



### **Senator Scott Brown's CROWDFUND Statement for the Record**

LIVE – I rise to speak about jobs and the Massachusetts innovation economy.

In July 2010, the Kauffman Foundation noted that “startups aren’t everything when it comes to job growth. They’re the only thing.” In fact, the Kauffman Foundation found that “without startups, there would be no net job growth in the U.S. economy.” And in Massachusetts, where we have the second largest venture capital market in the country, venture capital helps drive our innovation technology. Massachusetts public companies that were once venture-backed start-ups account for 775,151 jobs and \$190 billion in revenue in the United States.

However, in the current economic climate, institutional investors are wary of investing in ideas that carry significant entrepreneurial and technological risk. With a high risk of failure and often a lack of collateral, small start-up companies cannot qualify for traditional commercial loans. Alternative capital markets are therefore critical to these engines of future economic prosperity. To give entrepreneurs and start-ups the access to capital they need to get their businesses off the ground, I introduced the *Democratizing Access to Capital Act* (S. 1791) to legalize crowdfunding on November 2, 2011. Crowdfunding will create a new alternative market for capital formation by allowing every American—regardless of income or wealth—to invest in a start-up or a great idea. And according to an economic model by Regional Economic Models, Inc. (REMI), crowdfunding has the potential to increase the number of start-ups by ten percent, potentially creating hundreds of thousands of new jobs.

Recognizing that crowdfunding could provide a huge new growth engine for the Massachusetts tech sector and the Internet, our brightest economic frontier, I wrote to President Obama on February 3, 2012 to ask for his help in urging the Senate to pass crowdfunding legislation. On February 27, 2012, I hosted a roundtable with Massachusetts entrepreneurs and small businesses at Boston City Hall. And on February 29, 2012, I called on my colleagues to work together and pass a crowdfunding bill in a speech from the Senate floor.

At the same time, entrepreneurs from the Cambridge Innovation Center created a petition to show Congress their support for crowdfunding. These entrepreneurs founded wefunder.com to rally support for crowdfunding. On March 5, 2012, wefunder.com and MassChallenge, a not-for-profit organization dedicated to supporting the work of entrepreneurs, hosted a roundtable on crowdfunding in Boston. As of March 26, 2012, three thousand investors pledged to invest \$7.5 million when crowdfunding becomes legal.

On March 8, 2012, the House of Representatives passed the *Jumpstart Our Business Startups (JOBS) Act* by a vote of 390-23, which included crowdfunding legislation. President Obama also issued a statement in support of the *JOBS Act*. Although my focus was on legalizing crowdfunding, I felt that the *JOBS Act* bill lacked basic investor protection standards that would give investors some confidence and help the market grow. I worked with Senators Michael Bennet and Jeff Merkley to introduce a bipartisan compromise crowdfunding bill, the *CROWDFUND Act* (S. 2190), on March 13, 2012. On March 22, 2012, the Senate passed the *CROWDFUND Act* as an amendment to the *JOBS Act*, which was approved by a vote of 73-26.

The CROWDFUND Act sets the framework for developing a new market in which entrepreneurs can raise capital and ordinary investors can invest in new ideas. To create a new marketplace for investment, the CROWDFUND Act creates investor protections that are designed to balance entrepreneurs' ease of access to capital with the need for transparency.

In prescribing requirements for issuers, the CROWDFUND Act addresses the importance of providing investors accurate information. While financial disclosures are necessary for investors to make wise investment decisions, the importance of disclosure should be balanced with individuals' right to privacy. The SEC should therefore, under its rulemaking authority provided in Section 4A(b), clarify that entrepreneurs will not be asked to disclose individual personal tax returns. In addition, while the bill clearly states that issuers should be liable for material misrepresentations or omissions, issuers should not be held liable for misstatements or omissions that were made by mistake. The standard of liability for issuers as described in Section 4A(c) should be "due diligence." In other words, issuers must do their "due diligence" to make sure that the information that they are providing to potential investors is accurate. This is a widely accepted liability standard.

