NSBA
National Small Business Association®

Comments on Regulatory Initiatives to Implement the JOBS Act

June 12, 2012

The National Small Business Association (NSBA) was founded in 1937 to advocate for the interests of small businesses in the U.S. It is the oldest small business organization in the U.S. The NSBA represents more than 150,000 small businesses throughout the country in virtually all industries and of widely varying sizes.

On Apr. 5, 2012, the President signed into law the Jumpstart Our Business Startups Act [Public Law 112–106] (the "JOBS Act"). The NSBA strongly supported this legislation. This bi-partisan legislation is designed to substantially reduce the regulatory impediments to small firms' access to capital markets. Properly implemented by the SEC, it will dramatically improve small companies' access to capital and reduce their cost of capital. It will reduce the legal, accounting and other administrative cost of small businesses and reduce the need to pay substantial fees to investment bankers and other broker-dealers to access capital markets. The passage of the JOBS Act demonstrates a broad bi-partisan understanding that existing securities laws pose an unreasonable burden on the ability of small firms to access the capital markets, harming economic growth and job creation.

The Securities and Exchange Commission ("SEC" or the "Commission") must adopt a number of rules to implement the JOBS Act. Moreover, clarification or amplification by the Commission would be highly desirable in a number of cases where adopting a regulatory regime is not specifically mandated by the Act but the statute is either very general or ambiguous. The Commission must guard against regulations that will undermine the purpose of the Act by imposing such complexity, opaqueness and regulatory risk that small firms or funding portals must either incur exorbitant legal and accounting fees or fail to take advantage of the new means of raising capital offered by the Act. The regulatory framework should be straight-forward and streamlined, imposing the minimum necessary cost and regulatory risk on small firms seeking to raise capital.

In response to Notice 2012-60 issued April 11, 2012 entitled "SEC Seeks Public Comment Prior to JOBS Act Rulemaking," the NSBA is pleased to submit these comments.

Title I — Reopening American Capital Markets to Emerging Growth Companies

Title I temporarily reduces the regulatory burden on new public companies classified as "emerging growth companies." Specifically, (1) certain executive compensation disclosure requirements are deferred, (2) only two years of audited financial statements are required in a registration statement, (3) the Sarbanes-Oxley section 404(b) internal control audit requirements are deferred, and (4) certain otherwise prohibited broker research reports and other communications are permitted. In addition, the Commission is directed to study how Regulation S-K may be changed to reduce the costs for emerging growth companies. Emerging growth companies are generally defined by the Act as a company with less than $1 billion in revenues that has had registered common stock for five years or less.

NSBA supports reducing the expense and administrative burden of going public and remaining a public company. The Act's definition of emerging growth company undoubtedly includes firms that are not small businesses and much of the relief in Title I is temporary in nature rather than permanent. Ergo, going public still entails assuming complex and expensive compliance responsibilities. Nevertheless, Title I will make it somewhat easier and less expensive to go public and, for up to five years, will make it less expensive to remain public. Thus, it is likely to encourage more IPOs, improving access to public securities markets for small, dynamic firms.

NSBA's comments regarding the regulatory framework for Title I are relatively limited.

Materials used to communicate with potential institutional or accredited investors to determine investor interest in accordance with section 105(c) of the Act should not have to be filed with the Commission.

Obviously, § 229.301 (Selected Financial Data) of Regulation S-K will have to be amended to conform with section 102(b) of the Act since the Act only requires two years of audited financial statements.

NSBA looks forward to providing the Commission with input at a later date with respect to other ways that Regulation S-K can be amended to reduce costs, especially for smaller reporting companies.

Title II — Access to Capital for Job Creators

Title II of the Act provides that the prohibition against general solicitation or general advertising contained in 17 CFR 230.502(c) shall not apply to offers and sales of securities made pursuant to 17 CFR 230.506, provided that all purchasers of the securities are accredited investors. It further requires the issuer to take reasonable steps to verify that purchasers of the securities are accredited investors, using such methods as determined by the Commission. The Act also provides, subject to various requirements, that no person shall be subject to registration as a broker or dealer solely because "that person maintains a platform or mechanism that permits the offer, sale, purchase, or negotiation of or with respect to securities, or permits general solicitations, general advertisements, or similar or related activities by issuers of such securities, whether online, in person, or through any other means."

The importance of this aspect of the Act is often underrated. Typical small business owners know a limited number of accredited investors (i.e. very affluent people). They are thus effectively forced by the securities laws pre-existing relationship requirements to pay broker-dealers large fees to make introductions. This aspect of the law will allow them, should they choose, to try to directly seek accredited investors.

