

## **Recommendation of the Investor Advisory Committee: Crowdfunding Regulations (April 10, 2014)**

### **Preliminary Observations:**

- Title III of the Jumpstart Our Business Startups Act (JOBS Act) provides the framework for a new online marketplace where companies can raise small amounts of seed capital from investors.
- Investing in early stage start-up companies of the type expected to raise capital through crowdfunding carries inherent risks. A high percentage of start-up companies fail. Their shares are difficult to value. Liquidating the investment can prove challenging.
- Even when the company succeeds, these companies will likely need additional capital to grow and flourish. Early crowdfunding investors may not know or be able to take appropriate actions to protect their interests to ensure that the value of their shares is not inappropriately diluted in subsequent financing rounds.
- Additionally, one of the benefits of current financing models is that either a skilled investor, a close-knit family or community, or a third party institution such as a bank providing debt financing, is reviewing, investing and then monitoring the investment. In contrast, crowdfunding enables a broad and diverse investing community where there may or may not be a person or entity that has the means or the interest to engage in such pre-investment review or post-investment monitoring.
- Recognizing these and other risks associated with crowdfunding, Congress included a number of provisions in the crowdfunding title of the JOBS Act designed to address those risks. These include first and foremost provisions to limit the amount individuals can invest through crowdfunding, to give crowdfunding intermediaries a role in ensuring compliance by issuers, and to educate investors about the risks of crowdfunding.
- Implementation of the crowdfunding title poses a significant regulatory challenge for the Commission, which must be sensitive both to the cost of compliance for issuers and intermediaries and the risk that investors will suffer unaffordable losses. Although these goals are sometimes seen as operating at cross purposes, crowdfunding ultimately cannot succeed unless investors perceive the marketplace as fair and believe they have a reasonable chance of profiting on their investments.
- While the crowdfunding title of the Act is quite prescriptive, the Commission has broad responsibility for drafting the implementing regulations. How those regulations are implemented will play a significant role in determining whether crowdfunding provides the reasonable investor protections, and the fair and cost-effective marketplace, necessary to ensure its viability as a small company capital formation tool. The current proposed rules issued by the Commission do not, in our view, achieve that balance as we believe they can.

## **Recommendations**

The Committee recommends that the Commission adopt regulations implementing crowdfunding that are both consistent with the statute and commensurate with the risks inherent in allowing early stage start-up companies to sell securities based on limited information to unsophisticated, low net worth investors. To achieve that goal, the Commission will need to strengthen its proposed rules in several key areas. The Committee believes the following changes are needed to better ensure that investors understand the risks of crowdfunding and avoid unaffordable financial losses.

### Recommendation 1

The Commission should, as an initial matter, adopt tighter restrictions on the amounts that investors can invest in crowdfunding. Specifically, the Committee recommends that the Commission initially use a “lesser of” approach to setting investment limits (as explained below), with the exception that investment limits for accredited investors be calculated using the “greater of” methodology. If experience suggests that crowdfunding is a success for investors, the Commission can consider whether to expand the amount that individual investors can place at risk by adopting a “greater of” methodology.

### Supporting Rationale

Experience tells us that early stage start-up companies have very high failure rates. According to the Bureau of Labor Statistics (BLS), for example, roughly half of all startups are out of business after five years. While improving access to capital for start-up companies could help to improve their prospects, it is equally possible that the very early stage companies that choose to rely on crowdfunding, especially with lesser levels of pre-investment review and post-investment monitoring, will have even higher failure rates. As a result, even with the best of regulatory protections, crowdfunding investors are likely to be at high risk of losing some or all of the money they invest in crowdfunding offerings.

The central provision Congress included in the crowdfunding title to minimize the risk of devastating financial losses is a limit on the amount that investors can invest in crowdfunding in a given 12-month period. Under the statute, any investor, no matter how low their income or net worth, can invest up to \$2,000 through crowdfunding in a 12-month period. And, no matter how high their income or net worth, no investor can invest more than \$100,000. In between these two outside limits, the statute allows for investments of up to five percent for investors with incomes or net worth below \$100,000 and ten percent for investors with incomes or net worth at or above \$100,000. Net worth is based on the accredited investor definition, which excludes the value of the primary residence.

