



**December 21, 2010**

Mr. Gerald J. Laporte  
Chief, Office of Small Business Policy  
Division of Corporate Finance  
Securities and Exchange Commission  
100 F Street NE, Room 3650  
Washington, D.C. 20549

**Re: SEC Government-Business Forum on Small Business Capital Formation— SBE Council Recommendation**

Dear Mr. Laporte:

Thank you for hosting the Forum on Small Business Capital Formation in November. As a follow up to the forum, the Small Business & Entrepreneurship Council (SBE Council) would like to submit the following comments/suggestions for review and consideration.

**Small Business Offering Exemption – Problem & Solution**

**Overview**

The U.S. Security and Exchange Commission (SEC) has an opportunity to make modest but important modifications to current securities regulations that would support American entrepreneurship while protecting the interests of investors. When the Securities Acts of 1933 and 1934 were passed, information, transparency, technology and social networks were severely limited. Today, however, the Internet has introduced real-time information, forced transparency and a greater desire to collaborate and innovate. Unfortunately, today's regulatory framework only allows the super elite to participate as investors/lenders to businesses, which effectively locks out the average American from helping businesses in their own community.

How can the SEC help turn ideas into viable companies? *By allowing them to access modest amounts of seed capital from individuals in a regulated manner.*

The vast majority of start-ups need less than \$1 million in capital to build their model. Following start-up, many viable firms need much more capital for scale. However, even when entrepreneurs first begin to raise capital, current regulations create barriers that stifle all but a select few from successfully building businesses because:

1. The costs of registration and compliance require the size of the offering to be significantly larger than \$1 million and;
2. Current regulations restrict who and how can be solicited to participate in the offering.

**Additional Background**

Let’s look at:

- Current exemptions to understand how they are a barrier to lending/investing;
- New ways that people are gaining funding for ventures that exist on the margins of current regulations;
- A proposal for a regulatory safe harbor that protects investors through ample oversight while opening meaningful access to seed capital.

<b>Rule</b>	<b>Barrier</b>	<b>Why is it a Barrier</b>
Intrastate Offering Exemption	Doesn’t allow for offerings across state borders	Nearly irrelevant today as commerce freely crosses state borders and new businesses that used to be considered mom & pop (i.e.: laundry, grocery, etc) are now incorporating to become interstate chains and are leveraging online channels that provide reduced costs thru economies of scale.
Private Offering Exemption	Prohibits any form of public solicitation	Given the existence of the Internet, how can any offering today not be a public one? The means to provide access to deals (via social networks, the internet and media) is just too great to “keep them private” and hence this rule is not only unrealistic but also unenforceable.
Regulation A	Must provide purchasers with an offering circular that is similar to a prospectus and must be reviewed by the SEC	Most entrepreneurs are not MBA’s with graduate degrees. They have a solution to a problem, and need a small amount of capital to get from proof of concept to going concern. This infant stage should not require a circular, but capital to see if it is viable. Compliance with this regulation at an early stage of life is impossible, as start-ups don’t have the time, money or “financial history” for the materials required. To be competitive when starting companies, time is a critical resource.
Regulation D: Rule 504	No public solicitation	See “Private Offering Exemption” above
Rule 505	Only 35 non-accredited investors allowed. No form of advertising or public	This limit may have made sense in 1934, but is unnecessarily restrictive today. With the rise of sites like <a href="http://www.kickstarter.com">www.kickstarter.com</a> ,

	solicitation.	<a href="http://www.profounder.com">www.profounder.com</a> , and <a href="http://www.indeegogo.com">www.indeegogo.com</a> , “crowd-funding” models are up and running successfully and are tiptoeing around regulations by terming the funding as “donations”. We would propose creating ways to provide regulation in other ways that achieves the goal of protecting individual investors while creating an open and fair market for providing seed capital. There needs to be flexibility for people who want to fund an idea but only want to do so with a small amount to be allowed to participate as well.
Rule 506	No public solicitation. You must provide non-accredited investors disclosure documents that are the same as those used in registered offerings.	The time and costs to put together the documents that are “the same as those used in registered offerings” creates an insurmountable barrier to entry to entrepreneurs and discourages them from seeking capital or creating new businesses.
Accredited investor exemption	Only available to accredited investors. No form of advertising or public solicitation	While the accredited investor segment is a great target, in reality they only fund a small percent of ideas. Many great ideas never get anywhere because the people who are given the right to invest are unable to see every viable idea or may choose not to invest.
California Limited Offering Exemption	Restricted to California. Only open to qualified purchasers	We need standardized regulation to enable modest capital raises that is uniform among all 50 states and territories.
Rule 701	Allows sales of securities to compensate employees	This is a barrier because friends and family of those employees should be allowed to invest as well.

