

**Legislative Bulletin..... November 3, 2011**

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**H.R. 2930 – Entrepreneur Access to Capital Act  
(McHenry, R-NC)**

**Order of Business:** The legislation is scheduled to be considered on Thursday, November 3, 2011, under a structured rule. The rule provides each measure one hour of general debate equally divided and controlled by the chairs and ranking minority members of the Committee on Financial Services. Lastly the rule provides each measure a motion to recommit with or without instructions.

**Summary:** H.R. 2930 would amend the securities laws to provide for registration exemptions for certain crowdfunded securities, and for other purposes. The legislation amends section 4 of the Securities Act of 1933 by exempting transactions involving the issuances of securities for which:

- the aggregate annual amount raised through the issue of the securities is \$1,000,000 or less, or if the issuer provides potential investors with audited financial statements, \$2,000,000 or less;
- individual investments in the securities are limited to an aggregate annual amount equal to the lesser of \$10,000, and 10 percent of the investor's annual income;
- in the case of a transaction involving an intermediary between the issuer and the investor, the intermediary complies with the requirements under section 4A(a) of the Securities Act of 1933;
- in the case of a transaction not involving an intermediary between the issuer and the investor, the issuer complies with the requirements under section 4A(b) of the Securities Act of 1933.

H.R. 2930 also does the following:

**4A. Requirements with Certain Small Transaction**

The legislation requires a person acting as an intermediary in a transaction involving the issuance of securities to comply with the following requirements if the intermediary:

- warns investors, including on the intermediary's website, of the speculative nature generally applicable to investments in startups, emerging businesses, and small issuers, including risks in the secondary market related to illiquidity;
- warns investors that they are subject to the restriction on sales requirement described under subsection;
- takes reasonable measures to reduce the risk of fraud with respect to such transaction;
- provides the SEC with the intermediary's physical address, website address, and the names of the intermediary and employees of the person, and keep such information up-to-date;
- provides the SEC with continuous investor-level access to the intermediary's website;
- requires each potential investor to answer questions demonstrating competency in—
  - recognition of the level of risk generally applicable to investments in startups, emerging businesses, and small issuers;
  - risk of illiquidity; and
  - such other areas as the SEC may determine appropriate.
- requires the issuer to state a target offering amount and withhold capital formation proceeds until aggregate capital raised from investors other than the issuer is no less than 60 percent of the target offering amount;
- carries out a background check on the issuer's principals;
- provides the SEC with basic notice of the offering, not later than the first day funds are solicited from potential investors, including—
  - the issuer's name, legal status, physical address, and website address;
  - the names of the issuer's principals;
  - the stated purpose and intended use of the capital formation funds sought by the issuer; and

- the target offering amount.
- outsources cash-management functions to a qualified third party custodian, such as a traditional broker or dealer or insured depository institution;
- maintains such books and records as the SEC determines appropriate;
- makes available on the intermediary's website a method of communication that permits the issuer and investors to communicate with one another; and
- does not offer investment advice.

### **Requirements on Issuers if No Intermediary**

H.R. 2930 will require an issuer who offers securities without an intermediary to comply with the following requirements if the issuer:

- warns investors, including on the issuer's website, of the speculative nature generally applicable to investments in startups, emerging businesses, and small issuers, including risks in the secondary market related to illiquidity;
- warns investors that they are subject to the restriction on sales requirement;
- takes reasonable measures to reduce the risk of fraud with respect to such transaction;
- provides the SEC with the issuer's physical address, website address, and the names of the principals and employees of the issuers, and keeps such information up-to-date;
- provides the SEC with continuous investor-level access to the issuer's website;
- requires each potential investor to answer questions demonstrating competency in—
  - recognition of the level of risk generally applicable to investments in startups, emerging businesses, and small issuers;
  - risk of illiquidity; and
  - such other areas as the SEC may determine appropriate.
- states a target offering amount and withholds capital formation proceeds until the aggregate capital raised from investors other than the issuer is no less than 60 percent of the target offering amount;

- provides the SEC with basic notice of the offering, not later than the first day funds are solicited from potential investors, including—
  - the stated purpose and intended use of the capital formation funds sought by the issuer; and
  - the target offering amount.
- outsources cash-management functions to a qualified third party custodian, such as a traditional broker or dealer or insured depository institution;
- maintains such books and records as the SEC determines appropriate;
- makes available on the issuer's website a method of communication that permits the issuer and investors to communicate with one another;
- does not offer investment advice; and
- discloses to potential investors, on the issuer's website, that the issuer has an interest in the issuance.

