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**NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.**

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March 5, 2012

The Honorable John Boehner  
Speaker  
U.S. House of Representatives  
H-232 The Capitol  
Washington, DC 20515

The Honorable Nancy Pelosi  
Minority Leader  
U.S. House of Representatives  
H-204, US Capitol  
Washington, DC 20515

*Re: H.R. 3606, The Jumpstart Our Business Startups Act*

Dear Mr. Speaker and Madam Leader:

On behalf of the North American Securities Administrators Association (NASAA)<sup>1</sup>, I am writing to express strong concern regarding several provisions that have been included in H.R. 3606, the Jumpstart Our Business Startups Act, which the House is scheduled to consider this week.

We applaud Congress' desire to facilitate access to capital for new and small businesses. State securities regulators support efforts by Congress to ensure that laws facilitating the raising of capital are modern and efficient, and that Americans are encouraged to raise money to invest in the economy. It is critical that in doing so, Congress not discard basic investor protections. Investment fraud is real, and in small exempted offerings can be particularly pervasive. Expanded access to capital markets for startups and small businesses may be beneficial, but only insofar as investors remain confident that they are protected, that transparency in the marketplace is preserved, and that investment opportunities are legitimate.

State securities regulators are acutely aware of today's difficult economic environment, and its effects on job growth. Small businesses are important to job growth, and to improving the economy. However, by placing unnecessary limits on the ability of state securities regulators to protect retail investors from the risks associated with smaller, speculative investments, Congress is poised to enact policies that, although intended to strengthen the economy, will likely have precisely the opposite effect.

The JOBS Act represents a repackaging of what were originally seven bills, reorganized into a single bill, with six distinct Titles and twenty-one sections.<sup>2</sup> While NASAA believes virtually every Title of this bill would benefit from greater scrutiny, we will confine our comments today to those Titles and Sections of H.R. 3606 that pose the most urgent risk to the average, "Main Street" investors that are NASAA's principal concern.

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<sup>1</sup> 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.

<sup>2</sup> H.R. 3606 as reported by the Committee on Financial Services, H.R. 1070 EH, H.R. 2930 EH, H.R. 2940 EH, H.R. 2170 as reported by the Committee on Financial Services, and H.R. 4088 IH

## **Title II - The Access to Capital for Job Creators Act**

Title II of the JOBS Act is identical to H.R. 2940, the Access to Capital for Job Creators Act, which passed the House last fall.

### **Section 201:**

Sec. 201 of the JOBS Act would repeal the SEC's ban on general solicitation under Regulation D Rule 506, and amend Section 4(2) of the Securities Act of 1933 to allow general solicitation in transactions "not involving any public offering, whether or not such transaction involve general solicitation or general advertising."

#### *General Solicitation of Accredited Investors in Regulation D Rule 506 Offerings*

NASAA has repeatedly expressed its concern to Congress about allowing general solicitation in rule 506 (Regulation D) offerings.

Since the enactment of NSMIA<sup>3</sup>, Regulation D, Rule 506 offerings - which are designed to be private offerings - have received virtually no regulatory scrutiny, and have become a haven for investment fraud. Moreover, unlike other types of Regulation D offerings, where the size of the offering is capped<sup>4</sup>, the amount of money that an issuer can raise under Rule 506 is unlimited, and hence the opportunity for fraud on a massive scale is, in this area, especially acute. Given state experience with Regulation D offerings, and the significant fraud and investor losses associated with them, NASAA opposes H.R. 2940.

#### *General Solicitation of Unaccredited Investors in Section 4(2) Offerings*

As amended by the Financial Services Committee, and as included in H.R. 2940, Section 201 would go beyond even the stated intention of the Committee by allowing public advertising in **all** offerings made under Section 4(2) of the Securities Act of 1933. The distinction between repealing the general solicitation prohibition for offerings made under Regulation D, Rule 506, and amending the entirety of Section 4(2), is a crucial one, and one that in its present form the JOBS Act fails to contemplate.

In its present form, the JOBS Act would permit general solicitation in all private placements, including those not restricted to "accredited investors," or covered by the investor protections associated with the Regulation D, Rule 506 "safe harbor."

State securities regulators are deeply concerned that if Section 201 of the JOBS Act is passed in its present form, the Internet will be flooded with new securities offerings, and there will be no way for regulators – or prospective investors - to reasonably determine if the particular issuer is a legitimate business, or a criminal with good computer skills. Simply put, Paragraph (a) of Section 201 will create chaos and confusion in the market and destroy investor trust, making it harder-not easier-for legitimate small businesses to access capital.

## **Title III - The Entrepreneur Access to Capital Act**

Title III of the JOBS Act is identical to H.R. 2930, the Entrepreneur Access to Capital Act, which was approved by the House last fall.