Unfortunately, the legislative language around these limits is ambiguous: Five or ten percent of which amount, income or net worth or both? And what is the Commission to do about the many individuals who will have income below \$100,000 and net worth above, or vice versa –

where the statutory provisions seem to be in conflict? The statute allows for any number of interpretations.

The Commission has proposed to adopt a “greater of” approach that maximizes the permitted investment amounts. Specifically, it has proposed to apply the ten percent calculation if either income or net worth is at or above the \$100,000 dividing line. And it proposes to allow the limit to be calculated based on the greater of income or net worth. So, a person with an income of \$150,000 and a net worth of \$25,000 would be allowed to invest \$15,000 every 12 months in these early stage start-up companies through crowdfunding platforms. Similarly, a person earning \$25,000 with a net worth of \$150,000 would be allowed to invest up to \$15,000 annually in these early stage start-up companies.

The Committee believes that this “greater of” approach, while one of several approaches that is generally consistent with the statutory language, is inconsistent with the intent of the provision to minimize the risk that investors will suffer unaffordable losses. The percent limits in the statute are already quite high. The Committee believes that few financial professionals would recommend that even their wealthiest clients put anything close to ten percent of their net worth in the individual stocks of early stage start-up companies. This concentration issue would be even more of a concern for the moderate income individuals who will be permitted to participate in crowdfunding.

While some assert that maximizing the permissible investment amounts could increase the ability of investors to diversify across multiple crowdfunding offerings, the Committee believes, based on what is currently expected in the crowdfunding space, that the risks of over-investing in the general category of companies that use crowdfunding far outweigh the benefits of increased potential for diversification within this category. Furthermore, increasing the investment limits without also limiting the amounts that can be put into any one individual company will not necessarily result in greater diversification across multiple offerings; it could just as easily result in investors’ making a bigger bet on a single offering. Indeed, the latter may be more likely to occur, since investing in a single offering is simpler than researching and investing in a multitude of offerings. In addition, significant diversification could still be achieved even within much lower investment limits if investors chose to invest small amounts.

The Committee therefore urges the Commission to adopt an interpretation of the statute that would be more consistent with congressional intent to limit investor losses. Specifically, the Committee recommends that, at least as an initial matter, the Commission adopt a “lesser of” approach for those investors who are not accredited investors. This is the opposite of the Commission’s proposed approach. It would base the calculation on the lesser of income or net worth and make the calculation using the lower five percent amount if either income or net worth fell below the \$100,000 threshold. This approach would mean that unless both an investor’s income and net worth exceeded \$100,000, they would only be allowed to invest up to five percent, and that five percent calculation would be applied to the lower of either their net worth or income. If both an investor’s net worth and income exceeded \$100,000, then they could invest up to ten percent, but that percent would still be calculated based on the lower of either their income or net worth. Additionally, however, the Committee believes it *would* be appropriate for the Commission to retain the “greater of” approach to setting investment limits

for accredited investors, who are at least in theory better positioned to understand the risks and absorb potential losses.<sup>1</sup>

Adopting a “lesser of” approach initially would enable the Commission to gain experience with crowdfunding in order to better understand the risks to investors and the effectiveness of the “wisdom of the crowd” in addressing those risks. If crowdfunded companies enjoy a lower than feared failure rate, if concerns about unfair valuations, liquidation risk, and risk of dilution are found to have been exaggerated, and if efforts to ensure that investors understand the risks of crowdfunding prove effective, then the Commission could consider adopting a “greater of” approach to setting investment limits for all crowdfunding investors.

## Recommendation 2

The Commission should strengthen the mechanisms for the enforcement of the investment limits in order to better prevent errors and evasion. To reduce errors in calculating investment limits, the Committee recommends that intermediaries be required to create a tool that investors would use to assemble the underlying data on which investment limits are calculated and to perform the calculations electronically. The Committee also recommends that the Commission view the provision allowing reliance on investor representations to enforce compliance with investment limits across platforms to be a temporary one. The Commission should monitor the effectiveness of this approach in order to determine whether it should be continued or whether a more stringent enforcement mechanism is needed.