Rule 506 Generally

Our primary concern with respect to Title II is that the Commission resist the temptation to alter Rule 506 in a way that increases the burden on, or risk to, those using the exemption. No additional requirements should be added.

In our judgment, the Act is clear:

> …the prohibition against general solicitation or general advertising contained in section 230.502(c) of such title shall not apply to offers and sales of securities made pursuant to section 230.506, provided that all purchasers of the securities are accredited investors.

The Act does not require or encourage other revisions to Rule 506.

General Solicitation or General Advertising

There is no need for the Commission to further regulate the general solicitation or general advertising seeking accredited investors. Issuers are subject to the anti-fraud provisions of federal and state securities laws and accredited investors and their advisors are in a position to look after themselves and take risks. If, however, the Commission undertakes to regulate those solicitations and advertisements directed at securing accredited investors, it is imperative that the rules be clear and simple to comply with. They should not introduce a series of difficult judgment calls that create regulatory risk that will serve as a powerful disincentive to take advantage of the changes made by Title II.

Reasonable Belief Standard

The reasonable belief standard regarding accredited investor status should be retained. The traditional and almost universal current practice of using investor questionnaires combined with investor self-certification to establish accredited investor status should continue to be allowed and be deemed to constitute taking "reasonable steps to verify that purchasers of the securities are accredited investors" as required by the JOBS Act.[1] There is neither legislative history supporting nor any other reason to believe the proposition that Congress intended to undermine the laudable policy goals of the Act by changing the current long-standing practice with respect to verifying accredited investor status.

Accredited Investor

Section 413 (b) of Title IV of the Dodd-Frank Act provides that "[t]he Commission may undertake a review of the definition of the term "accredited investor", as such term applies to natural persons, to determine whether the requirements of the definition, excluding the requirement relating to the net worth standard described in subsection (a), should be adjusted or modified for the protection of investors, in the public interest, and in light of the economy."

NSBA strongly opposes increasing accredited investor threshold. In "light of the economy," the last thing regulators should do is make it more difficult for small, dynamic companies seeking investors to raise capital. There is no evidence that the threshold is too low. And it is not in the public interest to deny investors access to the investments that will create jobs, enhance productivity and foster innovation.

[1] If the Commission feels compelled to change existing practice, then a certification by the investor's attorney, CPA, certified financial advisor or other professional should be sufficient. This, of course, will add expense to the entire process and have a negative impact on investor returns and willingness to invest in Regulation D offerings.

Title III — Crowdfunding

Title III of the Act provides a crowdfunding exception to the registration requirements of the Securities Act of 1933. The crowdfunding exception will allow issuers to raise, subject to substantial regulation, up to $1 million a year in small increments from ordinary investors through a registered funding portal. State Blue Sky laws regarding registration and qualification are preempted. This aspect of the Act has the potentially to transform small firms' access to capital provided that the regulatory framework adopted by the Commission does not unnecessarily impede either issuers or funding portals.

$1 million Limitation

New section 4(6) permits offerings under the crowdfunding exemption up to an aggregate of $1 million in a twelve-month period. The statutory language is not a model of clarity regarding whether the $1 million limitation pertains only to offerings under Section 4(6) of the Act or includes all exempt offerings. NSBA supports the $1 million limitation applying only to crowdfunding offerings. In any event, the Commission should clarify its position.

Self-Regulatory Organizations and Registration as a Broker

New section 4A(a)(2) requires funding portals to register with any applicable self-regulatory organization (as defined in section 3(a)(26) of the Securities Exchange Act of 1934). Section 304(a) of the Act provides that [t]he Commission shall, by rule, exempt, conditionally or unconditionally, a registered funding portal from the requirement to register as a broker or dealer.

The Commission must designate with which SRO a funding portal should register. Nor is it clear what the funding portal should register as. The Act makes it clear that a funding portal is distinct from a broker or dealer from a regulatory standpoint. The difficulty is that the current stance of the Commission is, effectively, that almost anyone no matter how tangentially involved in a securities transaction may be a dealer (see, e.g., the SEC's Guide to Broker-Dealer Registration http://www.sec.gov/divisions/marketreg/bdguide.htm#II). It is clear that the state of SEC "guidance" in this area is not clear.

For example, the SEC "Guide to Broker-Dealer Registration" states that (1) "[f]inding investors for "issuers" (entities issuing securities), even in a "consultant" capacity," (2) "[e]ngaging in, or finding investors for, venture capital or "angel" financings, including private placements" or (3) "persons that operate or control electronic or other platforms to trade securities" can trigger registration. That, of course, is what funding portals will be doing and what both Congress and the President intend for them to do.

