578484810838726222?mod=dist__smartbrief.*

[17] Id.

[18] Eric Onstad, "Analysis: 'Slow Frequency' Technology Faces Tough Shift From FX to Stock Markets", Reuters, October 2, 2013, available at *http://www.reuters.com/article/2013/10/02/us-hft-curbs-analysisidUSBRE9910PJ20131002.*

specific."[19] Therefore, Congress might consider amending the laws to allow this type of reform in the United States equities marketplace.

Congress could also study the numerous electronic "glitches" that have plagued the markets with market shutdowns and price instability. Many have called for mandatory "kill switches" to stop trading when problems occur, but we believe more aggressive steps should be taken to ensure that our markets are protected. If such havoc can be wrought from innocent errors by companies who have every incentive to get things right, then we worry what could be done by someone with a malicious intent to harm the markets or the country.

State securities regulators support efforts to seek legislation that would authorize the SEC to collect "user fees" from federally registered investment advisers (an idea proposed in the Dodd-Frank mandated Section 914 study), and to use the revenue derived from these fees to fund more frequent examinations of such advisers. NASAA also supports legislation that would preserve an investor's right to access the court system if they have a dispute against their broker-dealer or investment adviser. As noted above, NASAA President Andrea Seidt has advocated for the equivalent of a CRD/IARD system (the centralized, Web-based system for processing of Federal and State licensing applications for broker-dealers and investment advisers) for multistate securities offerings. In fact, NASAA has already taken the first major step in that direction by setting up the EFD, an electronic filing depository for Form D notice filings, which is set to launch in the coming year.

The House of Representatives has been circulating additional deregulatory proposals for a sequel to the JOBS Act referred to as "JOBS Act 2.0." NASAA would encourage this Subcommittee to reject further changes to the securities laws until at least after the full impact of the JOBS Act on investors and securities markets can be determined. Until that time, the potential costs and benefits of further expanding the JOBS Act is impossible to determine.

Conclusion

NASAA has been working expeditiously and diligently to update applicable statements of policy and coordinate a new multistate review program for Regulation A+ offerings. We have also been working to provide investor-friendly, yet sensible and realistic comments to the SEC as it finalizes the rules implementing Title II of the JOBS Act and Form D changes. We are optimistic that the new rules will lead to investor confidence and renewed participations in the markets. NASAA and State securities regulators look forward to working with this Subcommittee on new and unmet opportunities to strengthen our securities markets.

Thank you again, Chairman Tester and Ranking Member Johanns, for the opportunity to appear before the Subcommittee today. I would be pleased to answer any questions that you may have.

PREPARED STATEMENT OF SHERWOOD NEISS

PRINCIPAL, CROWDFUND CAPITAL ADVISORS LLC

OCTOBER 30, 2013

Introduction

Chairman Tester, Ranking Member Johanns and distinguished Members of the Committee, thank you for holding this hearing on the status of the JOBS Act in relation to Title III, Crowdfunding. My name is Sherwood Neiss. I am a Principal at Crowdfund Capital Advisors, LLC (CCA). CCA works with Governments, multilateral organizations, investors, and entrepreneurs on creating crowdfunding ecosystems. I am also an entrepreneur and one of the cocreators of the Startup Exemption, the framework used by Congress to create Title III. I was honored to be with my partners Jason Best and Zak Cassady-Dorion at the White House on April 5, 2012, as President Obama signed our idea into law. This law allows entrepreneurs to use their social networks and regulated Web sites to raise capital for their endeavors from people who believe in them. It addresses the funding void faced by startups and small businesses and, if implemented according to the intent of the law, may result in much needed economic growth, innovation, and jobs.

At a period of time when there are such polarized interests in Washington, DC, I continually point to the fact that when it comes to jobs, everyone here agrees, more are better. Washington understood this when the House voted in favor of our bill 407–17 and the Senate passed it, as part of the JOBS Act, 73–26. We can now include the Securities and Exchange Commission in that rank. On October 23, 2013,

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[19] Id.

they voted unanimously, 5–0 in favor of the proposed rules related to Title III. This represents a huge step forward as this vote included skeptics among the Commissioners.

Jason and I worked hard as cofounders of the Crowdfund Intermediary Regulatory Advocates (CFIRA) and the Crowdfunding Professional Association (CFPA) to pull the industry together behind two unified voices to make sure the SEC had as much guidance to craft rules that followed the intent and spirit of the legislation. We think, while not perfect, the proposed rules go far to strike a fair balance. The intent of the legislation was to take what currently exists and efficiently operates in the crowdfunding space and layer on securities regulation in a way that provides oversight without undue burden. We believe there is still work to be done on the "undue burden" part. In the end, we believe Washington understands that technology is something to get in front of and not behind and if we do it right we can help fund our Nation's innovators and job creators.

The Challenging Entrepreneurial Environment

There is plenty of research that indicates the important role that startups and small businesses play in an economy. For one, they are the breeding ground for new ideas. Such innovation used to cost a lot but is rapidly decreasing. According to Don Tapscott, author of Wikinomics, "readily available resources such as open source software, cloud computing, and the rise of the virtual office infrastructure has driven the cost to launch an Internet venture down from $5 million in 1997 to less than $500,000 today." The decreased startup costs allow for more market entrants, which can lead to greater innovation. This innovation can spur the M&A market as larger companies who often find it challenging to innovate, buy these smaller companies.

