



April 13, 2016

The Honorable Jeb Hensarling
Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Hensarling and Ranking Member Waters:

Engine commends you for holding today's hearing entitled "The JOBS Act at Four: Examining Its Impact and Proposals to Further Enhance Capital Formation." Engine is a non-profit and advocacy group that supports high-growth, high-tech startups through research, advocacy, and policy analysis. We work to foster and promote forward-looking government policies and a regulatory environment in which entrepreneurs can launch innovative, new companies that grow and thrive. Through conversations with diverse startups across the country, we know that capital access remains a top challenge in getting a business off the ground.

The Jumpstart Our Business Startups (JOBS) Act has played a vital role in enhancing access to investment capital for entrepreneurs. In the four years since its passage, the JOBS Act has already had an immense impact on the startup economy. The IPO "on-ramp" has simplified the process for going public, general solicitation under Regulation D has allowed startups to publicly solicit investments from accredited investors, Regulation A+ has created a means for startups to raise up to \$50 million from the public, and regulation crowdfunding, set to go live in May, will allow startups to raise capital from everyday investors over the Internet.

However, the positive steps taken in the JOBS Act are just that—steps. Steps in a larger effort towards improving capital access for young firms that have the potential to make an outsized impact on our economy. As the effects of the JOBS Act are realized, there will be both successes and failures. Importantly, modifications may need to be made to broader capital access and securities policies, and lawmakers must be open to refining and enhancing the existing framework to better enable capital formation for entrepreneurs and startups.

Engine supports the four bills being discussed at today's hearing and believes that they represent commonsense, meaningful reforms that will improve the current capital access landscape for innovators across the U.S.

H.R. 4850, the “Micro Offering Safe Harbor Act”

A large portion of startups rely on small, non-public offerings (also known as a “private placements”), such as a “friends and family” round, to raise initial, early-stage, seed capital. In fact, a 2014 survey by the Kauffman Foundation found that over 28 percent of startups raised some amount of funding from their personal network.¹ However, the Securities Act does not clearly define what constitutes a public offering, or conversely, a non-public offering, making it easy for early-stage companies to unintentionally run afoul of the law when doing a private placement.

H.R. 4850 would create three bright-line safe harbor exemptions for non-public offerings. Under the legislation, offerings would be exempt from registration with the Securities and Exchange Commission (SEC) if each purchaser has a substantive pre-existing relationship with the issuer, there are 35 or fewer purchasers, or the amount being raised does not exceed \$500,000. These exemptions would bring much needed clarity for startups and ensure that a company doing a small, private placement is not forced to complete burdensome paperwork or spend precious resources on an expensive lawyer in order to comply with ambiguous regulatory requirements. Finally, H.R. 4850 would exempt these micro-offerings from state blue sky registration and qualification laws, decreasing the regulatory complexity for startups doing a small raise.

H.R. 4852, the “Private Placement Improvement Act of 2016”

In 2013, the SEC lifted the ban on general solicitation, pursuant to Title II of the JOBS Act, allowing companies to publicly solicit funds from accredited investors under Rule 506(c) of Regulation D. This change has enabled the emergence of numerous crowdfunding portals where accredited investors can browse through and connect with hundreds of startups and entrepreneurs seeking funding. However, since the ban on general solicitation was lifted in 2013, only 2 percent of capital raised in Regulation D offerings has been raised through this new pathway.² Additionally, when the SEC lifted the ban on general solicitation, they also proposed new, substantial burdens on Regulation D issuers that were arguably not consistent with the original intent of the JOBS Act.

H.R. 4852 would clarify Congressional intent under the JOBS Act and explicitly eliminate a number of burdensome requirements for startups under Regulation D, such as submitting an additional Form D filing to the SEC both prior to and at the conclusion of an offering. This would ensure that startups do not face outsized burdens in raising funds through general solicitation, either now or in the future. Additionally, it would likely improve the attractiveness of conducting offerings under this new framework.

¹ Kauffman Foundation, “How Entrepreneurs Access Capital and Get Funded,” June 2, 2015, http://www.kauffman.org/~media/kauffman_org/resources/2015/entrepreneurship%20policy%20digest/june%202015/how_entrepreneurs_access_capital_and_get_funded.pdf

² Securities and Exchange Commission, “Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2014,” October 2015, <https://www.sec.gov/dera/staff-papers/white-papers/unregistered-offering10-2015.pdf>

H.R. 4854, the “Supporting America’s Innovators Act of 2016”

As noted above, the JOBS Act has enabled a nascent ecosystem of accredited angel investing portals under Rule 506 of Regulation D. One successful tool that has emerged on a number of these portals is what is known as a syndicate. Syndicates allow for a group of accredited investors to pool their funds into a larger LLC. This approach simplifies the transaction for a startup, which ends up with only one investor on its cap sheet—the syndicate LLC—instead of numerous individual investors. However, under the securities law, if a syndicate LLC exceeds 99 investors, an SEC registration requirement is triggered. As a result, most syndicates are currently capped at 99 investors. This is problematic for two reasons: first, it limits investor participation, and second, it limits the amount of capital that startups receive from a syndicate, since there may be investors who would like to contribute additional funds but are excluded from the syndicate.

H.R. 4854 aims to remedy this “99 Investor Problem” by raising the cap to 500 investors for qualifying venture capital funds that purchase no more than \$10 million in securities per round. This narrow fix would address the above issues and enhance Regulation D for both investors and issuers.

H.R. 4855, the 'Fix Crowdfunding Act"

For the startup community, one of the most heralded provisions of the JOBS Act was Title III regulation crowdfunding. Engine applauds the SEC for finalizing the rules in October of last year, and we continue to believe that investment crowdfunding has the potential to revolutionize startup financing and enable new groups of entrepreneurs to participate in the startup ecosystem. However, we have advocated for several basic adjustments to the regulation crowdfunding framework that could help create a more vibrant non-accredited investor crowdfunding market.³

H.R. 4855 would implement a number of these fixes, and we appreciate Representative McHenry’s continued efforts to make investment crowdfunding more attractive and viable for young companies. First, the bill would increase the annual raise limit on issuers from \$1 million to \$5 million. We have advocated for this change in the past, noting that the \$1 million cap is arbitrary and will exclude a large swath of potential issuers.⁴ Additionally, H.R. 4855 would allow for innovative special purpose vehicles (SPVs), such as syndicates, to participate in this new non-accredited framework. SPVs are useful for mitigating investor risk, diversifying investor portfolios, and simplifying the fundraising process for issuers.⁵ Finally, the bill would give portals more flexibility to vet offerings on their site and includes an important “testing the waters” provision that would allow issuers to communicate with potential investors to gauge interest before incurring burdensome filing and preparation costs. We have supported these two reforms to the existing framework in the past, and we remain hopeful that these changes will help investment crowdfunding realize its full potential.⁶

³ Engine Advocacy, “Financing the New Innovation Economy: Making Investment Crowdfunding Work Better for Startups and Investors,” October 2015, <http://engine.is/wp-content/uploads/Crowdfunding-White-Paper.pdf>

⁴ *Id.* at 27.

⁵ *Id.* at 30.

⁶ *Id.* at 29 and 32.

Collectively, the above mentioned bills would greatly enhance a number of the capital-raising options for small private companies. Engine appreciates the Committee's consideration of these policies and its continued engagement on capital access issues for emerging firms. We look forward to further engagement with the bills' sponsors and Committee members on these important issues.

Sincerely,

A handwritten signature in black ink, appearing to read 'Evan Enstrom', with a stylized flourish at the end.

Evan Enstrom
Executive Director, Engine

cc: Members of the House Committee on Financial Services