### Supporting Rationale

The Committee is concerned that investors will not receive the full benefits of tighter investment limits unless the Commission also significantly strengthens the mechanisms for enforcing the limits. Although Congress intended intermediaries to play an active role in enforcing the limits, the Commission proposes to allow intermediaries to rely solely on the representations of investors to meet this requirement. The Committee believes there is a high likelihood of unintended errors in making these calculations. The most likely error – failing to subtract the value of the home from the net worth calculation – could have an enormous impact on the outcome of the calculation. That one mistake could move many investors above the \$100,000 threshold and increase by tens or even hundreds of thousands of dollars the amount on which the investment limit is based.

Investor education advocates and financial surveys all reflect that most Americans do not have a financial plan, making it more likely than not that they do not know what their net worth is. At a minimum, therefore, the Committee believes it is essential that intermediaries create an electronic work sheet to prompt investors to enter a set of required underlying data on which the investment limits are based. Instead of simply requiring investors to enter their net worth, for example, platforms should be required to create a tool for investors to use to calculate their net worth appropriately, identifying categories of assets and liabilities (bank accounts, investment

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<sup>1</sup> The Committee has previously suggested and continues to believe that changes are needed to the accredited investor definition to ensure that it achieves this goal.

accounts, house value, etc.) on which net worth is typically based. Prompts could be included informing investors of the need to deduct outstanding liabilities or exclude the value of the principle residence and providing fields for the investor to use to enter those amounts. The portal software would then perform the actual computation of net worth and the investment limit based on the information provided. Such an approach would not prevent all errors, but it would in our view be significantly more accurate than the Commission's proposed approach. Moreover, we believe this improved protection for investors could be achieved at minimal cost and inconvenience to investors. This clear-cut software tool could also help to serve part of the critical educational role the JOBS Act contemplated for portals.

While such a tool would reduce the likelihood of unintentional errors, that still leaves unaddressed the question of how much intermediaries are required to do to substantiate the data underlying those calculations. Congress made portals responsible for enforcing both the individual and aggregate investment limits, but the proposed rules would allow portals simply to rely on investor representations. As discussed further in the following recommendation, the Commission could provide a safe harbor that allows for reliance on investor representations with regard to the underlying income and net worth information on which the calculation is based in cases where the investment amount is quite small, such as \$500 in a single offering and \$2,000 overall during a 12-month period. This could further benefit investors by providing an incentive for issuers and platforms to allow small investments, something they may be reluctant to do if the costs of compliance make that unaffordable.

A second issue stems from the fact that some investors will likely use multiple crowd funding portals, and there is no easy method for determining eligibility or tracking an investor's total investments for compliance with the annual cap. The investment limits in the crowdfunding title are intended to apply cumulatively to all of an investor's crowdfunding investments within a 12-month period, as well as to investments in an individual offering. As Senator Jeff Merkley, a key author of the crowdfunding title stated, "Without aggregate caps, someone could in theory max out a per-company investment in a single company and then repeat that bet ten, a hundred, or a thousand times, perhaps unintentionally wiping out their entire savings."<sup>2</sup> Congress clearly saw the aggregate caps as a significant component of the bill's overall investor protections. They do, however, pose significant implementation challenges.

As the Commission notes in the proposing release, there currently is no central database that portals could rely on to monitor investments across multiple portals. However, even if a centralized database were developed that would enable funding portals to easily and affordably monitor cumulative investments across different portals, the proposed rule as currently drafted would arguably not require portals to avail themselves of that information. The Committee is concerned that this approach fails to create an incentive for private parties to develop this sort of technological solution to the problem of cross-portal monitoring. The Committee urges the Commission to create an incentive to improve cross-portal monitoring by including an expectation that it will not only monitor the effectiveness of this provision but also that it would expect to terminate it if a cost-effective and suitable cross-portal monitoring system is developed.