These young companies can also be job creators. As noted in a Kauffman Foundation study, 65 percent of net new jobs come from startups and small businesses. These jobs can address a problem that persists not only in the USA but globally, youth unemployment. As we note in our World Bank report "Crowdfunding's Potential for the Developing World", startups and small businesses may have the greatest potential to fill this void. From a personal experience, I cofounded and acted as Chief Financial Officer of a company called FLAVORx. We flavored medicine so children were more compliant. We sold our system to pharmacies and grew it from one pharmacy to over 40,000. To help us grow we hired along the way. Prior to selling the company in 2007, we had up to 50 direct employees and over 100 indirect (contractors, subcontractors, etc.) employees. The average age of our staff was 27, which falls right in line with the youth unemployment gap. Companies like ours played an important role in hiring youth.

But you cannot have businesses nor jobs without capital or properly functioning capital markets. The capital crunch was exacerbated with the Global Financial Crisis (GFC) in 2008. Prior to the GFC startups and small businesses had similar choices for access to capital; savings, home equity, friends and family, bank credit, bank loans, Angels or Venture Capital (VC). With the collapse of the financial markets this funding dried up. The banks stopped lending. Interest rates rose and limits were cut on credit cards such that credit card financing was no longer an option. Home equity values dropped and HELOCs shrunk or disappeared as a funding option. And Venture Capital saw more opportunity upstream and shifted their focus on bigger deals as the Investment Banks braced. The net result was a negative impact on startups and small business financing that is still struggling to recover.

It was at this time that we showed up in Washington with a solution to the funding void called the Startup Exemption. It was a 10-point framework to use the principles of crowdfunding—raising many small amounts of money from a large group of people via the Internet and merge it with startup and small business financing.

Title III—Crowdfunding Framework

What ended up being signed into law was strikingly similar to the Startup Exemption even though it went through several iterations in Congress. The net result is an exemption from registration with the SEC provided that rules and procedures are followed. To this effect, the SEC released on October 25, 2013, a 585-page report detailing the proposed rules for Title III.

Under "Regulation Crowdfunding" an entrepreneur otherwise known as an issuer can raise up to $1 million per year on Web sites (also known as intermediaries, platform, or portals) that are registered with the SEC and overseen by FINRA.

Issuers and those holding more than 20 percent equity in the business must submit to a fraud/background check to weed out any bad actors. Issuers must upload disclosures to the SEC and the intermediaries that include the following:

- the name, legal status, physical address, and Web site address of the issuer;

- the names of the directors and officers (and any persons occupying a similar status or performing a similar function), and each person holding more than 20 percent of the shares of the issuer;
- a description of the business of the issuer and the anticipated business plan of the issuer;
- a description of the financial condition of the issuer;
- a description of the stated purpose and intended use of the proceeds of the offering sought by the issuer with respect to the target offering amount;
- the target offering amount, the deadline to reach the target offering amount and regular updates regarding the progress of the issuer in meeting the target offering amount;
- the price to the public of the securities or the method for determining the price; and
- a description of the ownership and capital structure of the issuer.

The disclosures, as well as other identifying information about the issuer, including in many cases a video about the entrepreneur(s) and the company will appear on the Web site as a campaign.

Once uploaded, issuers can use their social networks to reach out to a community of individuals they have an established relationship with to learn more about the investment by pointing them to the crowdfunding Web site. While most solicitations are expected to happen online, issuers are allowed to use other means of solicitation (in-store placards, newspapers, etc.) provided that the notice point the potential investor to the crowdfunding Web site. The intent of this is to make sure that all investment activity take place on Web sites that are registered and overseen by the SEC and FINRA and prevent unscrupulous actors from claiming to crowdfund when they are not.

Investors who come to the site must register and take an education series and certify they understand the risk. The proposed rules include education on:

- the process for the offer, purchase and issuance of securities through the intermediary;
- the risks associated with investing in crowdfunded securities;
- the types of securities that may be offered on the intermediary's platform and the risks associated with each type of security, including the risk of having limited voting power as a result of dilution;
- the restrictions on the resale of crowdfunded securities offered and sold in reliance on this exemption;
- the types of information that an issuer is required to provide in annual reports, the frequency of the delivery of that information, and the possibility that the issuer's obligation to file annual reports may terminate in the future;
- the limitations on the amounts investors may invest, as set forth in the legislation;
- the circumstances in which the issuer may cancel an investment commitment;
- the limitations on an investor's right to cancel an investment commitment;
- the need for the investor to consider whether investing in a security offered and sold in reliance on this exemption is appropriate for him or her; and
- that following completion of an offering, there may or may not be any ongoing relationship between the issuer and intermediary.