Given the highly expansive interpretation of current SEC guidance, any funding portal would presumably be required to register as a dealer. Yet this clearly is not consistent with Congressional intent and would impose an unreasonable burden on funding portals. In fact, it would defeat the primary purpose of the legislation, to wit, to allow investors to invest and small issuers to raise capital without being required to cut Wall Street in for a large piece of the company.

NSBA does not believe that registration as a dealer should generally be required of organizations that are only funding portals for crowdfunding and/or Regulation D offerings. It is imperative that the Commission guidance adopt this position and makes this clear. It is important that the Commission make it clear that funding portal fees set, in whole or in part, as a percentage of the amount raised do not trigger dealer registration requirements. It is also important that the Commission designate the crowdfunding SRO as soon as possible so that it can be created (if necessary) or can begin adopting the rules necessary to accept funding portal registrations.

Disclosure

New section 4A(a)(3) requires an issuer "to provide such disclosures, including disclosures related to risks and other investor education materials, as the Commission shall, by rule, determine appropriate." To eliminate uncertainty and ensure that the information deemed by the Commission to be necessary is conveyed to prospective investors, we strongly urge the Commission to provide model language that it wants in the disclosures and educational materials or, as necessary, to provide detailed templates.

Background Checks

New section 4A(a)(5) requires an issuer to "take such measures to reduce the risk of fraud with respect to such transactions, as established by the Commission, by rule, including obtaining a background and securities enforcement regulatory history check on each officer, director, and person holding more than 20 percent of the outstanding equity of every issuer whose securities are offered by such person."

We would urge the Commission to indicate what behavior uncovered by a background check is disqualifying, which needs to be disclosed and which does not. For example, is a 15 year old DUI or marijuana possession felony conviction disqualifying? Does it need to be disclosed? Are the requirements limited to crimes of moral turpitude? Is the background check requirement limited to a *criminal* background check and, if not, what other types of background check will be required? For example, is it mandatory to disclose tax liens, judgments, bad debts or similar issues and if so, how is such a background check to be conducted? Liens and judgments, for example, are often not on a central database. Guidance on the parameters of this requirement is very important.

Section 15(b)(4) of the Securities Exchange Act could be used as the template for a rule regarding disqualification but would not necessarily be appropriate for a mandatory disclosure standard.

We would also advise the Commission of the recent EEOC revised "Enforcement Guidance on the Consideration of Arrest and Conviction Records in Employment Decisions under Title VII of the Civil Rights Act of 1964." It is clear that the EEOC and SEC are pursuing very different policy agendas in this area and we would ask that SEC and EEOC guidance be consistent since our membership cannot comply with conflicting legal requirements issued by two different agencies.

Aggregation

New section 4A(a)(8) of the Act requires intermediaries to ensure that no investor in a twelve-month period has purchased crowdfunding securities that, in the aggregate, from all issuers, exceed the Section 4(6) investment limits. It is unclear how an intermediary will be able to verify whether an investor had exceeded these limits unless it is entitled to rely upon the representation of an investor regarding prior investments in such securities.

Rescission

New section 4A(b)(1)(G) requires an issuer to offer investors a reasonable opportunity to rescind the commitment to purchase the securities. Dovetailing this provision with the Truth in Lending Act (TILA) provisions contained in 15 USC §1635 and many state consumer protection statutes seems appropriate since the policy goals are substantially similar and it is less likely to lead to consumer confusion. The TILA statute provides consumers the "right to rescind the transaction until midnight of the third business day following the consummation of the transaction or the delivery of the information and rescission forms required under this section together with a statement containing the material disclosures required under this subchapter, whichever is later." The period should commence upon the investor entering into a binding initial commitment.

It should also recommence if the issuer makes a change in the investment terms or provides a new material adverse disclosure before the offer is closed (and should not terminate until substantially after the issuer provides actual notice of the change or adverse disclosure). In our judgment, in these two cases, the period should be much longer than three days.

Offering Notices or Announcements

New section 4A(b)(2) provides that an issuer shall "not advertise the terms of the offering, except for notices which direct investors to the funding portal or broker." The Commission should provide guidance as to what information is permitted in the notice. At a minimum, the issuer should be allowed to provide the following information in the notice:

(1) The name of the issuer;
(2) The name and web site of the funding portal or portals;
(3) The type of security being offering;
(4) The offering amount;
(5) The opening and closing date of the offering; and
(6) The line of business that the issuer is in (or will be in if the offering will fund a new line of business).

