Tiny Cat Loans

*Customer Sourced Loans for Small Businesses*

www.tinycatloans.com

**February 3, 2014**

Via e-mail to rule-comments@sec.gov

U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

**Re: Request for Comment on Proposed Rules for Regulation Crowdfunding**
**[Release No. 33-9470; File Number S7-09-13]**

Dear Chairperson, Commissioners and staff of the SEC:

It is an honor to have the opportunity to offer comment on the Securities and Exchange Commission's proposed rules for regulation crowdfunding under the requirements of Title III of the JOBS Act that was signed into law in April, 2012.

We are writing on behalf of Tiny Cat Loans, a proposed funding portal that intends to enable small businesses to sell debt based securities to investors. While the majority of other proposed funding portals are focused on equity in early stage businesses and startups, our target market is main street "brick and mortar" businesses; such as restaurants, retailers, private schools and service companies. By offering 'community loans', small businesses can deeply connect with their friends, family and customer networks and directly involve them in their future growth. As the Federal Reserve has noted[1], there is a huge unmet need for small business capital, and we firmly believe that small businesses can prosper when their community is literally invested in their success.

Through CFIRA, we have been involved in conversations with the SEC since 2012, and would like to thank the SEC staff for their openness and thoughtfulness throughout the rulemaking process. We'd also like to express genuine thanks to David Blass and the other hardworking folks in Trading and Markets, as well as Corporation Finance and the other divisions within the SEC who obviously put much hard work and deliberation into these proposed rules. The proposed regulations are generally excellent, and walk the fine line between regulatory oversight and providing space for a new capital market to take root. This is easily the largest change to federal financial regulations since the Securities Act of 1933 and the Securities Exchange Act of 1934 and it is a great privilege to be a part of it.

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[1]*See* Ann Marie Wiersch and Scott Shane, *Why Small Business Lending Isn't What It Used to Be,* FEDERAL RESERVE BANK of CLEVELAND 08.14.13 *available at* http://www.clevelandfed.org/research/commentary/2013/2013-10.cfm

Tiny Cat Loans

Without further ado, we would like to express our thoughts on the proposed regulations:

**Section II.B.1: Disclosure Requirements**

***Question 50****: Under the statute and the proposed rules, issuers are required to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors financial statements. The proposed rules would require all issuers to provide a complete set of financial statements (a balance sheet, income statement, statement of cash flows and statement of changes in owner's equity) prepared in accordance with U.S. GAAP. Should we define financial statements differently than under U.S. GAAP? If so, what changes would be appropriate and why? What costs or challenges would be associated with the use of a model other than U.S. GAAP (e.g., lack of comparability)? What would be the benefits? Please explain.*

We believe that mandating GAAP accounting for all issuer financial statements would present a significant challenge for many "Main Street" businesses. Nearly half of small businesses do cash accounting, rather than accrual[2], which would make it a burden for them to provide GAAP financials for both the initial issuance and the ongoing annual reports.

For a small business with two years of operating history, there are several challenges with presenting GAAP financial statements. Not only would businesses incur the expense of re-examining their books for conversion to accrual accounting, but they would most likely need to switch to accrual accounting going forward in order to provide comparable and accurate financial statements for annual reporting. Such a change would have tax implications, including the necessity of filing an "Application for Change in Accounting Method" with the IRS[3]. With these factors in mind, mandating GAAP for all issuers seems disproportionately burdensome, especially when considering that some issuers will be looking to raise comparatively small amounts of money, often less than $100,000. It is our belief that requiring GAAP financial statements would likely prevent many "Main Street" businesses from utilizing the JOBS act.

Furthermore, for small offerings, permitting a cash basis method of accounting would provide many of the same comparability benefits as GAAP for investors when evaluating the merits of a particular investment. Since a large percentage of other small offerings would also have cash basis accounting, and all active crowdfunding investments would be available on the public internet, it would be possible for investors to compare the relative merits of different investments on a variety of different platforms. It's highly likely that members of the "crowd" would also be familiar with small business cash accounting, and be able to provide wisdom on the communication channels available on the crowdfunding platform.

