



Supplemental Comments on Regulatory Initiatives to Implement the JOBS Act

August 2, 2012

The National Small Business Association (NSBA) was founded in 1937 to advocate for the interests of small businesses in the U.S. It is the oldest small business organization in the U.S. The NSBA represents more than 150,000 small businesses throughout the country in virtually all industries and of widely varying sizes.

On Apr. 5, 2012, the President signed into law the Jumpstart Our Business Startups Act (the “JOBS Act”).¹ The NSBA strongly supported this legislation.

Title II

These supplemental comments are in response to a request made during the NSBA meeting with Securities and Exchange Commission (SEC) staff held on July 11, 2012 for additional feedback regarding Title II of the JOBS Act.² Specifically, the SEC sought additional comments regarding the provisions in section 201(a) of the Act amending section 230.506 of Title 17 of the Code of Federal Regulations to allow general solicitation or general advertising provided that the issuer takes “reasonable steps to verify that purchasers of the securities are accredited investors, using such methods as determined by the Commission.” These comments address the verification standard generally (including the legislative history of the provision), possible bifurcation of Rule 506 so that changed verification standards apply only to offerings involving general solicitation or general advertising, the current reasonable belief standard and potential ways to implement a higher verification standard if, contrary to our recommendation, such an approach is adopted by the SEC.

The importance of Title II of the Act is often underrated. Typical small business owners know a limited number of accredited investors (i.e. very affluent people). They are thus effectively forced by the securities laws’ pre-existing relationship requirements to pay broker-dealers large fees to make introductions. Title II of the law will allow them, should they choose, to try to directly seek accredited investors.

¹ Public Law 112–106

² We also intend to offer later supplemental comments on a number of issues raised in the meeting regarding Title III (crowdfunding).

Verification Requirement Generally

Our primary concern with respect to Title II remains that the Commission resist the temptation to alter Rule 506 in a way that increases the burden on, or risk to, those using the Rule 506 exemption.

In our judgment, the Act is clear:

...the prohibition against general solicitation or general advertising contained in section 230.502(c) of such title shall not apply to offers and sales of securities made pursuant to section 230.506, provided that all purchasers of the securities are accredited investors.

The Act does not require or encourage other revisions to Rule 506. Moreover, contrary to the assertions of some, Congress did not intend that the SEC impose a complex new regulatory regime on Rule 506 issuers requiring them to engage in complex and burdensome investigations of their investors. The reason, we believe, that Congress gave the SEC only 60 days to implement this requirement is clear. They simply expected the SEC to delete the provisions in Regulation D that prohibited general solicitation and general advertising and had no expectation that the SEC would create a complex and burdensome regime regarding accredited investor verification.

Let us be clear. This is not about protecting innocent little old ladies from fraudulent issuers. Title II leaves all anti-fraud laws in place. Those advocating a complex regime regarding verification of accredited investor status are seeking to protect those who are willing to lie to issuers about their income or net worth. In order to protect those investors who are willing to fraudulently fill out investor suitability questionnaires and fraudulently attest to a false income or a false net worth, proponents of such a regime are willing to prevent countless job creating small businesses from raising the capital necessary to launch or grow their business. That is not what Congress had in mind when it passed Title II of the JOBS Act.

The verification language in the final Act is identical to the relevant language in the House bill. The relevant legislative history is the House report. There was no Senate report. The House report language states:

To ensure that only accredited investors purchase the securities, H.R. 2940 requires the SEC to write rules on how an issuer would verify that the purchasers of securities are accredited investors.³

This is simply a paraphrasing of the underlying statutory language. Since the law is requiring a modification to the underlying regulation, namely Regulation D, it is utterly unremarkable that the Committee in its report noted that the SEC would have to write rules implementing the requirements of the Act. There is no indication that the Congress contemplated a complex and

³ Access To Capital For Job Creators Act, Report from the Committee On Financial Services October 31, 2011, p. 2 and p. 5.

burdensome regulatory regime governing the verification of accredited investor status that would effectively defeat the underlying purposes of the Act.