Investors could make commitments provided they are limited to the greater of:

- $2,000 or 5 percent of annual income or net worth, if annual income or net worth of the investor is less than $100,000; and
- 10 percent of annual income or net worth (not to exceed an amount sold of $100,000), if annual income or net worth of the investor is $100,000 or more (these amounts are to be adjusted for inflation at least every 5 years);

Issuers must hit 100 percent of their funding target within the deadline to reach the target-offering amount or the money is returned from escrow to the investors. Investors would have the ability to communicate with issuers on the intermediary and ask questions.

Intermediaries are defined as either funding portals or broker-dealers. Funding portals are a new entity created by Title III and regulated by FINRA. Funding portals were created to act in the limited capacity that current crowdfunding Web sites do. In order to create funding portals, it was necessary to determine activities they cannot perform. These include:

- offer investment advice or recommendations;
- solicit purchases, sales or offers to buy the securities offered or displayed on its platform or portal;
- compensate employees, agents, or other person for such solicitation or based on the sale of securities displayed or referenced on its platform or portal;
- hold, manage, possess, or otherwise handle investor funds or securities; or
- engage in such other activities as the Commission, by rule, determines appropriate

The intent of this was to create a "broker-dealer light" regulatory scheme for funding portals that do not perform the wide array of activities (including promoting and selling) and hence the costs and compliance of a broker-dealer. It would allow these intermediaries to list crowdfund opportunities and allow the crowd to do the diligence, vetting, and funding very much like what currently happens on donation and perks-based crowdfunding Web sites.

Addressing Pumping, Dumping, and Fraud

The legislation effectively addresses earlier attempts at easing regulations to stimulate capital formation. It deters the "pumping" of securities by disallowing compensation tied to the success of an offering unless this duty is performed by an individual who is registered as a broker-dealer, expressly disclosed to investors and regulated as a broker-dealer activity. It deters the "dumping" of securities by requiring them to be held for a 1-year period. It deters potential scam artists from entering the market by performing background checks, mandating disclosures, forcing the transactions to take place on regulated intermediaries, and requires issuers to hit 100 percent of their funding target or no money is exchanged.

When speaking at an event in Scottsdale, Arizona, I had the opportunity to talk with a skeptical FBI Securities fraud agent about the JOBS Act and crowdfunding. He has spent the better part of 20 years trying to find and hold accountable securities fraud scam artists. When I explain the background check requirements within the legislation he responded, "Then I'm not that concerned with fraud." Apparently, the biggest challenge enforcement officials face is identifying the fraudster post-fraud and the trail leading up to that fraud. With a mandated background check before funding required, potential fraudsters will be self-identifying making for easier accountability. With this entire process happening online, it creates a digital footprint that is recorded in history and easily referenced if needed.

If we look at data from the major existing platforms, they show no successful fraud has been perpetrated through pledge-based crowdfunding. Attempts at fraud have been made but were thwarted by the transparency inherent in crowdfunding: would-be investors asked questions and challenged the fraudulent postings, revealing the frauds and resulting in their removal from funding platforms within 24 hours.

Fraud is a legitimate concern. However, successful fraud with crowdfunding has been relatively rare. While most fraud is perpetrated on a one-to-one basis (for example, an identity scheme solicits personal information via email), fraud in the context of the social media and crowdfund investing in particular would have to occur on a many-to-many basis: a potential fraudster would have to stand up to the wisdom, queries, and insights of the entire crowd. For this reason the most likely scenario for successful fraud involves criminals creating fake crowdfunding platforms and fake companies to attract investors' money.

Of the nearly 50,000 projects funded through Kickstarter to the tune of $815 million, there are four documented cases of attempted fraud. One was a campaign to raise capital for a video game. The campaign received numerous questions and accusations on the Kickstarter comments page that the game developer was unable to address. This response, combined with the revelation that many of the images and content in their pitch were taken from other companies, was seen as an indicator of potentially fraudulent activity and the campaign was quickly shut down without any donor losing money.

Because no case has been filed, it can be hard to tell the difference between a fraud and a well-intentioned project whose creators failed to fulfill on their promise. The most notorious example was a Kickstarter project called ZionEyez, which claimed to stream video directly from a pair of eyeglasses to a person's Facebook stream. The project netted US$343,415 in 2011, and the creators have yet to deliver its product. The company, which has since changed its name, still claims it intends to deliver and is seeking outside capital.

The primary risk to consumers from donation-based crowdfunding is fulfillment risk. Some companies raise funds through crowdfunding without having thought through production, shipping, tax issues, and other essentials of their business model. There have also been examples of technical failure risk, usually involving the presale of software. In these cases companies received funds for products they intended to build, but technical problems prevented them from shipping the product. These same types of risks appear in debt and equity crowdfunding.