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<sup>2</sup> See 158 Cong. Rec. S5476 (July 26, 2012)

Specifically, during the monitoring period in which reliance on investor representations is allowed, the Commission should review both the effectiveness of this approach and subsequent developments. Depending on what it found, the Commission could then determine whether to extend the rule allowing for reliance on investor representations, if that proved effective, or adopt a more rigorous approach to enforcement of the investment limits if it did not. If some alternative enforcement mechanism emerged during this time, such as development of a centralized database, the Commission could determine whether that provided a more effective means of monitoring investments across platforms at an affordable cost. At the same time, the Commission could determine what regulatory requirements should be applied to the operators of such a database in order to ensure the security, privacy, and accuracy of information collected and the smooth functioning of the marketplace.

### Recommendation 3

The Commission should clarify and strengthen the obligations of crowdfunding intermediaries to ensure compliance by issuers with the crowdfunding title and relevant regulations. The Commission should clarify the requirements for background checks. It should also clearly affirm the right of portals to “curate” offerings, including the right to reject offerings based on whatever factors the portal deems appropriate (including the issues of liquidity and dilution referred to in our Preliminary Observations) without automatically triggering regulation as a broker-dealer. In revising the compliance obligations of intermediaries, the Commission should consider adopting a tiered approach – based on such factors as the size of the offering, permitted investment amounts, and participation by individuals with a record of securities law violations – in order to minimize regulatory costs where the risks are smallest and maximize protections where risks are greatest.

#### Supporting Rationale

Many of the small, early stage start-up companies expected to raise capital through crowdfunding will be headed by individuals with little or no previous experience in conducting securities offerings. Moreover, many of these issuers will not have the benefit of advice from legal counsel with extensive capital markets experience or expertise. Even under the relatively streamlined approach imposed on crowdfunding, issuers’ legal obligations are complex and, for the neophyte, often confusing. As a result, absent an effective means of ensuring compliance with the crowdfunding title and relevant regulations, violations can be expected to be common even among the best intentioned of issuers. In addition, crowdfunding may become a magnet for the types of fraudulent offerings that have traditionally been found in the less regulated private offering markets.

Congress anticipated this problem and, in response, gave crowdfunding intermediaries a role in ensuring compliance by issuers. In implementing this requirement, the Commission proposes to require intermediaries to have a reasonable basis for believing issuers are in compliance but to allow them to satisfy their general obligations in this regard by relying on the representations of issuers that they are in compliance, “absent knowledge or other information or indications that the representations are not true.” The Committee believes this approach, if

adopted, will be ineffective in preventing either intentional fraud or the inadvertent, but potentially serious, compliance violations of honest issuers. We urge the Commission to require intermediaries to play a more active role in insuring compliance by issuers, both before and during the offering.

One of the most cost-effective ways to reduce the risk of serious compliance violations is to give crowdfunding intermediaries a free hand to reject any offering they believe could pose an undue compliance or fraud risk. The proposed rule lays the groundwork for such an approach. It would, for example, require an intermediary to deny access to its platform to an offering if the intermediary believes that the issuer or the offering presents the potential for fraud or otherwise raises concerns regarding investor protection. But this is a vague standard that will inevitably be interpreted differently by different intermediaries. It is unclear, moreover, how this proposed approach would function in conjunction with the proposed limitations on activities that portals are permitted to engage in without triggering full-scale regulation as broker-dealers. As a result, the effectiveness of this proposed approach could be compromised.

The release states, for example, that a funding portal that wishes to avoid regulation as a broker-dealer may not use criteria based on an assessment of the merits or the shortcomings of a particular issuer or offering to restrict its offerings. The rule as proposed creates an unanswered question regarding what would “raise a concern with regard to investor protection” but not constitute an assessment of the shortcomings of a particular offering. This is at best ambiguous, and that ambiguity would likely make intermediaries reluctant to exercise this authority in a way that would maximize the benefits to investors. For example, could an intermediary reject an offering based on the participation of individuals who, but for the forward-looking nature of the bad actor rules, would be defined as bad actors based on their past actions?<sup>3</sup> Could an intermediary that wished to do so reject an offering based on its belief that the securities were unfairly valued or that it failed to adequately protect investors against dilution of the value of their shares? These are among the primary threats to investors identified by the Commission in its economic analysis accompanying the proposed rule. The Committee therefore urges the Commission to clarify that funding portals would be free (though not required) to “curate” their offerings based on these or other factors.