The comments of individual members of Congress are not true legislative history except, arguably, in the case of floor managers or the relevant committee chairpersons.⁴ They reflect only the opinions of one member. Nevertheless, the only discussion of the verification issue on the Senate floor during the JOBS Act debate appears to be a discussion by Sen. Levin in support of the Reed-Landrieu-Levin amendment (SA 1833) that was **not** adopted by the Senate.⁵ Sen. Levin stated:

The Reed-Landrieu-Levin amendment would direct the SEC to revise its rules to allow companies to offer and sell shares to a credited investor (sic), but it then directs the SEC to make sure those who offer or sell these securities take reasonable steps to verify that the purchasers are actually accredited investors. It requires the SEC to revise its rules to make sure these sales tactics are appropriate. There are not going to be, under our language, billboards or cold calls to senior living centers. I wish I could say the same about the House bill.⁶

This clearly implies that Sen. Levin thought the House bill (which is the language that was signed into law) did not require all of these things.

It is clear that imposing additional burdens on Rule 506 issuers who engage in general solicitation or general advertising would make it more difficult for small firms to raise capital. It would raise their cost of raising capital. It would make it less likely they will find needed investment. It would make it less likely that investors will invest in small firms since the cost of doing so will be higher. This is clearly contrary to the general purposes of the Act.

⁴ This, of course, is even more true of the comments of a single member in committee. Moreover, committee debate transcripts are rarely available to attorneys or courts since they are neither published in *U.S. Congressional and Administrative News* nor the *Congressional Record* nor by the Government Printing Office. Only committee hearings and reports are usually published. See, e.g., “Legislative History Research: A Basic Guide.” Julia Taylor, Congressional Research Service, June 15, 2011. *Ergo*, the comments of a single member in committee is accorded virtually no weight as legislative history even by proponents of using legislative history as an aid in statutory interpretation. Justice Stephen Bryer, for example, is one of the foremost proponents of using legislative history as an aid in interpreting statutes. Even he, however, mentions only “congressional floor debates, committee reports, hearing testimony, and presidential messages,” none of which support the proposition that the JOBS Act provision at issue was meant to inaugurate a complex verification regime. See, “On The Uses Of Legislative History In Interpreting Statutes,” 65 S. Cal. L. Rev. 845 (1992). Many other leading jurists and scholars oppose using legislative history for purposes of interpreting statutes at all. See, e.g., *Reading Law: The Interpretation of Legal Texts*, Justice Antonin Scalia and Bryan A. Garner, West, 2012.

⁵ Cloture on amendment SA 1833 (the Reed-Landrieu-Levin amendment) was not invoked in Senate by Yea-Nay Vote. 54 - 45. See Record Vote Number 51.

⁶ March 15, 2012, Congressional Record — Senate, S1727.

Such a regime would also increase the risk to issuers of lawsuits or disqualification of their offering if they sell to an investor who lied to them about their accredited investor status. This risk would very dramatically reduce the willingness of issuers to take advantage of Title II of the JOBS Act. This also is clearly contrary to the general purposes of the Act.

Rule 506 Bifurcation

We are deeply concerned that the SEC not modify Regulation D in such a way as to actually impede rather than enhance the ability of small firms to raise capital. This would certainly be the case if a new burdensome regulatory regime was created and applied to all Rule 506 offerings (including those that made no general solicitation). It would also be diametrically opposed to the intent of Congress.

Thus, we strongly urge that if the SEC imposes additional requirements on Rule 506 issuers who engage in general solicitation or general advertising, that it bifurcate the Rule so that these new requirements do not apply to issuers that do not engage in general solicitation or general advertising. In other words, issuers that do not engage in general solicitation or general advertising should be in no worse a situation than they were prior to passage of the JOBS Act. The existing rules should apply to them no matter what verification procedures the SEC adopts with respect to Rule 506 offerings involving general solicitation or advertising as authorized by the JOBS Act.

Reasonable Belief Standard

Regulation D current provides that exempt sales may be made to an investor that an issuer “reasonably believes” is an accredited investor.⁷ The traditional and almost universal current practice of using investor suitability questionnaires combined with investor self-certification to establish accredited investor status should continue to be allowed and be deemed to constitute taking “reasonable steps to verify that purchasers of the securities are accredited investors” as required by the JOBS Act. There is neither legislative history supporting nor any other reason to believe the proposition that Congress intended to undermine the laudable policy goals of the Act by changing the current long-standing practice with respect to verifying accredited investor status.