The Benefits of Crowdfund Investing

There are many benefits to crowdfunding outside of access to capital. In our World Bank report we identify 8 main benefits to crowdfund investing:

1. It fills a void left by traditional financing and creates an efficient mechanism for raising money by standardizing and centralizing the process of private capital formation.
2. It is an efficient mechanism for investors to analyze if a company fits their portfolio strategy.
3. It disrupts the reliance on business angels and venture capitalist so that enterprising entrepreneurs can leapfrog the venture investor boardroom to their social network. It also provides validation from other investors, which may lower the risk for follow on investment.
4. It expands the geographic range of angel investment. Social networks demonstrate that investments need not be tied to geography, as are many VC investments. Crowdfunding allows entrepreneurs all over the country to have equal access to capital.
5. It provides product validation, support networks and partnerships. Companies can use crowdfunding to explore a product's viability and to engage early adopters at lower costs. This also provides campaigns and the companies hosting them exposure.
6. It provides market testing and demand measurement. Successfully funded projects show crowd validation. This validation, or lack thereof, can help determine if enough of a market exists to fund an idea or not.
7. It provides access to support networks. Crowdfund supporters that become investors are a highly motivated group that acts as product evangelists and feedback providers. These investors have skills and experience from which entrepreneurs can benefit.
8. It provides feedback on the market and how to move forward. Active investors may help enhance an issuer's business plan with ideas and suggestions for moving forward.

Issuers interested in choosing Regulation Crowdfunding over Regulation D would do so for several reasons:

1. Companies that use Regulation D are usually more established and can incur the costs associated with putting together a full private placement memorandum that is usually associated with such offerings. Companies using Regulation Crowdfunding can use technology and software programs to create a business plan and financials necessary for this offering at much lower costs.
2. Companies that use Regulation Crowdfunding are seeking less than $1 million. Companies using Regulation D may be seeking more than $1 million.
3. Companies using Regulation Crowdfunding would benefit from the standardized forms used on crowdfunding platforms and the tools to keep the issuer compliant.
4. Companies using Regulation Crowdfunding want to leverage their social network that includes both accredited and unaccredited investors for which companies using Regulation D are only limited to up to 35 unaccredited investors.
5. Companies using Regulation Crowdfunding do not have to worry about hitting the investor cap of 2,000 before filing with the SEC that a Regulation D offering would subject them to.
6. However companies using Regulation Crowdfunding will be subject to mandated annual reporting that issuers using Regulation D might not. This may increase the burden on Regulation Crowdfunding companies.

Firms That Might Be Interested in Utilizing Crowdfunding

Given the $1 million cap per year that entrepreneurs can seek from the crowd and the all-or-nothing financing mechanism, Regulation CF is geared towards small businesses.

There are many business types that could benefit from crowdfunding. I list some of them below and why:

- High-growth/technology businesses are uniquely suited to crowdfund investing because they find general market understanding and acceptance.
- Research institutions can enable researchers and students to demonstrate broader interest in their research topics.
- Main Street USA businesses may not have access to bank loans since the financial crisis and crowdfunding may serve as a way to convert customers into investors and lenders.
- Franchisees may gain because there has been an absence of financing available to individuals who want to start a business franchise. Individuals well suited for this may be retirees looking for additional financial security or a military veteran who can leverage the franchise support system to transition to business ownership.
- Real estate companies can use crowdfunding as a means to rehabilitate communities ravished by the economic crisis and allow these same communities to benefit from the rehabilitation both physically and financially.
- Women and minorities who have historically been both underfunded and left out of the startup and small business financing realm can now access capital from other women and minorities who until now haven't had either the way or an efficient means to support their peers.

Because Regulation Crowdfunding has yet to go into effect it is difficult to gauge the impact it will have on the economy and jobs. However, on September 24, 2013, Title II, another provision of the JOBS Act went into affect and this might be a leading indicator. Title II lifted the ban on general solicitation. For the first time in 80 years issuers can raise an unlimited amount of money from investors provided that they only take money from accredited investors. Such a change essentially allows issuers to use crowdfunding Web sites to market their offering to accredited investors.

This opened the door for platforms like AngelList, an online accredited investor platform, to expand their reach. Based on conversations with Kevin Laws at AngelList, over 2,959 companies have listed since Title II went into effect. At a crowdfunding event last week in New York City it was remarked that over $50 million of capital has already been committed to those companies. To put this into perspective, last year Venture Capitalist funded only 3,800 deals. While VC deployed over $26 billion we can see that increasing both deal flow and reach may lead to more business funding outside of what VC's deploy. Initial estimates from the Program for Innovation in Entrepreneurial and Social Finance, a crowdfunding think tank at the University of California, Berkeley, estimates that within its first few years the crowdfund investing market size could be as high at $4 billion.

One trend we expect to develop is more and more businesses circumventing the traditional means of finance and seeking funds from the crowd. Successful companies at crowdfunding may use their vested customers to help fine tune product offerings. They will leverage the crowd's marketing power to promote the business, which may in turn lead more sales, visibility and Angels getting involved. Angels who have an interest in the business can play a lead investor role in a Title II offering or as a syndicate, meaning they come in with say the first $100,000 and syndicate the other $150,000 to accredited investors. Continued growth and success may raise the interest of Venture Capitalists who can come in at a later stage when a business is developed, product tested and market validated. They can provide the stronger hands and deeper pockets to take the company to the next level. All along the way, the crowd investors can either be bought out in successive rounds at the current price thus experiencing liquidation and cash flow or stay along for the ride with the knowledge that they own less (due to dilution) of a more valuable company for which they may experience greater benefit down the road.

When this industry is up and running we should have answers to questions we never could answer before like what is the valuation of dry cleaner, hair salon, or small farm. As investors come in and invest in these businesses, valuations at different company sizes will be determined. These valuations will be stored online for all to see and may shed light on what has historically been a challenging exercise; how to value your company?