Moreover, while we appreciate the Commission’s efforts to carefully consider what actions by funding portals would necessitate regulation as broker-dealers, the Committee questions the logic of restricting funding portals’ right to curate offerings based on its evaluation of the quality of those offerings or on any other criteria determined by the portal. Just as brokers are permitted to restrict the range of their offerings without being deemed to be making a recommendation, funding portals should enjoy a similar freedom subject to appropriate restrictions designed to ensure that they do not present their offerings in a way that will be perceived as making a specific recommendation by investors. In determining whether a recommendation has been made, the Commission should look to its existing guidance (with regard to the presence or absence of a “call to action” for example) to draw that distinction. While there are risks that some funding portals will either intentionally or inadvertently cross the

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<sup>3</sup> The bad actor rule identifies a series of regulatory and legal sanctions that would disqualify an individual from participating in crowdfunding offerings. However, the rules do not apply to sanctions that occurred before the rules were adopted.

line, the potential benefits of enabling portals to specialize in certain types of offerings or compete based on the quality of their offerings appear self-evident. Indeed, with regard to the latter point, we encourage the Commission to explore whether it would be possible to require or encourage intermediaries to post standardized information about the failure rates, returns and other relevant information of start-up companies funded through their portals.

In a related provision, the proposed rule also requires intermediaries to deny access to their platform if the intermediary has a reasonable basis for believing that an issuer, or any of its officers, directors (or any person occupying a similar status or performing a similar function) or 20 Percent Beneficial Owners, is subject to a disqualification under the proposed rules. As part of their obligations to fulfill this requirement, intermediaries are required to conduct background and securities enforcement regulatory history checks on individuals associated with an offering. However, the Commission has failed to set any standards for these background checks, relying instead on intermediaries to use their “experience and judgment ... to design systems and processes to help reduce the risk of fraud in securities-based crowdfunding.” The Committee is concerned that this approach is likely to result in background checks of uneven quality. We therefore urge the Commission to clarify intermediaries’ obligations in this regard in order to ensure that a minimum standard of quality is met.

The Committee urges the Commission to require that a summary of the sources consulted as part of the background check be posted on the website along with a description of the portal’s standards for determining which offerings present a risk of fraud. Requiring posting of information about the sources consulted in compiling the reports would better enable investors to evaluate the thoroughness of the background check, thus creating an incentive for intermediaries to conduct thorough reviews in the absence of clear Commission guidelines. Moreover, as noted above, under the Commission’s proposed regulatory approach, intermediaries would be expected to use their own judgment in determining whether a particular issuer presents the “potential for fraud or otherwise raises concerns regarding investor protection.” Investors may judge the issues differently from intermediaries. Requiring portals to clearly describe the criteria they use in determining which offerings may pose a fraud risk, including the types of findings that would and would not be viewed as disqualifications, would better enable investors to determine for themselves how carefully offerings are being screened and whether additional research or action by the investor is needed.

While clarifying intermediaries’ rights to reject offerings and responsibilities with regard to background checks could reduce the risk of fraud, these steps are unlikely to address the problem of more routine violations of the crowdfunding title and the relevant regulations. The Committee believes that investors would benefit if intermediaries played a more active role in preventing these violations than the Commission rules require. This could include, for example, ensuring that all the required disclosures are provided by the issuer,<sup>4</sup> ensuring that the issuer meets the criteria appropriate to its offering amount (such as providing audited financial statements for offerings raising more than \$500,000), and stays within the funding cap. We are

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<sup>4</sup> We refer here to ensuring that there is indeed a “risk factors” section, but we are *not* suggesting the portal should be required to attempt to determine if the risks listed are a comprehensive list of risks for that issuer or are properly and fully stated. The Committee understands that effort would necessitate a due diligence review by the portal, which the Committee is not suggesting.

concerned that simply relying on representations by issuers that they are in compliance will not significantly inhibit either intentional or unintentional violations. If more rigorous compliance requirements are adopted, intermediaries could choose whether to perform some or all of these functions in-house or rely on independent compliance services, whichever is more cost-effective.