We would respectfully suggest that the commission permit OCBOA reporting for issuances worth less than $500,000; making reporting less burdensome for smaller businesses, while maintaining the benefits of GAAP reporting for larger transactions.

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[2] *See* http://www.nsba.biz/wp-content/uploads/2013/04/Taxation-Survey-2013.pdf

[3] *See* http://www.irs.gov/publications/p334/ch02.html#en_US_2013_publink1000313285

Tiny Cat Loans

### Section II.B.6.c: Types of Securities Offered and Valuation

***Question 113:*** *Should we limit the types of securities that may be offered and sold in reliance on Section 4(a)(6) (e.g., should the exemption be limited to offers and sales of equity securities)?*

No. In our countless conversations with small business owners and potential investors, we've come to the conclusion that loans, and not equity, are the most effective financial instruments for the vast majority of small businesses. Loans are predictable, finite, and easily understood by small business owners, whereas issuing equity is seen as much more daunting. Loans also provide easy liquidity to investors, and a predictable return, while equity investments in small businesses are notoriously illiquid and hard to value. Put another way, equity investment is a great match for speculative ventures like early stage technology companies, but debt is a much better fit for a pizza parlor who wants to open a new location.

In fact, "crowdfunded" debt offerings have already been successful for a variety of small businesses[4], using the intrastate DPO process in California. Notably these offerings often have an element of creativity to them, with elements specific to their business and community.

For example, Capay Valley Farms offered repayment of loan interest in either cash or credit for their fresh vegetables[5]. We have had conversations with the management of Capay Valley Farms, and their "Green Loan" program has been enormously successful in enabling their business expansion while providing a good return (in both cash and lettuce) to their investors.

We believe that it is **critical** for the commission to permit all types of securities in crowdfunding transactions, so as to enable and engage the greatest number of potential issuers and investors.

### Section II.C.1: Brokers and Funding Portals

***Question 116:*** *Are there other funding portal activities, other than those in Exchange Act Section 3(a)(80), that we should prohibit? If so, which activities and why? Are there any prohibitions that should be modified or removed? If so, which ones and why?*

In the requests for comments, the commission often asks whether new requirements or restrictions on funding portals are necessary. Except where we specifically ask for new restrictions in this comment letter, we would suggest that the proposed regulations regarding funding portal and issuer activities are currently sufficient for investor protection and proper regulatory oversight.

The proposed regulations provide a healthy level of investor protection, but are not overly burdensome and we wholeheartedly appreciate the commission's general attitude of restraint. Once crowdfunded offerings

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[4] *See* http://www.nytimes.com/2013/08/01/business/smallbusiness/seeking-capital-some-companies-turn-to-do-it-yourself-ipos.html

[5] *See* http://farmfreshnews.blogspot.com/2009/02/local-beef-green-loans.html

begin, we think the proposed reporting requirements for issuers and intermediaries should allow the commission and FINRA to rapidly assess whether new limitations are necessary.

### Section II.C.2: Requirements and Prohibitions

***Question 125**: The proposed rules define "financial interest in an issuer," for purposes of Securities Act Section 4A(a)(11), to mean a direct or indirect ownership of, or economic interest in, any class of the issuer's securities. Should we define the term more broadly to include other potential forms of a financial interest? For example, should the term include a contract between an intermediary and an issuer or the issuer's directors, officers or partners (or any person occupying a similar status or performing a similar function), for the intermediary to provide ancillary or consulting services to the issuer after the offering? Should it include an arrangement under which the intermediary is a creditor of an issuer? Should it include any carried interest or other arrangement that provides the intermediary or its associated persons with an interest in the financial or operating success of the issuer, other than fixed or flat-rate fees for services performed? Should any other interests or arrangements be specified in the term "financial interest in an issuer?" If so, what are they and what concerns do they raise?*

The proposed definition of "financial interest in an issuer" seems appropriate, particularly in consideration of the underlying statute. However, there are many useful services that portal providers might wish to provide to issuers on an ongoing basis, such as maintaining a communication channel between the issuer and investors. Further expanding the definition of financial interest would preclude those service offerings, and diminish the utility of portals to both issuers and investors.