The disclosure requirements could also improve informational efficiency in the market. Specifically, the required disclosures would provide investors with a useful benchmark to evaluate other private issuers both within and outside of the securities-based crowdfunding market. Companies like Crowdnetic, a New York-based company, are already stepping into the space by providing an in-depth view into the private capital markets, who is getting funded, what sectors see the most funding, where trends are developing and more.

Rulemaking Overview

I would like to commend the Securities and Exchange Commission for the detailed and thorough analysis of Regulation Crowdfunding. I personally would like to acknowledge the incredibly hard work performed by the staff at the SEC. Since the bill was signed into law we as an industry have requested and been granted meetings with key stakeholders in the SEC to share our knowledge, experience, and concerns. All our meetings were accepted and we are gracious for the staff's time and consideration. We note that the 13 letters from CFIRA, the organization we helped cofound to work with the SEC and FINRA on the rules, was referenced 57 times in the proposed rules.

When considering the 585-page report on the proposed rules put out by the SEC the following thoughts come to mind:

1. The SEC worked really hard to follow the majority of the spirit and intent of the legislation. However they missed the ball on funding portals and need to make some enabling changes.
2. Compliance is the key word to come out of these 585 pages. Issuers will have to files forms with the SEC periodically and these forms are attached to either dates or milestones. It is critically important for a small issuer who is new to running a business, raising capital or being compliant with regulation to either find an individual, technology or a portal that can keep them compliant.
3. Education is key. Probably the most important thing potential issuers can do is to learn as much about crowdfunding and these rules as possible. Issuers will need to learn about types of securities, valuation, and investor relations. If they want to be successful they should study prior to crowdfunding. This is one of the reasons we started an online education training series called "Success With Crowdfunding". Investors too need to be educated and we are pleased to see that the SEC expanded upon what they believe investors should know prior to putting their money behind a crowdfund offering. We were surprised though that there was no mention of the importance of diversification.

The Good

There are parts of the rulemaking that could make this offering more appealing to prospective issuers.

First, the SEC did not create rules that would kill crowdfunding before it had a chance to start. By this I mean, while there is a 2,000 limit on the number of investors before a company needs to essentially be a public reporting company, the SEC understood that since there can be many crowdfund investors, they needed to be grouped together and exempted from that ceiling. Doing so will allow successful crowdfund companies to continue on the funding lifecycle without having to worry about the costs of becoming a reporting company prior to their desire or opportunity to do so.

Second, issuers don't have to decide whether to do a Title III or Title II offering. The proposed rules seem to understand that the type of investors in each Title may be different and not to preclude issuers from choosing one over the other. The proposed rules allow for concurrent offerings without integration, so if an issuer wishes to do parallel offerings, the issuer would be able to exceed the $1 million cap in Title III without losing his exemption.

Third, as mentioned earlier Title II of the JOBS Act lifted the ban on general solicitation provided that investments only come from accredited investors. Title II requires that issuers affirm the status of an accredited investor. In Title III this burden is left with the investor. This will ease the compliance burden of verifying income or net worth of individual investors, allow them to self-disclose these amounts and allow them to represent and certify that they have not gone over their individual investment limits.

Fourth, while there are disclosures mandated the SEC did not define set disclosures for a business plan or use of proceeds. This will help new entrepreneurs who are otherwise unsure of what is in a business plan to try crowdfunding. It would be highly recommended though that these entrepreneurs use technology, business planning software, or advisors to generate the reports necessary for disclosure.

Fifth, you can exceed your offering amount as long as you disclose what you would do with the extra money in your use of proceeds. This is actually very good. It allows issuers to set a minimum amount they need to achieve and allows others who come in toward the end to still have an opportunity to participate even if the company hits its minimum funding target. I believe that companies that exceed their funding targets will be the first point of contact and follow on deal flow for Angels and VCs.

Sixth, while not expressly stated in the legislation, it was good of the SEC to understand that crowdfunding operates in conjunction with the social network and that issuers should use their social networks to drive people to the intermediaries Web site provided they don't talk about specifics of the offering.

And, seventh, the SEC added the flexibility of dynamic pricing without limiting the types of securities. This may allow issuers to offer different types of shares at different prices to investors. While this may not benefit the untrained issuer, it allows more sophisticated issuers to raise money from more sophisticated investors, reward early supporters and increase the likelihood that the offering would be successful.

The Bad

There are parts of the rulemaking that could make this offering less appealing to prospective issuers.

As mentioned above, the biggest hurdle issuers face will be compliance. There is a lot of reporting required in the system. While such reporting will promote transparency and deter fraud, it may also deter the honest yet new issuer from deciding to crowdfund. It may also force issuers to raise more money to either pay for a compliance officer or an alternative solution. While this may promote jobs, this was not the intent of the legislation.

Second while the legislation does allow for both accredited and unaccredited investors to support issuers, accredited investors are not usually capped in their investment, within Regulation Crowdfunding, they are capped at $100,000.

