

MEMORANDUM:

FROM: PolitiHacks
DATE: June 28, 2012
RE: House Hearing on JOBS Act, SEC Oversight

SUMMARY:

- Startups and investors remain excited about crowdfunding, JOBS Act
- Senate changes before final passage remain a cause of concern re: restrictions, regulations
- Prefer regulations to be directed at crowdfunding platforms and brokers, not founders
- SEC missing first deadline: 7/4 lifting of general solicitation ban
- Solution is engagement through SEC to make sure crowdfunding works

CALL TO ACTION: The SEC has wide discretion in implementing the crowdfunding provisions of the JOBS Act; therefore, further startup community engagement is needed to fix SEC delays.

Over the past two days, the House Oversight and Government Reform Subcommittee on TARP, Financial Services, and Bailouts of Public and Private Programs (committee), has heard testimony from a panel of experts composed of industry and academic representatives. Testimony touched on the implementation of portions of the JOBS Act, which aims to eliminate government barriers for small businesses and startups from raising capital and growth.

Passed unanimously on April 5, 2012, by both Chambers with the full support of the Obama Administration and Republican House leadership, the JOBS Act makes significant changes to the federal securities law and requires the SEC to implement these rules within the next 270 days.

The SEC's first major deadline to lift the ban on general solicitation is set for July 4th. The SEC has already confirmed that it will not meet this deadline. The deadline for Title III—crowdfunding—is set for December 31.

Overall, the first day's panel expressed support of crowdfunding and its potential to serve as a tool in re-energizing America's economy. Panelists cited effects such as an injection in investor confidence and the wisdom of crowds as positive results of crowdfunding offerings.

House Committee Chairman Patrick McHenry (R-NC), who first introduced equity-based crowdfunding legislation (H.R. 2930) in 2011, highlighted a source of delays and problems:

“unfortunately, due to a few Senators who I think misinterpreted the spirit and promise of crowdfunding, the Senate inserted “imperfect” provisions that jeopardize the vitality of equity-based crowdfunding and complicate SEC rulemaking. As the SEC considers comments regarding crowdfunding, the crowdfunding title of the JOBS Act, it's clear that the Senate's eleventh hour changes have unnecessarily made sections of the JOBS Act ambiguous and inconsistent.”

Underlying the enthusiasm for the opportunities crowdfunding may allow, it was clear that the Wednesday panel of experts had concerns related to bill's legislative language. The panel cautioned the SEC to consider the following:

- *That the SEC clarifies and writes in its own plain-English standard the regulations.* Given the range of experience, financial literacy and legal sophistication often associated with the buying, trading and selling of public stock, it is imperative that the language be clear and concise while consumable to all actors involved in the process.
- *That the SEC exercises its discretion in rulemaking;* by minimizing expenses to entrepreneurs and small businesses that seek to crowdfund. Professor Steven Bradford proposed that SEC regulations “should be as light-handed and unobtrusive as possible”. He argues that additional regulation would “significantly reduce the utility of the exemption and would be inconsistent with the intent of the JOBS Act.”
- *That the burden of additional regulation and disclosure be placed on crowdfunding intermediaries—brokers and funding portals—rather than on entrepreneurs raising funds.*

Potential for lawsuits to disrupt implementation: Professor Coffee questioned the ability of the SEC to promulgate rules quickly, while facing a bench (D.C. Circuit) that is “unsympathetic” and “skeptical” of rulemaking in general. Specifically, he claims that much of Section 4A is “left open-ended and could be subjected to a cost/benefit-based judicial review.” He also notes that, “the great danger is that excessive deregulation could cause investors to lose confidence in the offering process.”

This morning’s hearing featured U.S. SEC Chairwoman, Mary Schapiro. Chairwoman Schapiro addressed concerns on whether the SEC could create rules in a cost effective way to allow crowdfunding to take place; so that smaller issuances do not need to bear the same costs/burdens as larger issuances.

Ms. Schapiro also mentioned that she tentatively favored *adding language to limit liability for issuers who make “innocent and immaterial” (Rule 508 Regulation D) mistakes*—also addressed by Professor Coffee—when using crowdfunding to raise capital. The protection currently applies to private securities offerings limited to wealthy people and institutions that meet the definition of “accredited investor” (Reg D offerings).

She also assured Chairman McHenry that while the additional layers added by the Senate provisions may make crowdfunding impractical due to high costs (though a cost/benefit analysis has yet to be completed), the Commission will follow “the language of the statute but will create exemptions that will actually make crowdfunding work.”

The takeaway is that the SEC has wide discretion in implementing the JOBS Act, and further engagement from the startup community is needed to overcome SEC delays.

For additional information, we recommend the following reading: <http://pandodaily.com/2012/06/29/jobs-act-tangled-in-red-tape-coming-2014-at-the-earliest/>