Higher Verification Standard Implementation

If, contrary to our strong recommendation and, we believe, the intent of Congress, the Commission nonetheless decides to change existing practice with respect to Rule 506 offerings that engage in general solicitation or general advertising, then NSBA has a number of suggestions.

First, as some have proposed, requiring investors to present a W-2 to issuers is unworkable. Most investors are not employees of someone else. They either have their own business or are investors, often retired, relying on investment income. In other words, they rely on Schedule B,

⁷ 17 CFR 230.501(a).

Schedule C, Schedule D, or Schedule K income to meet the accredited investor income requirements.

Second, requiring investors to provide their entire tax return to issuers will radically reduce the number of investors willing to invest. People are justifiably reluctant to give their tax returns to virtual strangers. They do not want their personal family, health and business lives to be disclosed and they cannot be sure that issuers will treat that information confidentially. As often as not, they will find some other way to invest their money.

Third, neither providing a W-2 nor a tax return will establish net worth for those investors relying on the net worth rather than the income test for meeting the accredited investor definition.

Thus, if there must be some kind of enhanced verification, we recommend that a certification by the investor's attorney, CPA, certified financial advisor or other licensed professional should be sufficient. This, of course, will add expense to the entire process (particularly if the investor is relying on net worth to meet the accredited investor standards). It will have a negative impact on investor returns and willingness to invest in Regulation D offerings. Moreover, unless there is a good faith provision in the rule absolving these professionals from liability for making such a certification if they did so in good faith having a reasonable basis for their certification, they will either be unwilling to make the certification or charge a great deal for doing so (if only to cover the increase in their malpractice premiums for being in the business of making Regulation D accredited investor certifications).

Obviously, this certification can only be with respect to income history or current net worth. It would be unreasonable to require these professionals to certify that the investor has 'a reasonable expectation of reaching the same income level in the current year' as currently required by Regulation D.⁸ Only the investor can reasonably attest to his or her expectations as to future income.

As we mentioned in the meeting, it would be possible to require investors to make their certifications under penalty of perjury. This should make investors less willing to lie on their certifications to issuers since a criminal penalty for doing so would attach to their fraudulent behavior. Section 1746 of Title 28 authorizes this approach. It reads:

28 USC § 1746 - Unsworn declarations under penalty of perjury

Wherever, under any law of the United States or under any rule, regulation, order, or requirement made pursuant to law, any matter is required or permitted to be supported, evidenced, established, or proved by the sworn declaration, verification, certificate, statement, oath, or affidavit, in writing of the person making the same (other than a deposition, or an oath of office, or an oath required to be taken before a specified official other than a notary public), such matter may, with like force and effect, be supported, evidenced, established, or proved

⁸ 17 CFR 230.501(a)(6).

by the unsworn declaration, certificate, verification, or statement, in writing of such person which is subscribed by him, as true under penalty of perjury, and dated, in substantially the following form:

- (1) If executed without the United States: “I declare (or certify, verify, or state) under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on (date). (Signature)”.
- (2) If executed within the United States, its territories, possessions, or commonwealths: “I declare (or certify, verify, or state) under penalty of perjury that the foregoing is true and correct. Executed on (date). (Signature)”.

To prevent investors from fraudulently asserting accredited investor status, the SEC may wish to require investors to sign such a form. Such a form would be only a few sentences long and the exact language required should be specified in the revised Regulation D. Such an approach is regularly used by the SEC Enforcement Division as a Google search of the SEC website demonstrates.

Requiring investors to provide to issuers an independent professional’s certification as to the investor’s accredited investor status and requiring the investor to certify his or her own status under penalty of perjury would provide a high degree of protection against non-accredited investors asserting accredited investor status in Regulation D offerings. It would also preserve the confidentiality of investors’ personal information.

Such a regulatory regime would have an adverse impact on the efficacy of Title II but should not render it an effective nullity as, for example, SEC Regulation A has rendered the small issues exemption a dead letter.⁹

Sincerely,



David R. Burton
General Counsel
National Small Business Association
1156 15th St., NW, Suite 1100
Washington, DC 20005

(202) 552-2924 (direct dial)
(202) 872-8543 (fax)
DBurton@nsba.biz
www.nsba.biz

⁹ See Regulation A and 15 USC 77c(b). See also “Factors That May Affect Trends in Regulation A Offerings,” United States Government Accountability Office, July 2012 (GAO-12-839), a report required by the JOBS Act.