Third there are disclosure requirements for directors and officers that include disclosing 3 years of business experience. While such disclosures may help investors understand who is running the company, depending on the number of owners, their backgrounds and the system used for gathering this information it might be challenging to disclose all this information.

Fourth, while the legislation mandates it, we were still hopeful that the SEC would understand the almost impracticality of audited financials for offerings in excess of $500,000. Audited financials are beneficial for large corporations to uncover nuances. Smaller corporations are more transparent by nature. According to the SEC's figures an audit would cost about $28,700. Given the 2 year required disclosures in the proposed rules, this figure could be well over $50,000 or 10 percent of the raise. This might deter some issuers. We would hope in future amendments; this figure would be scaled up or just switched to CPA review.

Fifth, while FINRA is the only National Securities Association in the United States and hence assigned to be the oversight authority of the crowdfunding portals, I believe that the industry might be better served if it were overseen by the industry participants itself who are more concerned about developing an efficient, credible, transparent marketplace and building this credible crowdfunding marketplace is their only priority and core competence. Not knowing whether the SEC and FINRA are making rules to benefit brokers over funding portals might deter both intermediaries and issuers from getting into crowdfunding.

The Really Bad

The proposed rules don't allow funding portals much flexibility when determining who can list on their sites. Not giving them the flexibility to deny a business they believe isn't ready for crowdfunding or won't be successful may decrease efficiencies and increase failure.

The proposed rules leave liability with the funding portals for material misstatements by the issuers. While it would seem obvious that material misstatements should be a reason for liability, a portal is not in the same business as the issuer and hence might not know a statement is material. In addition, the roles and responsibilities of a funding portal are much less than that of a broker and while brokers may be paid to provide detailed vetting, portals are not. In reality, under the proposed rules, funding portals have greater liability because the Due Diligence defense afforded to brokers is not afforded to them. When it comes to funding portals, it is the role of the crowd to do the diligence on the issuer and question the disclosures on the comment pages of the campaign. Funding portals should not be held accountable for misstatements. As a matter of fact, funding portals should explicitly state on their Web sites that it is the job of the issuers to review the disclosures for nonfactual statements and that the portal is just providing the matching service. This was the intent of the legislation.

It is unclear from the proposed rules of funding portals can receive payment for a successful campaign in terms of a percent of the raise. This is how current donation and perks crowdfunding platforms operate and the intent of the legislation. One part of the proposed rules talks about disclosing the amount of compensation paid to the intermediary for conducting the offering. Another part states the funding portal cannot compensate employees, agents or other person for such solicitation or based on the sale of securities displayed or referenced on its platform or portal. And a third part goes on to state the proposed rules would define "funding portal" consistent with the statutory definition of "funding portal," substituting the word "broker" for the word "person," seemingly implying that the intermediary cannot be paid a success fee. This would effectively remove the economic model for the intermediary.

The proposed rules also require the escrow agent for a funding portal to be a bank. While escrow services are part of a bank's duties it is not their primary focus of activity. By not allowing other escrow agents into the process, this makes it not only challenging for funding portals to develop and flourish but increases the cost of capital for the issuer.

The reality of these four items, I believe, will make it very hard for funding portals to succeed in the space. Anyone that wants to be a funding portal will have to form a strategic relationship with a broker. Doing so might allow them to perform more activities but the funding portals will probably have to give up an excessive amount of their fees with the broker. Unfortunately the additional costs of capital will come out of what issuers raise and not where investors want their investment going.

The reality for an issuer is also fairly stark. In my calculations and conversations with Kevin Laws at AngelList we both came to the same conclusion, crowdfunding might be too expensive from a prepare and comply point of view to event get in the game at the low end. Karen Kerrigan, President and CEO of the Small Business and Entrepreneurship Council (SBE Council) stated it another way, "the rules as proposed will prevent or turn off many small businesses and entrepreneurs with limited resources from tapping into this new financing opportunity." Quite simply, at least at present, SBE Council believes the regulations work against the efficiency and transparency of technology in this space.

"The complexity and burden of the SEC's proposed regulations, FINRA requirements, and the potential threat to regulate even more will act as a barrier to entry to new funding portals, which means less innovation and competition," says Kerrigan. "We are not opposed to regulation and accountability, but SEC Title III rules tip the scales, which create immediate barriers to funding portal competition and choice for entrepreneurs in this new space."

In sum, the potential for equity and debt-based crowdfunding will be constrained by the proposed regulations (as they now stand) to implement Title III of the JOBS Act. Entrepreneurs who have the resources to comply with the various requirements at each step of their funding (pre-, during, and post raise) will be fine. Small business owners and entrepreneurs with limited resources will have more difficulty tapping into this opportunity.

What Can We Learn From Crowdfunding Internationally?

In our World Bank report we have a section titled Early Data from the Developed World. In there we state, "Currently there is limited data to report on equity and debt-based crowdfunding, but Australia and the United Kingdom are demonstrating interesting results. After 7 years of crowdfunding companies, the Australian Small Stock Offering Board (ASSOB) shows that 86 percent of companies crowdfunded on its platform were still operating in 2012. This contrasts with a figure of 40 percent of noncrowdfunded (non-ASSOB) companies that fail after 3 years.

