



February 3, 2014

Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

RE: File Number S7-09-13 – Crowdfunding

These comments are submitted for the record to the Securities and Exchange Commission (SEC) on behalf of the National Federation of Independent Business (NFIB) in response to the notice of proposed rulemaking (NPRM) regarding Crowdfunding published in the November 5, 2013, edition of the *Federal Register*.

NFIB is the nation's leading small-business advocacy association, representing members in Washington, D.C., and all 50 state capitals. Founded in 1943 as a nonprofit, nonpartisan organization, NFIB's mission is to promote and protect the right of its members to own, operate, and grow their businesses. NFIB represents about 350,000 independent-business owners who are located throughout the United States.

Introduction

Crowdfunding is a new and evolving method to raise money using the Internet. It serves as an alternative source of capital filling the niche between personal resources and venture capital. An entity or individual raising funds through crowdfunding typically seeks small individual contributions from a large number of people. A crowdfunding campaign generally has a specified target amount for funds to be raised, or goal, and an identified use of those funds. Individuals interested in the crowdfunding campaign may share information about the project, cause, idea or business with each other and use the information to decide whether or not to fund the campaign based on the collective "wisdom of the crowd."

The Jumpstart Our Business Startups (JOBS) Act, enacted in 2012, establishes the foundation for a regulatory structure for startups and small businesses to raise capital through securities offerings using the Internet through crowdfunding. This provision allows small businesses to offer securities through a crowdfunding exemption to SEC rules governing traditional publicly traded enterprises. This regulation implements this section of the JOBS Act.

NFIB supports legitimizing the crowdfunding market through the JOBS Act. Crowdfunding could become a critical financing tool for start-up and established small businesses. NFIB does not want to see abuses in the market that spoil the opportunity for crowdfunding to gain legitimacy. At the same time, NFIB members have always been ardent supporters of the free-market system. Accordingly, NFIB's position on Regulation Crowdfunding is that the SEC

should only intervene in the market to the extent necessary to ensure legitimacy of crowdfunding as a valid financing tool.

For the most part, NFIB believes the NPRM is a reasonable approach toward achieving this aim. Therefore, the bulk of these comments will focus on areas where we believe the SEC could strike a better balance between protecting the investing public and limiting burden on small businesses.

Requirements of the NPRM on issuers

In order for a company to claim the exemption afforded under the JOBS Act, it must file certain information with the SEC, provide certain similar information to the intermediary conducting the offer, and provide ongoing updates as items in the offering change or on a basis specified in the regulation.

These requirements include basic disclosures about the officers, financial condition of the company, business plan, and compensated individuals that promote the offering. In addition, issuers are required to provide ongoing updates for as long as the securities are owned by investors.

Many of these requirements are necessary to ensure investor confidence in the crowdfunding market. The remainder of these comments will focus on NFIB's concerns and suggested improvements that we believe will protect investors and intermediaries while being less burdensome on the small businesses likely to be issuers.

Allow for the use of cash accounting

Many of the requirements of this NPRM mandate use of U.S. generally accepted accounting principles (U.S. GAAP). However, many small businesses that may be interested in crowdfunding utilize cash basis accounting. According to a 2006 survey of small businesses by the NFIB Research Foundation, only 19 percent of small businesses surveyed solely used the accrual method of accounting. The remaining 81 percent used either a cash basis (41 percent), a hybrid cash/accrual system (12 percent), or were unsure what system they used (28 percent) or refused to answer (one percent).¹ It is widely used by small businesses because it is the simplest accounting method allowed by the Internal Revenue Service.

Requiring issuers to solely use the accrual method would act as a substantial barrier. From the data above, nearly 80 percent of small businesses seeking to take advantage of crowdfunding would need to reform their accounting methods. Switching from a cash basis is not easy and nor is it inexpensive, particularly for very small businesses and startups likely to be seeking crowdfunding. For these reasons, we suggest the SEC develop an allowance for cash-basis companies that would not require them to convert their accounting methods, at least not immediately. NFIB believes that failing to do would prevent many of the companies Congress intended from entering the crowdfunding market.