However, we believe it is reasonable to require full disclosure of any such service contracts, similar to disclosure of the compensation to the intermediary for conducting the initial offering.

### Section II.C.3: Measures to Reduce Risk of Fraud

***Question 128:** We are not proposing to require that an issuer relying on Section 4(a)(6) engage a transfer agent due, in part, to the potential costs we believe such a requirement would impose on issuers. What would be the potential benefits and costs associated with having a regulated transfer agent for small issuers? Are there other less costly means by which an issuer could rely on a qualified third party to assist with the recordkeeping related to its securities?*

In the proposed rules, the commission has properly pointed out that requiring a registered transfer agent for crowdfunded securities would add to the cost of a crowdfunded offering, and that there are a variety of alternate ways in which accurate recordkeeping might be provided. Not only might diligent issuers be able to handle transfers themselves, but many competent third parties are already well equipped to provide such services[6]. As the market for crowdfunded offerings grows, it is reasonable to expect that even more service providers will emerge, which will increase competition and reduce cost.

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[6] *For example:* https://www.capschedule.com/


Since accurate records of ownership are critical for investor protection, we firmly agree with the commission's position that intermediaries have a "reasonable basis" for belief that accurate recordkeeping will be provided for any offering. We would also suggest that there be a mandatory disclosure to investors about who will be providing recordkeeping for the securities, as well as a disclosure statement from the intermediary regarding the reason for their belief that recordkeeping will be adequate.

**Section II.C.5: Requirements with Respect to Transactions**

***Question 178:*** *Should we require funding portals to maintain a certain amount of net capital? Why or why not? If so, what would be an appropriate amount, and how should that amount be determined?*

Funding portals are already prohibited from handling funds and securities, and are also subject to a fidelity bond in the proposed regulations. We believe that adding further net capital requirements would increase the cost of starting a new funding portal and reduce the potential number of intermediaries, while providing little additional protection to investors and issuers.

Therefore, we request that the commission not add an additional net capital requirement to funding portals.

**Section II.D.1: Registration Requirement**

***Question 190:*** *Should we impose other restrictions or prohibitions on affiliations of the funding portal, such as affiliation with a registered broker-dealer or registered transfer agent? If so, what are they and why?*

While many funding portals might find it beneficial to partner with a registered transfer agent or registered broker-dealer, it should not be necessary. If these partnerships are mandatory, it would give broker-dealers and transfer agents an enormous amount of leverage in negotiating contracts with funding portals, which would inevitably increase the cost of running a funding portal. Also, managing a mandatory partnership would increase our operational complexity.

Reading the original text of the JOBS act, it seems that the intent of congress was that funding portals should be a viable alternative to established broker-dealers, which implies their independence. Also, for many functions that portals cannot perform, such as handling of securities and escrow, there are viable alternatives to broker-dealers and transfer agents. We would respectfully request that any partnerships for funding portals be optional, so that the portals may enter into the agreements that best suit their business model while maintaining regulatory compliance.

Tiny Cat Loans

***Question 191:*** *Should the Commission, as proposed, permit a funding portal to have multiple intermediary websites under a single registration application? Why or why not?*

While we are currently building a single portal focused around small business loans, we may eventually decide to utilize our technology and operational expertise to construct another portal to target another market segment. So long as this expansion provides no material changes to anything that was in our initial application, a new registration application would not provide any new information for either the commission or the public. Thus, we think that a new application should not be necessary.

Thank you for considering these comments, and we hope that our perspective as a potential funding portal is useful to the commission.

If you wish to contact us regarding any of this, we may be reached at (415) 689-6783, or via email at info@tinycatloans.com.

*Respectfully Submitted,*

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