Comment on
Concept Release on Harmonization of Securities Offering Exemptions

Summary

Businesses raising less than $500,000 are unduly restricted from raising funds under the securities laws as currently constructed. Exemptions available to these entities are insufficient to meet the needs of the low dollar market, which in turn unduly burdens the small and minority owned businesses that primarily make up that market. This comment suggests two amendments to address the issue:

A. Exempt Crowdfunding issuers raising less than $500,000 from the requirement that they file a Form C in the Edgar filing system. Alternatively, the rules should require these issuers make regular financial disclosures in a form of their choosing, including much of the same content mandated in the Form C, outside the Edgar filing system either through direct correspondence or a web portal.
B. Create a de minimis exemption for issuers raising less than $500,000.

Background

Securities Laws and Low Dollar Funding.
The investment regime currently promulgated under U.S. Securities laws does a very good job at regulating (i) the public markets and (ii) the mid to high end private funding markets. However, in general it is particularly challenging for those seeking to raise small amounts of funds (for small businesses etc). The process is ripe with regulatory hurdles and costly fees that although absorbed by issuers raising over $1,000,000, can be fatal for issuers seeking low dollar fundings.

Current Funding Sources for Low Dollar Amounts.
According to the Small Business Association, the average amount of an SBA loan is $35,000-$65,000. If individuals want to raise amounts at these levels, there are very few avenues available to them in the funding markets. Primarily, such individuals are limited to SBA loans, credit cards or friends and family. This is particularly troubling for minority and women owned businesses. Traditionally, such entrepreneurs don’t have access to the personal networks that serve as the primary source of investment in the low dollar market.

Under the securities laws, rule 506 is commonly referenced as the primary exemption available for low dollar issuers raising funds through a private offering. However, under rule 506, issuers are limited to 35 non-accredited investors. Therefore, in practice, this exception limits issuers to accredited investors only. In most cases, issuers raising below $500,000 don’t have access to accredited investors and are therefore barred from using the exemption.

Crowdfunding Market

The new crowdfunding (CR) rules have been a great step forward toward addressing funding challenges for small dollar issuers, however the rules as currently mandated are overly burdensome to the same businesses they are meant to foster. The crowdfunding portal marketplace has failed to materially develop. There are only three financial institutions (as of the date of this comment) willing to act as escrow agents for CR portals. In engaging these institutions, it was disclosed by them that there is little to no money in this market because the amounts are too low. Indeed, the only real profitable CR portals in the market are focused on real estate funding that primarily caters to accredited investors. Finally, it should be noted that the requirement to fill out a Form C through the Edgar system is currently (almost unanimously) being performed by the CR Portal market leaders (ie Wefunder etc) themselves as agents for their issuers and not the issuers directly.

Regulatory Purpose

In the interest of completeness, it should also be noted that the intent of the investor protections promulgated by the current regulatory regime is well founded. It is of vital importance to the market to foster investment in a safe, fair manner. However, it was never intended that the benefits of the investment markets should be limited to solely wealthy investors and large corporations. The securities laws were meant to create a level marketplace for investment, where all investors, rich and poor, sophisticated and unsophisticated, could have equal access to the opportunity to prosper from the growth of businesses within the system.

Market Consequences under the Current CR and Low Dollar Funding Rules

Ongoing Financial Disclosures

Under the current framework, CR issuers have to provide extensive financial disclosures. Under certain circumstances, these disclosures must be reviewed by an independent accountant. This obligation can be both confusing and costly for small businesses raising less than $1 million dollars. In many instances, these issuers need to retain all the funds they can in order to operate their businesses. They don’t have the resources necessary to track their disclosure deadlines or hire third party accounting firms to review their records. It could also be argued that most non-accredited, unsophisticated investors will not, either due to lack of awareness or caring, review these filings. This is particularly true given the investment limits for most CR investors. The amount is so low, (below around $2000), that it is not worth the time for most CR investors to follow up to review disclosures for an investment that was made over twelve (12) months earlier. Additionally, at these levels, most investors understand the risk at the time they made the investment that businesses of this size often fail. Continued financial disclosures therefore provide limited protection value.

Edgar Filings and Form C

CR Issuers have to go through the burden of registering and submitting their disclosure filings through the Edgar filing system. Today, this process is extremely rigid an onerous, particularly for issuers who are themselves financially unsophisticated and unaccustomed to the filing

process. This is evidenced by the fact that the leading CR Portals **all file form C's on behalf of their issuers**. Form C must be in a form dictated by the Commission which is confusing and overly detailed. Additionally, Form C includes information that most low dollar issuers don't have as they are start ups with limited operational history.

Conclusion

It is imperative that we facilitate a safe marketplace where issuers are given an opportunity to benefit from the financial markets in general and the CR exemption specifically. The first step toward achieving this is to remove unnecessary obligations that provide minimal investor protections.

Exclusion from Edgar for CR Issuers raising less than $500,000
Form C is a restrictive document that is confusing and overly complicated for CR issuers attempting to raise less than $1 million dollars. Although there is a vested interest in ensuring fair and relevant disclosure is provided to the public, Form C's format and the Edgar filing system in general provides minimal benefit towards that goal. I suggest creating rules that mandate the **content of an issuer's disclosure** rather than **the form** that content is communicated through would go a long way towards easing the administrative and financial burden on small dollar issuers while maintaining a relevant disclosure regime for the public. Under this construct, issuers raising less than $500,000 would have to include relevant financial information in a disclosure document to its investors but the issuers themselves will dictate the form of that disclosure. They would also be excused from including that disclosure in the edgar filing system. As an alternative, the issuer would have to deliver (and retain in their records) the disclosure directly to their investors (via email etc) or notify their investors of a general location where the information is available (web portal etc). Also, note, issuers raising between $500,000 and $1,000,000 would be subject to the system as it exists today as issuers raising amounts at those levels most likely have the resources to hire third parties to assist with their filing obligations.

De Minimis Exemption
It could also be argued that there is little value to mandating disclosures at all for businesses that raise less than $500,000. Again, mandated disclosure requirements are costly to create and are of questionable value to the public for investments of that size. In most cases, fund raises below $500,000 are for small local businesses with limited operational history. Investors are investing with these businesses knowing they are extremely risky. Such investments are usually sourced through personal relationships and referrals. As of today, investments of this sort are limited to lending institutions who impose strict lending guidelines or wealthy (accredited) investors. As such, local small businesses, many owned by women and minorities, are effectively shut out of most funding markets. I would suggest a new exemption from the securities filing requirements for de minimis raises below $500,000.

Finally, it should also be noted that this comment does not propose an exemption from the anti-fraud and fair marketing provisions of the securities laws. Those rules would be maintained under both suggestions advocated herein.

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