We recognize, however, that imposing greater oversight obligations on intermediaries will also impose greater costs and that, taken to the extreme, this could make crowdfunding unaffordable for the issuers crowdfunding is intended to serve. To reduce that risk, we encourage the Commission to consider a tiered approach to compliance obligations that imposes heightened obligations as the risks to investors increase, just as the legislation itself tiers requirements regarding financial disclosures. Under such an approach, for small offerings that cap investments at a low level, \$500 for example, and where there is no participation by individuals with a history of security law violations, the intermediary could be permitted to rely on representations by issuers to satisfy their obligation to ensure compliance. As the size of the offering, the size of permitted investments, or other risk factors increase, the Commission should consider requiring intermediaries to conduct more rigorous compliance reviews. In addition, the Commission could take a similarly tiered approach to the reporting obligations of issuers, requiring more detailed disclosure by issuers with regard to such factors as their business plan, pricing of the securities, their financial condition, and the risks of the particular offering. This would impose the greatest costs where the risks to investors are greatest while minimizing costs where risks of unaffordable financial losses are reduced.<sup>5</sup>

#### Recommendation 4

The Commission should take further steps to ensure that educational materials clearly convey the required information and are reviewed and, to the degree possible, understood by investors.

#### Supporting Rationale

In order to better ensure that investors understand the risks associated with crowdfunding, the statute makes intermediaries responsible for ensuring that: investors review educational materials, positively affirm that they understand that they could lose all their money and that they can afford to do so, and “answer questions demonstrating an understanding of the level of risk generally applicable to investments in startups, emerging businesses and small issuers, the risk of illiquidity and such other matters as the Commission determines appropriate.” While we recognize that regulatory flexibility can lead to innovation, the Committee is concerned that crowdfunding intermediaries will be reluctant to do anything that could discourage investment. As a result, the flexibility that the proposed rules provide could leave room for intermediaries to develop educational materials that downplay the risks and to deliver them in ways that minimize the likelihood that they will be read and understood. We therefore urge the Commission to strengthen requirements with regard to content and delivery of educational materials in order to

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<sup>5</sup> The Committee recognizes that small offerings may have a high level of compliance violations. The risk we refer to here is the risk that investors will, as a result, suffer serious financial harm.

increase the likelihood both that they will be read and that they will clearly convey the essential information.

The Committee believes it would be appropriate for regulators (the Commission, state securities regulators, FINRA or all three working together) to develop a sample guide designed to alert investors to the risks of crowdfunding. Such a guide should cover, in plain language, the key risks to investors – risks that are clearly identified in the economic analysis accompanying the proposed rule. Any such material should highlight the high failure rate of small startup companies, the fact that shares will not be set based on market data and may therefore be mispriced, the lack of liquidity, and the risk that, absent appropriate protections, the value of their shares could be diluted. It should include explicit warnings that investors should not invest in crowdfunding unless they can afford to lose the entire amount of their investment or if they expect to have an immediate need for the funds. Ideally, regulators would test the materials with investors to ensure their effectiveness.

Instead of allowing intermediaries to rely on the representations of investors that they have reviewed the material, the Commission should consider requiring or encouraging the material to be presented in the form of participatory education such as an interactive questionnaire that investors are required to complete successfully before being allowed to invest through the intermediary's portal. The questionnaire could be designed in such a way that it combines a test of the investor's understanding of these basic concepts with educational messages designed to increase that understanding. This would satisfy the statutory requirement that the investor actually review the material in a way that the proposal to rely on investor representations would not. Much as the proposal currently requires, the Commission could then require that investors reaffirm each time they invest that they understand the risks associated with crowdfunding, can afford to lose their entire investment, and to not expect to need the funds being invested in the near term.

