NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.
750 First Street N.E., Suite 1140
Washington, D.C. 20002
202/737-0900
Fax: 202/783-3571
www.nasaa.org

NASAA

June 15, 2011

The Honorable Spencer Bachus
Chairman
House Financial Services Committee
Washington, DC 20515

The Honorable Barney Frank
Ranking Member
House Financial Services Committee
Washington, DC 20515

The Honorable Scott Garrett
Chairman
Capital Markets and Government-Sponsored Enterprises Subcommittee
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
Capital Markets and Government-Sponsored Enterprises Subcommittee
Washington, DC 20515

RE: H.R. 1070 and H.R. 1082

Dear Chairman Bachus, Ranking Member Frank, Subcommittee Chairman Garrett and Subcommittee Ranking Member Waters:

On behalf of the North American Securities Administrators Association ("NASAA")[1] I am pleased to provide comment and recommendations on two bills the Capital Markets Subcommittee considered on May 3.

H.R. 1070 – the Small Company Capital Formation Act

NASAA fully appreciates Congressional efforts to reduce burdensome regulation on small business. However, NASAA firmly believes that these efforts will not be effective if they eliminate necessary disclosure requirements or otherwise limit the states' ability to protect investors.

The comments below first identify a troublesome amendment that, if improperly construed, could seriously jeopardize the states' ability to protect investors. The subsequent sections discuss the substance of the original bill by highlighting the need to retain investor protections and providing one possible way to reduce regulatory burdens in a manner consistent with investor protection.

[1] The oldest international organization devoted to investor protection, the North American Securities Administrators, Inc. 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.

The Schweikert Amendment

On May 3, 2011, Representative David Schweikert introduced an amendment to H.R. 1070 that provides in pertinent part that "[a]ny securities exempted under this subsection that are offered by any means other than through a broker or dealer shall not be covered securities within the meaning of section 18(b) or exempt from State regulation under section 18(a)." Representative Schweikert assured the Subcommittee that the amendment would only clarify that "even … if you're not a broker-dealer, you also are subject to the blue sky laws."

NASAA is concerned that the wording of the amendment could be construed to limit state authority despite Representative Schweikert's assurances to the contrary. By stating that non-broker-sold offerings will not be covered securities, the amendment leaves open, by implication, the argument that broker-sold Regulation A offerings could be construed to be covered securities. Accordingly, NASAA strongly urges the Committee to remove or clarify this language to avoid any unintended limitations on the states' ability to protect investors.

Reducing Regulatory Burdens While Promoting Investor Protection

State securities regulators have long been leaders in developing and administering programs that help to facilitate small business capital formation consistent with our mission of investor protection. These efforts consist of specialized registration and exemption programs designed to help local entrepreneurs raise seed capital to expand their businesses through small stock offerings; review programs that create uniformity and decrease costs and effort; and outreach efforts and technical assistance that help small businesses navigate through the regulatory process.

Accordingly, we support the bill's premise of reducing burdensome regulation on small business, and want to share our perspective regarding H.R. 1070. We believe the disclosure and investor protection provisions contained in both the registration and exemption provisions of the Securities Act of 1933 ("Securities Act") and the rules promulgated thereunder, as well as the applicable provisions of the Securities Exchange Act of 1934 ("Exchange Act"), are not unnecessarily burdensome. Rather, these provisions are absolutely necessary for fair and efficient capital formation considering the speculative nature of the businesses that would take advantage of the changes proposed by H.R. 1070.

The fundamental goal of both the Securities Act and Exchange Act is disclosure, because it ensures that investors receive accurate and sufficient material information prior to making an investment decision. While filing a registration statement and "going public" involves some expenses, much of this cost results from requirements that are necessary to ensure adequate disclosure of material information and provide sufficient investor protection. This system of disclosure ensures investor faith in the integrity of the public markets. Investors are more likely to invest when they receive necessary material information through this type of system that requires accurate, reviewed information, and that also provides a remedy in cases of fraud. Growth follows investment, and investment follows confidence in the system.

State and federal securities regulators have long exempted smaller companies that sell securities privately or in a limited manner from certain registration and reporting requirements. However, these exemptions are available only when disclosure through the filing of a registration statement would not further the cause of investor protection. For example, Section 3(b) of the Securities Act

(pursuant to which Regulation A is promulgated) allows the SEC to exempt an issuer from registration if it is not necessary because of the small amount involved or the limited character of the public offering. Similarly, Section 4(2) of the Securities Act exempts transactions not involving any public offering but only where certain investor protections are present. For example, the private offerings typically must be limited and conducted without advertising or solicitation. Additionally, appropriate resale limitations must be in place, and investors must be financially sophisticated or be advised by someone who has the requisite sophistication.

Currently, Regulation A blends certain elements of a registered offering and an exempt offering. It is, to some degree, a mini-public offering on a private offering scale. It does not have all of the investor protection provisions of a typical registered offering. But as currently utilized, Regulation A does retain the investor protections contemplated by Section 3(b) of the Securities Act because of the small amount involved.

The changes proposed by H.R. 1070 would afford small, untested companies all of the benefits of a public offering, but would strip the Regulation A exempt offerings of all investor protections. H.R. 1070 would open up a quasi-public market without the market integrity and investor protections that currently exist in both the public offering and exempted offering setting. It would result in the broad marketing and sale of the riskiest, most speculative securities to the least sophisticated investors.

NASAA's Model Accredited Investor Exemption

NASAA supports SEC Chairman Mary Schapiro's plan to establish the Advisory Committee on Small and Emerging Companies, which is to develop ideas for the Commission about ways to reduce the regulatory burdens on small business capital formation in a manner consistent with investor protection.