¹ Dennis, William J. *NFIB National Small Business Poll: Expenses*. NFIB Research Foundation. 2006. pp. 13. [http://411sbfacts.com/files/Expenses\[1\].pdf](http://411sbfacts.com/files/Expenses[1].pdf)

Remove ongoing reporting requirements

The NPRM would require issuers to file ongoing reports on an annual basis once they have sold securities through a crowdfunding offering. These reports must include much of the information required in the initial disclosure reports to the SEC and intermediary. NFIB believes that these ongoing reporting requirements should be rescinded from the final rule for two reasons.

The first reason is that the provision is extremely burdensome for small businesses. The amount of time it will take small companies to put together the required information will be considerable, and take away time from operating the business to earn a return for investors. In addition, depending on the amount raised in the offering, the reviewed or audited financials requirement will cost thousands of dollars the business could otherwise use to invest in the business.

The second reason is that the proposed requirement is inconsistent with a recently proposed SEC rule stemming from the JOBS Act that does not require a business to file ongoing reports with the Commission if it offers up to \$5 million in securities annually (Regulation A). If the SEC believes that it is unnecessary for companies offering up to \$5 million for one rule, it does not logically follow it would require it in another for businesses offering up to \$1 million. The SEC should address this inconsistency by removing the ongoing reporting requirements in the NPRM.

Remove auditing burden for companies seeking more than \$500,000

NFIB believes the requirement for a company seeking more than \$500,000 to have audited financials filed with the SEC is unduly burdensome on small businesses. This requirement will substantially increase the upfront costs to issuers – which will have the effect of taking away a greater percentage of capital raised through an offering so that the issuer can cover compliance costs.

For existing small businesses and startups, NFIB fears this provision will incentivize these issuers to limit their annual offerings to below \$500,000. In addition, for startups or businesses with no operating history the audit requirements will be a waste of time and money.

Enforcement of the business plan requirement

Businesses seeking to conduct an offering must submit to the SEC a business plan in its initial disclosure filing. NFIB is pleased that in the NPRM the section dealing with business plans provides a broad definition to issuers. The SEC is correct to allow issuers to provide a great deal of latitude with regard to what elements are in the plan.

NFIB's concern lies in how the SEC will enforce this requirement. Specifically, NFIB cautions against enforcement practices that have the effect of specifying particular elements of a business plan. Such a development would cause a great deal of confusion and uncertainty for small businesses and act to deter these companies from the market. In addition, the SEC should not retroactively go back during an enforcement action once the offering has been completed and cite a small business for having an inadequate business plan. The SEC should determine adequacy at the outset of the filing.

Areas needing clarification

NFIB suggests the SEC clarify two particular areas of the proposed rule. The first is regarding a second-round sale of securities. It is unclear from the NPRM what obligations an issuer has to those that purchased securities during the initial offering. Also, we believe investors would benefit from understanding how a second round of an offering would affect those that invested at the outset.

Second, the SEC could clarify when it considers a business to be formed for purposes of the initial disclosures. The Panel Study on Entrepreneurial Dynamics has established two realities regarding business formation. First, there is no order in which business people take steps to go into business. Second, many starts require long, often halting, entry periods.² As an example, if the owner of Company X developed an idea a decade ago, but abandoned the idea until last year, does the company need to only go back in its records one year? Or does it need to provide information on the company and its officers for the past several years? Clarifying this definition would make it easier to for small businesses to complete the initial disclosures.

Conclusion

NFIB believes that the SEC has taken a reasonable approach in its proposed rule to ensure investor confidence and limit burden on the issuer. With that said, we are concerned about a few elements of the proposal. First, we believe the SEC must make allowances for cash accounting practices. Second, the Commission should remove the ongoing reporting requirements for issuers. Third, the SEC should eliminate the audited financials requirement for issuers seeking more than \$500,000. Fourth, the Commission needs to be careful in its enforcement not to limit the breadth of the business plan it requires in its initial disclosures.

Finally, NFIB believes issuers and investors would benefit from further clarification regarding a second offering of securities and when a business is considered formed.

We appreciate the opportunity to comment on the NPRM. Should the SEC require additional information, please contact NFIB's manager of regulatory policy, Daniel Bosch, at [REDACTED].

Sincerely,



Dan Danner
President and CEO
NFIB

² *New Firm Creation in the United States: Initial Explorations with the PSED II Data Set*. 2009. Reynolds, Paul D., and Curtin, Richard T. (eds.) Springer: New York, NY.