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<sup>3</sup> The National Securities Markets Improvement Act of 1996

<sup>4</sup> For example, Rule 504 offerings are capped at \$1 million; Rule 505 offerings are capped at \$5 million.

While intending to promote an internet-based fundraising technique known as "crowdfunding" as a tool for investment, this legislation will needlessly preempt state securities laws and weaken important investor protections. NASAA appreciates that the concept of crowdfunding is appealing in many respects because it provides small, innovative enterprises, and access to capital that might not otherwise be available. Indeed, this is precisely the reason that states are now considering adopting a model rule that would establish a more modest exemption for crowdfunding as it is traditionally understood, with individual investments capped at several hundred dollars per investor.

### **Section 301: Individual Investment Limit**

Section 301 contemplates a hard-cap on individual crowdfunding investments that goes far beyond anything that is being contemplated by the states, or even by the overwhelming majority of advocates of crowdfunding. By setting an individual investment cap of 10 percent of annual income, or \$10,000, H.R. 2930 will create an exemption that will expose many more American families to potentially catastrophic financial harm.

NASAA recognizes that for certain very wealthy individuals, or seasoned investors, a cap of \$10,000 may make sense. Unfortunately, Sec. 301 fails to distinguish between these few wealthy, sophisticated investors, and the general investing public, imposing a \$10,000 cap on both groups. Given that most U.S. households have a relatively modest amount of savings, in the majority of cases a loss of \$10,000, in even a single case, can be financially crippling.<sup>5</sup>

NASAA believes a superior approach to limiting individual investment amounts would be a scaled approach that would cap most investments at a modest level, but allow experienced investors, who can afford to sustain higher losses, to invest up to \$10,000.

### **Section 301: Aggregate Offering Limit**

Section 301 would also permit businesses to solicit investments of up to \$2 million, in increments of \$10,000 per investment. Such a high cap on aggregate investment makes the bill inconsistent with the expressed rationale for the crowdfunding exception.

Registration and filing requirements at both the state and federal level exist to protect investors. A company that is sufficiently large to warrant the raising of \$2 million in investment capital is also a company that can afford to comply with the applicable registration and filing requirements at both the state and federal level.

### **Section 303: Preemption of State Law**

Section 303 would preempt state laws requiring disclosures, or reviewing exempted investment offerings, before they are sold to the public. The authority to require such filings is critical to the ability of states to get "under the hood" of an offering to make sure that it is what it says it is. Moreover, as a matter of principle and policy, NASAA ardently believes that review of offerings of this size should remain primarily the responsibility of the states. State regulators are closer, more accessible, and more in touch with the local and regional economic issues that affect both the issuer and the investor in a small business offering.

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<sup>5</sup> According to the U.S. Department of Labor, the average American household takes in \$63,091 per year from income and investments, before taxes, and spends \$49,638 a year on a range of necessary and desired expenditures. (Source: *Consumer Expenditures*, U.S. Bureau of Labor Statistics, April 2010)

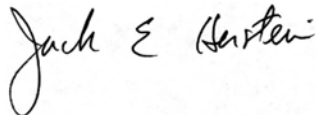
Preempting state authority is a very serious step and not something that should be undertaken lightly or without careful deliberation, including a thorough examination of all available alternatives. In this case, preemption for a very new and untested concept to raise capital, without a demonstrable history of reliability, is especially unwarranted, as the states have far more experience with crowdfunding than Congress or the SEC, and as the states have historically been the primary “cops on the beat” in the regulation of all areas of small business capital formation.

**Instead of preempting states, Congress should allow the states to take a leading role in implementing an appropriate regulatory framework for crowdfunding.**

As the securities regulators closest to the investing public, and in light of their distinguished record of effective regulation, the States are the most appropriate regulator in this area. State securities regulators are not only capable of acting, but, indeed, are acting in this critical area<sup>6</sup>, and Congress should continue to allow the states the opportunity to protect retail investors from the risks associated with smaller, speculative investments.

Thank you for your consideration of this important issue. If you have any questions, please feel free to contact Michael Canning, NASAA Director of Policy, or Anya Coverman, NASAA Assistant Director of Policy, at (202) 737-0900.

Respectfully,



Jack E. Herstein  
NASAA President  
Assistant Director, Nebraska Department of Banking & Finance, Bureau of Securities

CC: The Honorable Harry M. Reid  
Majority Leader  
United States Senate  
Washington, DC 20510

The Honorable Mitch McConnell  
Minority Leader  
United States Senate  
Washington, DC 20510

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<sup>6</sup> NASAA is currently in the midst of a rulemaking intended to produce a Model Exemption for “Crowdfunding.” The first stage of this rulemaking was completed when the Model Exemption was circulated for internal comment from January 24 to February 7, 2012. A revised version of the Model Exemption is expected to be posted for public comment later this month, and thereafter NASAA’s members will vote on the adoption of the Model Exemption.