One option for the Advisory Committee to consider is the Model Accredited Investor Exemption ("MAIE"), which was adopted by NASAA in 1997. This exemption, subsequently adopted by 32 states, maintains appropriate investor protections while giving small businesses the ability to conduct general solicitation and a cost-effective means to raise capital. The MAIE allows the issuer to use a general advertisement to "test the waters." There is no limit on the number of investors under the MAIE, and there is no limit on the amount an issuer may raise in an offering under the MAIE. Although only accredited investors may purchase securities offered through the MAIE, dissemination of the general announcement of the proposed offering to non-accredited investors will not disqualify the issuer from claiming the exemption. The MAIE also contains a number of important provisions that reflect the speculative nature of the offerings and the need for reasonable investor protections, such as limiting sales to accredited investors. Moreover, the MAIE is not available to issuers in the development stage that either have no specific business plan or purpose, or have indicated its business plan is to engage in a merger with an unidentified company.

Small businesses, typically with no operational history, untested technologies, and limited resources, are extremely speculative. It is absolutely vital that any efforts to lessen the requirements of the capital raising process for these companies maintain appropriate, necessary investor protections. H.R. 1070 as currently drafted focuses entirely on the desires of the small business issuer and ignores the need for reasonable investor protections that are currently contained in existing law. While H.R. 1070 will allow business to engage in general solicitation and advertising to sell their securities, it will also remove all of the other reasonable investor protections that are absolutely

necessary when a small business is looking to publicly market and sell its securities. The MAIE, or a provision containing similar protections, is a reasonable middle ground that was adopted by NASAA but, as yet, has not been adopted by the SEC. This is one strong, workable option that should be considered before final action is taken on H.R. 1070.

H.R. 1082 – the Small Business Capital Access and Job Preservation Act

During the legislative process leading to enactment of Dodd-Frank, NASAA supported efforts to strengthen the regulation of investment advisers by "switching" regulation of mid-sized investment advisers from the SEC to oversight by state securities regulators. NASAA also supported efforts to close long-standing loopholes that had previously allowed advisers to private funds to avoid regulatory scrutiny.

Ultimately, Dodd Frank provided exemptions for advisers who solely advise "venture capital funds" (to be defined by the SEC) and for advisers who solely advise private funds and have assets under management in the United States of less than $150 million; however in each case, such exempted advisers will still be subject to recordkeeping and reporting requirements (to be determined by the SEC). Certain advisers to family offices, foreign private advisers and advisers to small business investment companies also will be exempt from registration. The Senate/House conference committee *removed* a provision in the Senate version of the bill which would have exempted private equity fund advisers from registration with the SEC. Thus, the registration and reporting requirements currently in place for private advisers would apply to private equity fund advisers.

H.R. 1082 would insert an exemption for private equity fund advisers from registration or reporting requirements. At the same time, the bill would require that advisers to private equity funds maintain records and provide reports as the SEC determines is necessary and appropriate. The bill gives the SEC 6 months to promulgate rules necessary to establish the record keeping and reporting obligations of these advisers. At least two fundamental components of the proposed legislation are so vague that they undermine any benefits the bill purports to confer on small business.

Definition of Private Equity Fund

First, the legislation does not define "private equity fund" but rather delegates this task to the SEC. According to Subsection 203(2)(B) of the bill, the SEC is required within 6 months *after* enactment of the legislation to define the term.

In essence, the amendment appears to treat "private equity funds" similar to venture capital funds for the purposes of exemption. However, without more specificity and a clear definition of what constitutes a "private equity fund", it is unknown what types of entities are covered by the exemption. Absent clarification of the universe of "private equity," any assessment of risk to financial stability posed by such capital investment would be invalid. In any event, it seems unwise to establish an exemption before defining what is covered by the exemption.

Reporting Requirements

Second, the bill is unclear as to what, if any, reporting requirements are required for private equity fund advisers. Section 2 is entitled: "Registration *and Reporting Exemptions* Relating to Private Equity Fund Advisors", which appears to indicate that an adviser to a "private equity fund," regardless of assets under management, would be exempt from both registration and reporting requirements. Subsection 203(o)(1) provides that "no investment adviser shall be subject to the registration *or reporting requirements* of this title with respect to the provision of investment advice relating to a private equity fund or funds." This proposed exemption from all registration and reporting requirements would likely have the unintended consequence of depriving the SEC of important regulatory information critical for assessing risk and protecting investors.

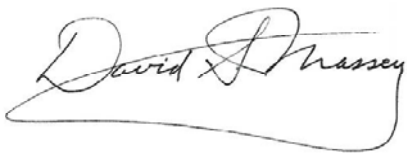
Scope of Exemption

As drafted the bill's scope appears to cover all investment advisers who advise undefined "private equity funds." Unlike exemptions established in Dodd-Frank for advisers to private funds, it is not limited to advisers who *solely* advise one type of fund. For instance, the exemption for advisers to venture capital funds is limited to advisers who solely advise venture capital funds. This is not the case for H.R. 1082 and the bill, as drafted, would exceed the limitations of the exemptions available to private funds and venture capital funds.

While NASAA understands the desire to facilitate job creation, we would respectfully point out that creating exemptions from important investor protection statutes may not be the best option. The registration regimes long in place for advisers and recently the reporting regimes established under Dodd-Frank for certain private fund advisers are designed to help insure that regulators and investors have access to important information. This information is critical to regulators and investors alike. Regulators use it to measure risk and assess compliance. Investors use this information to guide choices in picking advisers and understanding their operations.

We look forward to working with you as these bills move through the legislative process. If you have questions, or if NASAA can be of assistance, please contact me or Joseph Brady, NASAA's Deputy General Counsel.

Yours,



David S. Massey
North Carolina Deputy Securities Administrator
NASAA President

cc: House Financial Services Committee Members