We need to adapt the rules meant to protect individual investors, while providing a way to connect entrepreneurs with the seed funding they need from individuals in their communities and social networks. This regulatory modification would create jobs, tax revenue and economic growth. The mechanisms are there to protect the unaccredited investor including the fact that all securities transactions are subject to the antifraud provisions of the federal securities laws. However we believe that current rules make it nearly impossible for most start-ups to conduct initial funding rounds of less than \$1 million.

### **New Ways Individuals and Organizations are Raising Money Online**

Over the past five years the amount of money directed thru microfinance organizations like Kiva and Kickstarter has reached \$350 million. That’s \$350 million that people are essentially giving away to individuals and organizations they believe in. These people,

many of whom are non-accredited, understand that a little money, from a large number of people, can go a long way in terms of helping a disadvantaged or underprivileged person, or a struggling artist or capital constrained entrepreneur. And almost a third of these funds were directed at projects outside of the USA at a time when we should be helping to spur our own economy.

Kiva and Kickstarter actively advertise and solicit for funds. Recently, [www.profounder.com](http://www.profounder.com) launched its site using Revenue Based Financing to crowdsource loans from friends, family and the general public. Because there is essentially no return, these investments go unaccounted. However, after \$350 million there are no complaints about fraud. Why? Because the people making the investments, both accredited or not, understand the social and financial impact that their small investments are making and are willing to give away their money to further a cause.

If in fact \$350 million has successfully funded startups, would not providing the mechanism (and incentive) for people to invest with the possibility of a financial return serve to increase the amount of capital flowing into the hands of the entrepreneurs?

### **Proposed Solution**

A new small offering safe harbor/regulation modification should be simple and follow the spirit of the 1933 and 1934 rules:

- No fraud.
- Limit risk and exposure for unaccredited investors.
- Ensure transparency and standards based reporting.
- Limit the amount of seed capital a company can raise.

With the Internet, people have much greater access to information to make informed decisions as well as the ability to communicate with associates regarding investment opportunities. Additionally, the companies that would use this funding method for seed capital are small enough and transparent enough to prevent fraud.

It is a sad commentary on the state of the U.S. economy and the degree to which our competitiveness is lagging when *more money has been raised outside the U.S. securities market than inside over the past 5 year*. We can change this by:

- Creating an exemption for small business offerings (debt or equity) of less than \$1,000,000.
- Limit the maximum contribution by *any one individual* to no more than 10% of their prior year's stated income or up to \$10,000/individual. (\$10,000 also matches banking, foreign exchange, and other established financial limits).
- Require a set of standardized and automated procedures for these financing offerings (debt or equity) to reduce time and expense for all parties while maintaining transparency. We suggest using a modified SCOR form. Especially for those companies that are just ideas and don't have financials yet.

- Have investors take an online “test” on the risks involved in private offerings before being allowed to invest. It would contain questions like, “This offering requires that I do/do not understand that all/some/none of my capital is at risk.” (Where the answers can be constantly moved to prevent gaming. For instance, Answer A on one exam would be “this offering requires that I understand that all of my capital is at risk” while on the next person’s exam that would be answer C. This is a simple trigger.)
- Allow the creation of channels/sites where ideas, individuals, companies and investors can meet, be vetted by the organizations hosting those channels and entrepreneurial funding can take place. The SEC could even go so far as to require the registration of these channels/sites for transparency purposes.

Modifying the rules would allow entrepreneurs to seek capital where they otherwise are currently locked out. Crowd-funding is a term that is only beginning to be used but it is a methodology that the SEC should open up so that it can be a part of the solution for capital markets that addresses the capital needs of entrepreneurs.

Please do not hesitate to contact me, or the SBE Council, if we may answer questions or provide further input.

**Respectfully Submitted by:**

**Woodie Neiss  
Member  
SBE Council Advisory Committee  
2944 Hunter Mill Road  
Suite 204  
Oakton, VA 22124  
(703)-242-5840**