#### Recommendation 5

The Commission should withdraw its proposed definition of electronic delivery, which fails to ensure that investors actually receive the required disclosures and educational materials, and continue to rely instead on the strong and effective policy for electronic delivery adopted by the Commission in the mid-1990s.

#### Supporting Rationale

The Committee agrees that it is appropriate in the context of an entirely online marketplace to require investors to agree to electronic delivery of disclosures. We are deeply disturbed, however, that the Commission has proposed a definition of electronic delivery that could be satisfied by delivery of “an electronic message that provides notice of what the information is and that it is located on the intermediary's platform or on the issuer's website.” As drafted, the proposal would not even require that the message clearly identify in general terms where on the website the information is located, let alone require that it provide a specific URL that would take the investor directly to the document. The information that could be delivered

through this method includes information that is essential to an informed investment decision, such as financial information about the issuer, the background of individuals associated with the offering, the risks specific to the offering, and much more.

Past experience and research tells us that, if we want investors to read disclosures, we need to make it as easy as possible for them to access that information. This is particularly important for the unsophisticated and inexperienced investors who are expected to participate in crowdfunding. By potentially forcing these investors to actively seek out disclosures, the Commission's proposed approach fails to meet this standard and thus reduces the likelihood that investors will base their crowdfunding investments on a careful consideration of all the relevant information issuers are required to provide. In short, the proposed approach would impose inappropriate and unwarranted burdens on investors to seek out required disclosures, particularly in circumstances where issuers have information they are reluctant for investors to see. In addition, it poses a significant risk that issuers and intermediaries would use this less transparent delivery mechanism to deliver information they prefer to obscure, thus lending itself to disclosure practices that are not simply opaque but also abusive.

Finally, there is simply no reasonable justification for permitting this approach. It is a simple matter to require that any electronic message through which disclosures are delivered include, at a minimum, the specific URL where the required disclosures can be found. The costs to issuers and intermediaries would be insignificant, far outweighed by the potential benefits to investors.

## Recommendation 6

The Commission should require crowdfunding offerings to be integrated with offerings in reliance on a separate exemption where needed and appropriate to prevent evasion of regulatory requirements.

### Supporting Rationale

The Commission has proposed to eliminate application of the integration doctrine in all circumstances. The Committee is concerned that, if adopted, the approach will allow issuers to circumvent many of the protections for investors proposed in Regulation Crowdfunding. In the absence of integration, issuers would be able to conduct offerings simultaneously under multiple exemptions with potentially conflicting regulatory requirements. Senator Merkley, one of the drafters of the legislation, recognized these concerns. He specifically noted, for example, that “[i]t is critical . . . that the now-looser solicitation rules for a post-JOBS Act Regulation D offering not be permitted to undermine the centralized transparency protections of crowdfunding's restrictions on advertising.”<sup>6</sup> To address these concerns, the Committee urges the Commission to take a narrower approach toward the integration doctrine. Rather than

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<sup>6</sup> See 158 Cong. Re. S5476 (July 26, 2012) (Statement by Senator Merkley) (“This is a difficult issue, especially as Regulation D's restrictions on general solicitation have been loosened by Title II of the JOBS Act. I believe that careful study and attention needs to be paid to how the two should interact in various contexts, including with respect to integration.”).

eliminate the doctrine, for example, the Commission could provide a safe harbor from integration that is shorter than the six-month period in Regulation D. A two-month period, for example, would facilitate the use of other exemptions yet allow much of the market conditioning that resulted from a general solicitation to dissipate. In determining the application of the integration doctrine, the Commission may determine that there are some exemptions that need not be prohibited or integrated at all. The Committee believes that the Commission should examine those offerings that may be used by an issuer and more finely tune its integration policy to include those offerings that may present an abuse or evasion of the various offerings' limitations, while not requiring integration that would interfere with needed capital raises when no possibility for abuse or evasion exists.