An engaged base of both customer and investors in the business is cited as one of the main reasons for longevity by ASSOB. ASSOB also vets deals prior to posting on their platform. Equity-based crowdfunding platforms have also launched in the Netherlands and Italy. No affirmative data yet exists to show investor returns from these platforms, though projected market size analysis has been completed by the University of California, Berkeley, and well-regarded venture capitalist, Fred Wilson.

Debt crowdfunding in the United Kingdom has had some early successes in providing returns to investors. Since 2007 investors in companies listed on U.K.-based Funding Circle have completed financing totaling over £156 million (about US$250 million), receiving an annualized return of 5.8 percent (after expenses and bad debt expense, but before taxes) with a 1.6 percent default rate." This represents much better performance for both investors looking to earn a yield and issuers seeking to borrow at competitive rates.

There have been no successful cases of fraud on any debt or equity-crowdfunding platform globally.

Conclusion and Recommendations

With the global financial crisis the funding void for startups and small businesses got bigger. Crowdfunding has emerged as a unique solution and now Congress, the President, and the Securities and Exchange Commission see its potential in addressing this problem but there is still work to do.

Youth unemployment in the United States according to one study is more than twice the national average. College graduates are competing for unpaid internships and not experiencing the benefit of having worked toward a degree. As stated by Judith Rodin in *Innovations Journal,* "Young people who are not on track to secure employment are often stuck in a self-perpetuating cycle of poverty and instability. Their future earning potential is stilted, and they are likely to settle for part-time jobs or temporary work. As a result, today's youth many of whom are concentrated in urban areas, face high levels of social exclusion and lack clear access to the safety nets that employment can provide: health benefits, retirement accounts and pensions." In other parts of the world we've seen civil unrest as dispirited youth take to the streets in anger. This was even evident during the Occupy movement in the United States.

We may stand at a unique time in history to address both the funding void and unemployment by allowing individuals with aspiring ideas to take them to regulated platforms and let the crowd decide if they are worthy of funding. However, entrepreneurs need to approach this opportunity with eyes wide open. There is a great deal of disclosure and compliance required in this opportunity and it is advised that they take the time to study and learn everything they can about crowdfunding and the proposed rules before moving forward.

For crowdfunding to really flourish under Title III, and be in line with the way crowdfunding currently operates, I would encourage Congress to have the SEC make the following changes to the proposed rules. Doing so will allow funding portals, which were intended to be stand alone entities from brokers in the first place, to survive:

1. Funding portals that are not broker dealers or partnered with a broker be allowed to be paid in the form of a success fee in the form of a commission on deals closed. Without this economic model, portals will not survive.
2. Funding portals be allowed to curate deals other than what type of offerings they allow on their portal so that they have the flexibility to keep deals off their platform that they do not deem worthy. This type of curation can only stand to benefit investors because it is not providing investment advice on a specific deal already listed on a platform but in essence keeping out deals that are not ready to raise capital, not fundable or not worthy from the portal's perspective for listing.
3. Funding portals not be liable for any material omissions or misstatements of the issuer. If the legislation approved by Congress and signed into law by the President meant to include funding portals in the liability it would have directly named "funding portals" in the list of those liable, forcing funding portals to diligence deals and be paid for that service like a broker. Funding portals play a limited role and shouldn't be held to the same liability standards as brokers.

With these proposed chances I believe a robust and efficient crowdfund investing market may develop in the United States. I look forward to your questions.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR HAGAN FROM KEITH HIGGINS

Q.1. In an address to the Security Traders Association on 10/2/13, Chairman White discussed one-size-fits-all markets. Could you please elaborate on why a one-size-fits-all market structure may not effectively serve smaller public companies?

A.1. In the speech you mention, Chair White discussed how, for the most part, market rules and trading mechanisms are today the same regardless of wide variations in the size of public companies. According to Commission staff in the Division of Trading and Markets, by its nature, such a one-size-fits-all market structure will be designed primarily to address stocks with the majority of trading volume, and the great majority of trading volume in the U.S. equity markets is attributable to larger company stocks. For example, the SEC Advisory Committee on Small and Emerging Companies received data indicating that the average daily dollar volume for NASDAQ-listed companies with $1 billion or more in market capitalization is vastly greater than for companies with less than $100 million in market capitalization. *See,* Presentation of Jeffrey M. Solomon, CEO, Cowen and Company (Sept. 17, 2013) (available at *http://www.sec.gov/info/smallbus/acsec.shtml*).

At the same time, the level of trading volume in smaller companies may not appropriately reflect the economic significance of the smaller company segment of the market in terms of capital formation and economic growth. To address this potential disconnect, Chair White highlighted the need to focus particularly on the market structure needs of smaller companies, rather than simply assuming that their needs are the same as larger companies. For example, smaller company stocks generally do not have the same sources of liquidity as larger company stocks, and an efficient market structure specifically designed for smaller company stocks that generates additional liquidity and protects investors may have greater marginal benefits for smaller companies than a one-size-fits-all structure.

Q.2. Chairman White also shared that staff has been working with exchanges to develop a plan to implement a pilot program allowing smaller companies to use wider tick sizes.