Issuer and Intermediary Liability

New section 4A(c) provides a cause of action to an investor in a crowdfunding offering against the issuer, a director or partner of the issuer, the principal executive officer or officers of the issuer, or the principal financial officer, controller or principal accounting officer of the issuer to recover damages for material misstatements and omissions by the issuer. Although it is Congressional intent that the issuer and its executives be legally responsible for material misstatements and omissions in the offering documents, the Commission should provide guidance as to whether an intermediary will be required to confirm any information presented by the issuer during the course of the offering (and if so, which information and to what extent) or will be subject to liability for any violations by the issuer of its Section 4(6) obligations. The Commission should provide guidance as to whether intermediaries will be permitted to request issuers to provide greater disclosure of information to the public than required by the Act and whether this additional disclosure would result in any liability to the intermediary in the event of fraud or negligent misrepresentation by the issuer.

Given the combination of a large number of potential investors making small investments and potentially risky investments, class action or shareholder derivative lawsuits (both warranted and unwarranted) are likely to be reasonably common. In order for this risk not to pose a major barrier to those wishing to maintain funding portals, it is important that the scope of intermediary duties be set forth with reasonable specificity. Moreover, it is our belief that a funding portal attempting to impose stricter standards than the minimum required by the Commission should not give rise to liability. Finally, a funding portal that complies with Commission requirements should not be co-liable for material misstatements and omissions by an issuer – otherwise, they are, in effect, being asked to become an insurer and the costs and risk of maintaining a portal will become prohibitive.

Investment Advice

Section 3(a) of the Securities Exchange Act as amended by new subsection 80 defining a "funding portal" prohibits an intermediary from offering investment advice or recommendations. However, the Act does not provide a definition of what constitutes investment advice or a recommendation. The commission should clarify whether the following actions would constitute either investment advice or a recommendation: (1) removing an offering before its offering period has expired for lack of sufficient investor commitments; (2) preventing an issuer from offering its securities on the funding portal's website because of failure to provide documents responsive to a the portal due diligence/disclosure standard; (3) establishing disclosure standards or qualification standards (e.g. prohibiting felons from being in issuer management) that are higher than the standards specified by the Commission (4) assuming a funding portal allows investors to comment or submit questions to an issuer on the funding portal's website, deleting a third party's statements that are false, obscene, defamatory or irrelevant; (5) defining the layout, format or positioning of the offering on the funding portal's website; (6) providing market and news updates; and (7) declining to post an offering due to the offering not fitting into the type of offering that the funding portal seeks to limit itself to offering (e.g. small businesses, businesses in a specific geographical area, prohibiting certain lines of business (e.g. gambling establishments), etc.)

Customer Funds

A funding portal may not "hold, manage, possess, or otherwise handle investor funds or securities" (new section 3(a)(80)) but must ensure that ensure that all offering proceeds are only provided to the issuer when the aggregate capital raised from all investors is equal to or greater than a target offering amount, and allow all investors to cancel their commitments to invest, as the Commission shall, by rule, determine appropriate; (new section (4A(a)(7)). Thus, a funding portal must effectively ensure that funds are held in escrow but may not do so itself. The

Commission should provide guidance as to what sort of institutions may provide this service, what the funding portal's responsibilities regarding this requirement are, who should bear the cost of this service, who should bear the risks associated with providing this service and what the escrow agent's duties are and to whom.

Title IV — Small Company Capital Formation

Regulation A and the small issue exemption has effectively become a dead letter. Increasing the aggregate 12 month offering exemption amount to $50 million has the potential to make it relevant again for larger small firms and medium-sized firms seeking to raise capital. We do not believe any changes to Regulation A other than the dollar threshold amount are warranted at this time.

Congress intends for this exemption to be used. Thus, if this change does not result in any appreciable Regulation A filings then the Commission should seriously assess whether the regulatory burdens on issuers imposed by Regulation A should be reduced so as not to frustrate Congressional intent.

Title V — Private Company Flexibility and Growth

The NSBA has no comments regarding the regulatory framework regarding Title V at this time.

Title VI — Capital Expansion

The NSBA has no comments regarding the regulatory framework regarding Title VI at this time.

Title VII — Outreach on Changes to the Law

Section 701 of the Act provides that:

> The Securities and Exchange Commission shall provide online information and conduct outreach to inform small and medium sized businesses, women owned businesses, veteran owned businesses, and minority owned businesses of the changes made by this Act.

The Commission should work with the leading small business associations to achieve the outreach required by the Act. NSBA would be glad to assist the Commission in conducting outreach and providing small businesses with information about the opportunities created by the Act.

Sincerely,

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