Although issuers may not advertise the specific terms of an offering, the CROWDFUND Act ensures that issuers are allowed to generally advertise their offerings through email and social media channels, as long as the intermediary website remains the location for all offerings. Potential investors should be given enough information about offerings to spark their interest. To discourage fraudulent operators, provide proper investor education and "crowdvetting" of opportunities by impartial third parties, issuers should not be allowed to encourage investment outside of the intermediary. In addition to facilitating communication between issuers and investors, intermediaries should allow fellow investors to endorse or provide feedback about issuers and offerings, provided that these investors are not employees of the intermediary. Investors' credentials should be included with their comments to aid the collective wisdom of the crowd.

Regulated intermediaries are necessary for investor protection; however, intermediaries should not be over-regulated. Specifically, none of the requirements placed on intermediaries should prevent an intermediary or funding portal from removing or preventing the public display of an offering that it deems not credible. To guarantee the quality of offerings, intermediaries

should be able to employ a Kickstarter-like process, in which the staff of an intermediary determines which issuers are invited to present their offerings to site visitors. Intermediaries should also be allowed to inform its users about offerings that may interest them, provided that this is not explicitly or implicitly recommending the offering to an investor. Although intermediaries must only provide offering proceeds to issuers once the issuers' target offering amount is reached, intermediaries should not be required to escrow proceeds.

To streamline the offering process, it makes sense to allow intermediaries to place a hold on investor credit cards until an offer is fully subscribed. At that time, investors' credit cards should be charged and the proceeds immediately transferred to the issuer. Intermediaries should also be permitted to act as the holder of record for offerings that they facilitate to reduce compliance complexity for issuers and to increase the likelihood of subsequent funding from institutional investors. Providing holder of record services will reduce compliance complexity for issuers and place the burden of managing crowdfunded investors on the intermediary. Without this mechanism, issuer capitalization tables may become unwieldy, discouraging subsequent funding from institutional investors. In addition, intermediaries should be allowed to take an equity stake in offerings. This however, does not mean that intermediaries should be able to choose which offerings to participate in but rather it should be a standard process for any offering that the intermediary facilitates. This will incentivize an intermediary to focus on issuer quality over quantity, providing more vetting for investors and greater alignment of interests. Of course, any equity stakes by the intermediary must be fully and meaningfully disclosed to investors. Of course, any equity stakes by the intermediary must be fully and meaningfully disclosed to investors. The SEC should carefully monitor any developments in this area and adjust practices, including restricting the ability for intermediaries to take equity positions, should fraud or manipulative practices arise.

Although the CROWDFUND Act requires intermediaries to register with the SEC and become members of a self-regulatory association, all rules, regulations and registration requirements should be developed with minimal burden and cost to the intermediaries. The SEC and any relevant self-regulatory association should bear in mind that these costs will ultimately be passed through to issuers – costs should not undermine the goals of crowdfunding to create low-burden alternative means of raising capital. In addition, the crowdfunding community may develop its own self-regulatory association to specifically oversee crowdfunding intermediaries.

While preemption of State securities law is necessary for crowdfunding to function, State securities regulators should play a role in crowdfunding offerings. In addition to allowing limited State securities registration, State should retain its authority to take enforcement action with regard to any issuer or intermediary. Further, where state authority is not specifically preempted, the SEC will not presume preemption. State securities regulators are the first line of defense against fraud and their ability to continue to combat fraud should not be curtailed.

Finally, I urge the SEC to take seriously the statutory directive to complete within 270 days of enactment the rulemaking necessary to make the law effective. Crowdfunding entrepreneurs and intermediaries are eagerly awaiting the rules to take full advantage of crowdfunding's potential to unlock capital for start-ups and small businesses. Based on my office's interactions with the SEC, I believe that the SEC is committed the success of this new market, and the rulemaking should be easily completed within 270 days.

Few entrepreneurs take a new start-up to a mature company on their own. New ideas need the support of investors to survive and thrive. Investments power payrolls across our nation and every sector. It's the grease that keeps the gears in the American economy turning. Crowdfunding will allow small businesses to bypass Wall Street and go straight to Main Street for financing. We know that new businesses are the source of all of the net job creation in the United States. This CROWDFUND Act provides an avenue for new growth for that crucial sector with unlimited potential.