H.R. 2930 will allow for an issuer or intermediary to rely on certifications provided by an investor to verify the investor's income. The legislation authorizes the SEC to make public the notices of:

- the intermediary's and issuer's physical address, website address, and the names of the intermediary and employees of the person, and keep such information up-to-date
- the offering, not later than the first day funds are solicited from potential investors, including—
  - the issuer's name, legal status, physical address, and website address;
  - the names of the issuer's principals;
  - the stated purpose and intended use of the capital formation funds sought by the issuer; and
  - the target offering amount.
- of the offering, not later than the first day funds are solicited from potential investors, including—
  - the stated purpose and intended use of the capital formation funds sought by the issuer; and

- the target offering amount.

## **Other Provisions**

H.R. 2930 prohibits investors from selling securities purchased through crowdfunding for one year, unless the securities are sold back to the issuer or to an accredited investor. The legislation requires that an intermediary to not be treated as a broker under securities laws. The legislation also requires that if an issuer raises capital using the methods described under this bill, nothing in this bill will be construed as preventing an issuer from raising capital through other methods not described.

H.R. 2930 requires the SEC to issue rules as are necessary for implementing the crowdfunding transactions as listed above and provide cost benefit analysis within 90 days of enactment. Also within 90 days of enactment the SEC must issue rules that disqualify from crowdfunding any issuers who have in the past been convicted of any felony or misdemeanor in connection with the purchase or sale of any security or involving the making of any false filing with the SEC.

Lastly, H.R, 2930 directs the SEC to make available to the states the information disclosed to it regarding the notice of crowdfunding offerings and the contact information for the intermediary or the issuer, as is relevant. The legislation also pre-empts state law by adding securities issued under crowdfunding agreements to the list of covered securities exempt from state law.

**Background:** The Securities Act of 1933 requires that investors receive financial and other significant information concerning securities being offered for public sale. The Securities Act of 1933 also prohibits deceit, misrepresentations, and other fraud in the sale of securities. The Securities Act of 1933 also gives the Securities and Exchange Commission (SEC) the authority to implement rules regarding general solicitation. The SEC currently prohibits the general solicitation for issuers of non-publicly traded securities, and thus prohibits crowdfunding. Current SEC regulations require that companies with a certain number of shareholders (or "holders of record") must register with the SEC, which triggers numerous reporting requirements.

According to the [committee report](#), "Crowdfunding is an increasingly popular method of capital formation, where, according to SEC Chairman Mary Schapiro, 'groups of people pool money typically comprised of very small individual contributions, to support an effort by others to accomplish a specific goal.' Current SEC regulations impede this innovative and lower-risk form of financing, by prohibiting general solicitation and advertisements for non-registered offerings and capping the number of shareholders for non-registered companies at 500."

**Committee Action:** H.R. 2930 was introduced by Rep. Patrick McHenry (R-NC) on September 14, 2011. On October 26, 2011 the Financial Services committee ordered

H.R. 2930, as amended, and favorably reported the legislation to the House by voice vote.

**Administration Position:** According to the Statement of Administration Policy, “the Administration supports House passage of H.R. 2930. In the President’s September 8th address to a Joint Session of Congress on jobs and the economy, he called for cutting away the red tape that prevents many rapidly growing startup companies from raising needed capital, including through a ‘crowdfunding’ exemption from the requirement to register public securities offerings with the Securities and Exchange Commission. This proposal, which would enable greater flexibility in soliciting relatively small equity investments, grew out of the President’s Startup America initiative and has been endorsed by the President’s Council on Jobs and Competitiveness. H.R. 2930 is broadly consistent with the President’s proposal. This bill will make it easier for entrepreneurs to raise capital and create jobs.”

**Cost to Taxpayers:** According to the [Congressional Budget Office \(CBO\) report](#), “implementing H.R. 2930 would have a negligible impact on the SEC’s workload, and any change in agency spending that is subject to appropriation would not be significant. Enacting H.R. 2930 would not affect direct spending or revenues.”

**Does the Bill Expand the Size and Scope of the Federal Government?:** No.

**Does the Bill Contain Any New State-Government, Local-Government, or Private-Sector Mandates?:** According to [CBO](#), “H.R. 2930 would impose an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA) by prohibiting states from requiring issuers of some securities to register the securities with the state, or to pay registration fees, prior to issuance. As defined in UMRA, the direct costs of a mandate include any amounts that state governments would be prohibited from rising in revenues as a result of the mandate. The cost of the mandate would be the amount of fee revenue that states would be precluded from collecting. Based on information from the SEC and industry sources, CBO estimates that forgone revenues would be small and would not exceed the threshold established in UMRA for intergovernmental mandates (\$71 million in 2011, adjusted annually for inflation). H.R. 2930 contains no new private-sector mandates as defined in UMRA.”

