

ACCESS TO CAPITAL FOR SMALL AND MID-SIZED FIRMS (JOBS ACT II)

When Congress passed and President Obama signed the Jumpstart Our Business Startups (JOBS) Act of 2012, it marked a bipartisan recognition that securities laws—some dating from before most Americans had a telephone in their home—were holding back capital raising in the age of the mobile app. “A lot has changed in 80 years, and it’s time our laws did as well,” the president said upon signing the bill. “Because of this bill, startups and small business will now have access to a big, new pool of potential investors—namely, the American people.” But although some regulatory barriers have been eased, the SEC has yet to finalize the crucial “crowdfunding” provisions of the JOBS Act to help the smallest startups partner with ordinary investors. As a result, opportunities for economic mobility are being lost.

Congress should:

- ◆ Permanently exempt publicly traded companies with a market value of less than \$700 million from the most onerous provisions of Sarbanes-Oxley, Dodd-Frank, and other securities laws. Rep. Michael Fitzpatrick’s (R-Ill.) Fostering Innovation Act (H.R. 2629), which passed the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises in 2014, would exempt companies meeting that threshold from the “internal control” auditing mandates of Sarbanes-Oxley.
- ◆ Lower the threshold for “accredited investors”—investors from whom entrepreneurs can raise capital while facing much less red tape than a public company—from its current floor of \$1 million in net worth to \$500,000. Further, as proposed by prominent crowdfunding attorney and blogger Mark Roderick, ordinary investors should be allowed to invest in a nonpublic firm if 25 percent of the initial capital is raised from accredited investors. That provision should satisfy many of the investor protection concerns by allowing wealthy accredited investors to give a “seal of approval” by putting their own money at stake.
- ◆ Revise the JOBS Act’s “crowdfunding” provisions to allow entrepreneurs to increase the amount they can raise from investors from \$1 million to \$10 million. Repeal the onerous liability provision in the JOBS Act’s crowdfunding section, which could potentially unleash a flood of lawsuits, not just for fraud but for vaguely defined “omissions of material fact.”

Repeal the mandate that crowdfunding portals must be registered broker-dealers. Those measures are contained in both Rep. Patrick McHenry’s (R-N.C.) Startup Capital Modernization Act (H.R. 4565), which passed the House Financial Services Committee in 2014, and his Equity Crowdfunding Improvement Act of 2014 (H.R. 4564).

Although the JOBS Act modestly loosened the reins on entrepreneurs and investors, markets and innovation have taken a gallop in progress. According to Renaissance Capital, 2013 had 222 initial public offerings (IPOs), the most in the United States since 2000. Ever since the burdensome Sarbanes-Oxley Act was signed by President George W. Bush in 2002, there has been a dearth of IPOs on U.S. exchanges. Title I of the JOBS Act allows “emerging growth companies”—those with less than \$750 million in market value and \$1 billion in annual revenues—a five-year exemption from the costly “internal control” audits of Sarbanes-Oxley, as well as some provisions of Dodd-Frank. There is more than a casual connection between that regulatory relief and the sudden IPO boom, as evidenced by the fact that 80 percent of IPOs are “emerging growth companies” using the JOBS Act exemptions.

New opportunities to raise funds from millionaire “accredited investors” have also sprouted after Title II of the JOBS Act repealed the 80-year-old ban on advertising for investors by nonpublic companies. New Internet portals, such as AngelList and OurCrowd, have sprung up to allow entrepreneurs to communicate with the general public about investment opportunities, so long as they verify that only “accredited investors” are the ones who sign up.

However, the crowdfunding provisions of Title III were greatly watered down at the last minute before the JOBS Act passed the Senate. And because even those weakened provisions have yet to be implemented by the SEC, ordinary investors and small entrepreneurs are still losing out on many of the opportunities crowdfunding can provide. Congress should eliminate barriers to ease crowdfunding’s move from a model based on donations to one based on wealth building and profit sharing.

Experts: John Berlau, Iain Murray

For Further Reading

John Berlau, "Regulatory Barriers Are Holding Back Investing and Lending Opportunities in Crowdfunding," *Forbes*, October 24, 2104, <http://www.forbes.com/sites/real-spin/2014/10/24/regulatory-barriers-are-holding-back-investing-and-lending-opportunities-in-crowdfunding/>.
Steve Case, "Hey, Washington, the JOBS Act You Passed Is Working," *Wall Street Journal*, April 2, 2014, <http://online>.

[wsj.com/articles/SB10001424052702304418404579469312174499556](http://www.wsj.com/articles/SB10001424052702304418404579469312174499556).

Samuel Guzik, "JOBS Act 2.0: Congressman McHenry's Cure for the Six Deadly Sins of Crowdfunding Regulation," *Crowdfund Insider*, May 2, 2104, <http://www.crowdfundinsider.com/2014/05/37673-jobs-act-2-0-congressman-mchenrys-cure-six-deadly-sins-crowdfunding-regulation/>.
Mark Roderick, "A Solution for Title III?" *CrowdfundAtty.com* (blog), June 2, 2014, <http://crowdfundattny.com/2014/06/02/a-solution-for-title-iii/>.