Could you provide an update on the progress the SEC has made in developing a pilot program and when I might expect the implementation of the pilot program?

A.2. At Chair White's instruction, SEC staff in the Divisions of Trading and Markets and Economic and Risk Analysis are continuing to work with the exchanges as they develop and, if possible, present to the Commission for its consideration a plan to implement a pilot program regarding tick sizes as soon as practicably possible.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TOOMEY FROM KEITH HIGGINS

Q.1. Some small businesses and investors have noted that the current definition of "general solicitation" is very broad. Does the Commission plan to provide additional clarification on what "general solicitation" means and how the concept can be applied to a number of common capital raising activities? If so, what are some key issues the SEC will address in the definition? If not, why not?

A.1. Title II of the JOBS Act mandated that the Commission amend Rule 506 of Regulation D to permit general solicitation and advertising in Rule 506 offerings, provided that all purchasers of the securities are accredited investors and the issuer takes reasonable steps to verify that such purchasers are accredited investors. The Commission adopted Rule 506(c), which permits the use of general solicitation and advertising in offerings relying on the exemption. In connection with the issuance of the new exemption, some have raised questions about what activities may be considered to be a general solicitation.

As you may know, the concept of general solicitation in connection with private offerings has been in existence for many years. Although the Commission's rules, including new Rule 506(c), do not provide a definition of general solicitation, the Commission has over the years provided guidance with respect to general solicitation and the analysis for determining whether a specific communication or activity constitutes a general solicitation for the offer or sale of securities. That guidance did not change with the adoption of Rule 506(c). As a general matter, since the determination of whether a specific communication or activity constitutes a general solicitation is dependent on the particular facts and circumstances, it is difficult to provide additional generally applicable guidance that would be helpful in this area beyond what is already provided. I anticipate that some of the concerns about what may constitute a general solicitation may diminish as companies and their advisers become increasingly familiar with new Rule 506(c). Commission staff will continue to carefully monitor developments and consider whether there is any more specific guidance we could issue that may be useful. As always, the Commission staff is available to consult with companies and their advisers about questions that may arise in connection with the use of the new rule.

Q.2. Regarding the verification of accredited investors in generally solicited offerings, will the Commission provide written clarification on application of the principles-based approach in common situations? For instance, if the investors are members of established angel groups, accredited investor platforms, or have made previous investments in Rule 506 offerings, could the issuers confirm their participation and reasonably believe these investors are accredited?

A.2. As you know, Title II of the JOBS Act mandated that the Commission amend Rule 506 of Regulation D to permit general solicitation and advertising in Rule 506 offerings, provided that all purchasers of the securities are accredited investors and the issuer takes reasonable steps to verify that such purchasers are accredited investors. In adopting Rule 506(c) to implement Title II, the Commission considered a number of approaches and the comments received, ultimately adopting a principles-based method of verification along with four nonexclusive methods of verifying the accredited investor status of natural persons. In so doing, the Commission concluded that a general requirement that issuers take "reasonable steps to verify" that the purchasers are accredited investors combined with a nonexclusive list of verification methods deemed to meet this requirement would maintain the flexibility of the verification standard while providing additional clarity and certainty to issuers if one of the specified methods is used. The adopting release provides guidance with respect to the methods for verifying accredited investor status.

Under the principles-based method, an issuer would look at the particular facts and circumstances of each purchaser and transaction to determine the steps that would be reasonable for verifying the purchaser's accredited investor status. In the adopting release, the Commission identified a number of factors that should be considered under this analysis, such as:

- the nature of the 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, such as the manner in which the purchaser was solicited to participate in the offering, and the terms of the offering.

After considering the facts and circumstances of the purchaser and the transaction, the more information an issuer has indicating that a prospective purchaser is an accredited investor, the fewer steps the issuer may have to take to verify accredited investor status, and vice versa. The Commission adopted this method to provide issuers and market participants with the flexibility to use verification methods tailored to their specific circumstances, to adapt to changing market practices, and to encourage innovative approaches for meeting the verification requirement, such as third-party databases of accredited investors and verification services.

The principles-based verification method allows issuers to consider the factors you identified, specifically, membership in established angel groups, the use of accredited investor platforms, and investments in previous Rule 506 offerings. A person's investments in previous Rule 506 offerings or membership in an established angel group is information about the person that may affect the likelihood of the person being an accredited investor and therefore may be useful in determining the steps that would be reasonable for an issuer to verify the person's accredited investor status. The issuer would, of course, still need to consider any other relevant facts in making its final determination about the person's accredited investor status.

In addition to the principles-based verification method, to provide greater certainty to those issuers seeking it, the Commission provided a nonexclusive list of methods an issuer may use to satisfy the verification requirement. These methods include, among other things: reviewing copies of any IRS form that reports the income of the purchaser and obtaining a written representation that the purchaser will likely continue to earn the necessary income in the current year; or receiving a written confirmation from a registered broker-dealer, SEC-registered investment adviser, licensed attorney, or certified public accountant that such entity or person has taken reasonable steps to verify the purchaser's accredited status.

Of course, as questions arise in connection with the use of the new rule, Commission staff will be available to consult with companies and their advisers.