**Does the Bill Comply with House Rules Regarding Earmarks/Limited Tax Benefits/Limited Tariff Benefits?:** According to the [committee report](#), “H.R. 2930 does not contain any congressional earmarks, limited tax benefits, or limited tariff benefits as defined in clause 9 of rule XXI.”

**Constitutional Authority:** According Rep. McHenry’s statement of constitutional authority, “Congress has the power to enact this legislation pursuant to the following: Article One, Section Eight.”

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## **H.R. 2940 – Access to Capital for Job Creators Act (McCarthy, R-CA)**

**Order of Business:** The legislation is scheduled to be considered on Thursday, November 3, 2011, under a structured rule. The rule provides each measure one hour of general debate equally divided and controlled by the chairs and ranking minority members of the Committee on Financial Services. Lastly the rule provides each measure a motion to recommit with or without instructions.

**Summary:** H.R. 2940 directs the Securities and Exchange Commission (SEC) to eliminate the prohibition against general solicitation as a requirement for a certain exemption under Regulation D Rule 506. The legislation authorizes that (not later than 90 days after enactment) the SEC to revise the Securities Act of 1933 to remove the prohibition against general solicitation or advertising on sales of non-publicly traded securities, provided that all purchasers of the securities are "accredited investors." The legislation requires the securities issuer to verify that the purchasers are accredited investors. Under current law, accredited investors are defined to include banks, insurance companies, registered investment companies, corporations and charitable organizations with more that \$5 million in assets, and wealthy individuals. In total, the bill makes the exemption under the SEC's Regulation D Rule 506 available to issuers even if the securities are marketed through a general solicitation or advertising so long as the purchasers are "accredited investors."

**Background:** Currently, [SEC's Regulation D Rule 506](#) provides that an offering is exempt from registration if the fund raises money from no more than 35 non-accredited investors, provided that all non-accredited investors, either alone or with his purchaser representative(s), has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment. This rule does allow a hedge fund to sell an unlimited dollar amount of interests. Section 4 of the Securities Act of 1933 provides various exemptions from the registration provisions of Section 5. According to the [committee report](#),

“Equity financing, in which investors purchase ownership stakes in a company in exchange for a share of the company's future profits, is an increasingly essential means of providing small companies with the capital they need to grow and create jobs. Unfortunately, regulations such as the prohibition of general solicitation and advertising in Regulation D Rule 506 offerings inhibit capital formation.

The Securities Act of 1933 requires that any offer to sell securities must either be registered with the SEC or meet an exemption. Regulation D Rule 506 is an exemption that allows companies to raise capital as long as they do not market their securities through general solicitations or advertising. This prohibition on general solicitation and advertising has been interpreted to mean that potential investors must have an existing relationship with the company before they can be

notified that unregistered securities are available for purchase. Requiring potential investors to have an existing relationship with the company significantly limits the pool of potential investors and severely hampers the ability of small companies to raise capital and create jobs.”

According to [Congressional Budget Office \(CBO\) report](#), “under current law, securities may be sold through private offerings, that is, sales that are made to a limited number of eligible investors rather than to the general public, without being registered with the Securities and Exchange Commission (SEC). Issuers of securities through such offerings are prohibited from using general solicitation or advertising to market the securities. H.R. 2940 would eliminate that prohibition, allowing an issuer to advertise the availability of a private offering to the general public, and would require issuers to verify that purchasers meet eligibility requirements as defined in the statute.”

**Committee Action:** H.R. 2940 was introduced by Rep. Kevin McCarthy (R-CA) on September 15, 2011. On October 26, 2011 the Financial Services committee ordered H.R. 2940, as amended, and favorably reported the legislation to the House by voice vote.

**Administration Position:** A Statement of Administration Policy has not been released.

**Cost to Taxpayers:** According to the [CBO report](#), “implementing H.R. 2940 would have a negligible effect on SEC’s workload, and any change in agency spending that is subject to appropriation would not be significant. Enacting H.R. 2940 would not affect direct spending or revenues.”

**Does the Bill Expand the Size and Scope of the Federal Government?:** No.

**Does the Bill Contain Any New State-Government, Local-Government, or Private-Sector Mandates?:** According to [CBO](#), “H.R. 2940 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would not affect the budgets of state, local, or tribal governments.”

**Does the Bill Comply with House Rules Regarding Earmarks/Limited Tax Benefits/Limited Tariff Benefits?:** According to the [committee report](#), “H.R. 2940 does not contain any congressional earmarks, limited tax benefits, or limited tariff benefits as defined in clause 9 of rule XXI.”

**Constitutional Authority:** According Rep. McCarthy’s statement of constitutional authority, “Congress has the power to enact this legislation pursuant to the following: Article 1, Section 8.”

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